



European Business in China POSITION PAPER 2020/2021

The *European Business in China Position Paper 2020/2021* 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 2020 to July 2020.

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Message from the President

In late 2019, we began looking forward to what was expected to be a pivotal year for the European Chamber. In addition to celebrating the 20th anniversary of the founding of the Chamber, with festivities arranged throughout the year to commemorate how far our organisation has come, we also expected 2020 to be a golden year for European Union (EU)-China relations. On top of regular annual meetings and dialogues, hallmark events were being planned, in particular the meeting between EU heads of state and President Xi Jinping in Leipzig. The centrepiece to this highly-anticipated summit was to be the successful conclusion of the negotiations for the EU-China Comprehensive Agreement on Investment (CAI).

Instead, we have observed a year of extraordinary challenges: COVID-19 has ravaged the globe and political tensions have ratcheted up quicker than anyone could have imagined. The result is profound uncertainty about the future, with the economy now clinging to what few handholds it can find. Companies are left navigating a political minefield during a health crisis of truly overwhelming proportions, and this situation is becoming more precarious, with the previously-isolated voices that were intent on sowing political discontent slowly building into a chorus.

The China market remains one of the main rocks to which our members can cling, especially after the country managed to eventually suppress the initial COVID-19 outbreak. However, while European companies' Chinabased operations have largely held fast, business prospects are increasingly overshadowed by other factors. The politics of the pandemic notwithstanding, sensitive issues in Xinjiang and Hong Kong have come to a head in Europe and North America. People who two years ago could not be counted on to find either region on a map are now demanding that their democratically elected leaders take action against China to bring about a resolution to these issues.

China's small but highly conspicuous army of 'wolf warriors' in the Ministry of Foreign Affairs have done little to help this situation, instead preferring to fan the flames with decidedly undiplomatic rhetoric. Fortunately, contrasting Chinese voices are still found in some diplomatic missions, such as the one to the EU. These embassies still prove that communication can be done in a constructive manner, which has long been the hallmark of China's professional diplomacy, much to the benefit of companies in both the EU and China.

Friction over the enduring lack of reciprocity in trade and investment terms between the EU and China has been reflected in the movement of people. At the time of writing, a large proportion of foreign national residents in China that were abroad during the early days of the outbreak remain unable to return to their offices, schools, homes and communities after China's borders shut and visas were suspended in late March with barely 24-hours' notice. The few that have returned had to navigate a labyrinth of approvals and ever-shifting requirements in order to do so. This stands in stark contrast to the fact that most European nations kept the doors open to Chinese nationals possessing respective member states' residency permits. This asymmetric treatment has stirred feelings of resentment, and is doing nothing to improve EU-China relations at a time when greater alignment is required.

Nevertheless, China does have the opportunity to do its part to strengthen bonds with the EU and further solidify important economic ties with its largest trading partner. The European Chamber was founded 20 years ago to oversee China's adherence to its World Trade Organization (WTO) accession agreement. Two decades on, the Chamber is playing a critical role in advancing the CAI, by providing crucial business input to negotiators. Choosing to embrace the spirit of WTO membership in a time of potential decoupling and rising protectionism would be a very positive way for China to show that it means business. At the same time, delivering on a CAI



that is sufficiently robust and produces investment reciprocity would prove to other economic partners that engagement, even after seven years and 30+ rounds of negotiations, delivers results.

Closing the gulfs between rhetoric and reality, market potential and market access, and the positive progress in China's private sector and the regression of the state-owned sector, is in China's immediate and long-term interests. Despite its undeniable economic clout, China continues to punch well below its weight, with total factor productivity—i.e. the contribution to economic growth made by managerial, technological, strategic and financial innovations—lagging well behind where it should be at this stage of the country's development. European companies and their technology and expertise are ready to act as the transition catalyst that China needs to continue down the development path to fulfil its huge potential.

It is unfortunate that, 20 years on, the European Chamber still has to pick and choose which of the challenges our members experience to include in our annual position paper, to prevent it growing much longer than its customary 400 pages. Each of the issues raised represents a roadblock, preventing European companies from bringing the full weight of their experience and expertise to bear. By positively addressing the recommendations in this paper, the Chinese authorities can release a vast reserve of untapped potential, and achieve its long-term sustainable development goals. The European Chamber will continue working with the Chinese Government and doing everything we can to ensure that this happens.

5 Alla

Jörg Wuttke President European Union Chamber of Commerce in China

ABOUT THE EUROPEAN UNION CHAMBER OF COMMERCE IN CHINA









The European Union Chamber of Commerce in China (European Chamber) was founded in 2000 by 51 member companies that shared a goal of establishing a common voice for the various business sectors of the EU and European businesses operating in China. It is a member-driven, non-profit, fee-based organisation with a core structure of 39 working groups and fora representing European business in China.

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.

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 37 non-EU countries around the world.

Mission statement

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

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

Principles

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



Executive Summary

Six centuries ago, in 1420, the Yongle Emperor became the first ruler of China to occupy the newlybuilt Forbidden City. The third monarch of the Ming Dynasty, Yongle would prove to be an altogether different kind of emperor than both his predecessors and successors. After founding the Ming, his father, the Hongwu Emperor, began closing off the country's maritime trade routes in 1371, in part to protect his reign from outside influences. When Yongle took the throne, he brought a different viewpoint. To him, engagement with foreign nations was an opportunity to project and advance China's greatness and increase trade, as a means to enforce the Chinese tributary system, thereby legitimising his reign.

Throughout his reign, Yongle sent his close friend, Admiral Zheng He, on seven voyages with the recently-built Ming treasure fleet to establish relations with civilisations as far west as Mogadishu and as far south as Surabaya. The admiral did indeed return with foreign dignitaries, who sealed new diplomatic connections between these distant lands, and with them came agreements for tributes and trade. China had opened to the world, and both sides enjoyed the economic benefits of the ensuing exchange of goods, technology and people.

After Yongle's death, the voyages of the treasure fleet came to an end. Resuming the policy of the Ming's founder, subsequent occupants of the Forbidden City imposed the *haijin*, a prohibition on Chinese maritime ventures. This persisted well into the Qing, China's final imperial dynasty. By then, what maritime trade existed was almost exclusively conducted by foreign vessels limited to the port island of Shamian, a spit of land in Guangzhou. The reason was rather infamously expressed by the Qing Emperor Qianlong in a letter to Britain's King George III, saying, "Our Celestial Empire possesses all things in prolific abundance... [and has] no need to import the manufactures of outside barbarians."¹

The China of 2020 has a far less restrictive economy than anything found in the imperial era. Yet, echoes of the contrasting viewpoints of Yongle and Qianlong persist. For much of the last four decades, European business has been confident that China's leaders were leaning heavily towards continued opening up after having emerged from an era of seclusion. Unfortunately, the last several years have challenged this confidence, with an increasing number of voices asking if China is leaning more towards Qianlong's belief that the Middle Kingdom has no need, or desire, for what foreigners have to offer.

The reality on the ground is not so black and white. European business sees China moving in multiple directions at the same time.

For example, as noted in the European Union Chamber of Commerce in China's *European Business in China Business Confidence Survey 2020*, a 'one economy, two systems' model has emerged. One half of China's economy continues to open, is increasingly fair and well regulated, and very much wants European investment. For instance, while late in the game, the lifting of equity caps in the automotive sector has led to meaningful opportunities for European manufacturers and their suppliers, several of which have either increased their shareholdings or are aiming to take full control of their long-held joint ventures.

However, this more market-driven half of the economy also includes saturated sectors that China seems to have finally unlocked purely to perpetuate its now familiar narrative that it will open its doors wider and

¹ Two Edicts From the Qianlong Emperor, on the Occasion of Lord Macartney's Mission to China, September 1793, Columbia University, viewed 21st July 2020, http://afe.easia.columbia.edu/ps/china/qianlong_edicts.pdf

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wider to foreign investors.^{2,3&4} The lifting of equity caps for foreign investment in the financial services sectors serves as a key example in this respect. China's closed-off banking sector allowed domestic financiers to fully saturate the entire market without the challenge of outside competition. The eventual removal of the direct barriers to foreign banks was then hailed in Chinese state media as a monumental step towards China opening its economy. However, the fact that the reform took place so late in the game made it more akin to letting foreign investors onto a railway platform only after the train had long since departed.

In a market already dominated by state-run banks—four of which are the largest in the world—only a few remaining niches, like cross-border services, still have space for European banks.⁵ After entering those niches, European banks are then confronted by secondary barriers, like restricted access to licences and complex administrative approvals, meaning that most cannot even catch the crumbs from the table. European bankers project that the already pitiful foreign share of less than two per cent of the market will shrink. Meanwhile, Chinese banks are feasting on Europe's open banking market.

The other, state-driven half of the economy sees China still nursing its national champions and stateowned enterprises (SOEs) that have largely uncontested access to a fifth of the world's consumers, producers, depositors and innovators. China's leaders reaffirmed its plan to enhance the role of its SOEs as recently as July 2020.⁶ China currently has 97 behemoths run at the central level by the State-owned Assets Supervision and Administration Commission (SASAC), and another 130,000 SOEs run at the provincial and local levels.⁷

Originally, the foundational and primary sectors of the economy, as well as anything that could be deemed 'strategic' in the government's broad definition of the term, were off limits, including energy, utilities, resource extraction, refining, steel production and rail. Worryingly, there now seems to be a growing list of sectors that either restrict foreign investment, or in which support is provided to China's national champions to the extent that it squeezes out any potential European competition.

This is particularly apparent in the industries promoted in the China Manufacturing 2025 plan and similar national goals. Renewables, telecommunications, internet and high technology industries, along with other key sectors projected to drive the most growth over the coming decades, are tightening up to foreign investors. European companies have found themselves only being permitted into these areas to perform specialist roles and provide inputs where Chinese expertise is lacking.

The enduring and growing challenges facing European companies in this half of the economy are depleting business sentiment. Meanwhile, as China's indigenous companies catch up to and even surpass European firms in some areas, many European business leaders are starting to wonder if Jeffrey Immhelt, former CEO of General Electric, was right a decade ago when he said, "I am not sure that in the end [China] wants any of us to win, or any of us to be successful."⁸

² Zhao, Yinan, China's Door to Open Wider, Li Tells Foreign Companies, China Daily Asia, 16th September 2014, viewed 21st July 2020, <https://www.chinadailyasia.com/ nation/2014-09/16/content_15166511.html>

³ Liu, Zhen, China's Door Will Open 'Wider and Wider' to UK, Li Keqiang tells Theresa May, South China Morning Post, 31st January 2018, viewed 21st July 2020, https://www.scmp.com/news/china/diplomacy-defence/article/2131456/chinas-door-will-open-wider-and-wider-uk-li-keqiang

⁴ Wang, Orange, China President Says 'Only When China is Good can the World get Better' Amid US Trade War, South China Morning Post, 19th October 2019, viewed 21st July 2020, https://www.scmp.com/economy/article/3033694/chinas-door-will-only-open-wider-xi-jinping-tells-delegates

⁵ Bagnall, Elinor, Top 1000 Banks 2019, The Banker, 1st July 2019, viewed 21st July 2020, https://www.thebanker.com/Top-1000-World-Banks/Top-1000-World-Banks-2019-The-Banker-International-Press-Release-for-immediate-release>

⁶ Tang, Frank, China Approves Plans to Boost Prominence of State Firms, Despite Complaints From Trade Partners, South China Morning Post, 8th July 2020, viewed 21st July 2020, https://www.scmp.com/economy/china-economy/article/3092339/china-approves-plan-boost-prominence-state-firms-despite

⁷ Ibid.

⁸ Dinmore, Guy and, Dyer, Geoff, Immelt Hits out at China and Obama, The Financial Times, 2nd July 2010, viewed 28th July 2020, <https://www.ft.com/content/ed654fac-8518-11df-adfa-00144feabdc0>



In the wake of the COVID-19 outbreak, new obstacles have emerged that have left Europeans feeling decreasingly welcome in China. While Chinese nationals have been able to get to Europe for essential business travel and work/residency, a large portion of China's European business community—many of them long-time, tax-paying residents—have been largely prevented from returning, even from places within China's borders like Hong Kong.⁹ Furthermore, instances of discrimination directed at foreigners in China went ignored by Chinese officials at best, and were outright denied at worst.^{10&11}

European Chamber members cannot help wondering if these actions and inactions are indicative of a broader mindset that while foreign capital and technology are desired in China, foreigners themselves are not.

These various directions that China is moving in indicate a huge difference in how the concept of 'openness' is understood. As an open economy, the EU has embraced the idea that market access is taken as granted through multilateral institutions like the World Trade Organization (WTO), and bilateral ones like investment agreements. Since EU-China negotiations on the Comprehensive Agreement on Investment (CAI) began in 2013, the EU has completed trade and investment agreements with several dozen other markets. But the China of 2020 seems to buy into a different way of thinking: market access is not seen as a right, but instead a privilege that is either extended to or removed from certain areas, depending on whichever part of the economy China's leaders want foreign investment to flow to at any given time.

Not only does this understanding clash with the rules-based economic order to which China voluntarily acceded, it also drags down business sentiment.

This is to China's detriment, as the potential of the market remains huge – China's development trajectory has been comparable to that of Japan and South Korea in the decades following their market reforms. As opposed to the growing narrative of foreign companies voluntarily 'decoupling' from China, European firms are actually eager to deepen their positions and compete for market share.

The European Chamber is frequently asked by the European Commission and member-state governments if Europe should seek deeper engagement with China, with the ultimate goal of China establishing a truly open and competitive market economy; or if it should accept that the state-driven half of the economy will eventually prevail. The answer is increasingly clear: build a toolkit that will work either way.

EU investment screening mechanisms directed at state-backed capital will not need to be employed if China truly liberalises its economy, but will be in place to protect against market distortions caused by SOEs if China chooses not to. Similarly, the International Procurement Instrument will have no effect on China if the country opens its procurement market, while protecting against anti-competitive bids from China's national champions if it does not. Leveraging trade and investment deals with third-market partners to counter market distortions resulting from competition from China's artificially-boosted national champions will be unnecessary if Beijing aligns with the rules-based economic system, but such steps would be needed to counter damage to European players in those markets should nothing change.

Meanwhile, both sides must commit to concluding a binding and robust CAI that brings the EU and China

⁹ Bradsher, Keith, To Slow Virus, China Bars Entry by Almost All Foreigners, The New York Times, 26th March 2020, viewed 28th July 2020, https://www.nytimes.com/2020/03/26/world/asia/china-virus-travel-ban.html

¹⁰ Vanderklippe, Nathan, 'Stay away from here': In China, foreigners have become a target for coronavirus discrimination, The Globe and Mail, 9th April 2020, viewed 28th July 2020, <https://www.theglobeandmail.com/world/article-stay-away-from-here-in-china-foreigners-have-become-a-target-for/>

¹¹ No discrimination against foreigners: China Daily editorial, China Daily, 8th April 2020, viewed 28th July 2020, http://www.chinadaily.com.cn/a/202004/08/WS5e8dd64aa310e232631a4cbf.html

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as close to a reciprocal trade and investment environment as possible, and provides investor protection on both sides. This would not only bear clear tangible benefits, but also demonstrate that deeper engagement is still the best way forward, countering the growing international narrative that playing hardball in a world of zero-sum games is the only viable option.

Realising its stated reform agenda and bilateral and multilateral commitments would also resolve many of the contradictions that see China's economy perpetually pulled in different directions: the tensions of one economy, two systems; the mismatch between market potential and market access; the conflict between business and politics; and the gulf between rhetoric and reality.



Section One

Executive Position Paper

Executive Position Paper

The EU-China 'decoupling story'

International coverage of China in 2020 has been dominated by two stories: the COVID-19 outbreak and the resulting economic challenges, which have left companies navigating in the dark; and the potential for various markets to decouple from China. While the former is all too real, the latter is a far less straightforward story.

In the areas where European Chamber members are able to participate in China's economy, they report no significant change in plans to redirect current or planned investments elsewhere. Results from the European Chamber's *Business Confidence Survey 2020* (BCS 2020) indicate that 11 per cent of member companies are considering doing so, which is towards the lower end of the norm for the last decade.¹

It should be noted that the 2020 survey was conducted throughout February, meaning that members were responding during the rapidly-changing, early days of the COVID-19 crisis. However, subsequent surveys, as well as discussions with the European Chamber's working groups, have not revealed any reason to expect a significant change on this point.

Even taking into account the potential economic upheavals that could follow the COVID-19 crisis, European multinational companies (MNCs) in China are not making plans based on the next one or two years – they are looking to the next one or two decades. Their small and medium-sized enterprise (SME) partners remain similarly committed to serving China's market, as do the European SMEs that target Chinese customers directly.

There is certainly now the potential that the economic impact of COVID-19 will result in the diversification of certain supply chains becoming more commonplace. Many companies are naturally seeking to build resiliency after suffering supply shortages when China's was the first market to be flattened by the pandemic. However, this should not be misunderstood as 'leaving'. Instead, it is likely to mean less new investment into China as resources are spent elsewhere.

The ongoing United State (US)-China trade war has also raised questions over who will leave China, and how quickly. After what started as a trade skirmish escalated into a tit-for-tat pitched battle, the European Chamber surveyed its members in September 2019 to measure the impact. The results show that although the effects were significant, the conflict was not driving substantial numbers of European companies out of China. While eight per cent of those surveyed indicated they were moving relevant production out, six per cent said they were actually increasing their investment into the market.²

Discussions on this topic with China-based business leaders across a range of industries revealed some

¹ The proportion of BCS respondents indicating that they planned to move current or planned investments to markets other than China has been between 10 and 22 per cent over the last 10 years; *European Business in China Business Confidence Survey 2020: Navigating in the Dark*, European Union Chamber of Commerce in China, 10th June 2020,

² European Chamber Survey on the US-China Trade War Finds More Companies Making Difficult Strategic Changes to Adapt to the Indefinite Nature of the Tensions, European Union Chamber of Commerce in China, September 2019, viewed 20th July 2020,



clear trends. European MNCs that are increasing investment are looking to onshore their supply chains into China and deepen their local production capacity to insulate themselves from further disruptions. Of those that are leaving, most are in China to produce for export markets rather than for local consumers.

Many companies producing in China for export have been steadily leaving for years, following market forces to set up more cost-effective production facilities to then export to China and other destinations, including the EU. Most producers for export of European origin had already been looking to leave China within a horizon of several years. The trade war has merely accelerated their decision.³

No economic decoupling, but a growing political story

While there are currently no economic factors strong enough in and of themselves to drive out European investors, business decisions are not made in a vacuum.

Political voices calling for a tougher stance on China are building into a chorus across the world.⁴ The loudest voice is undoubtedly President Trump's, but he is hardly alone, either in Washington or globally. The only thing Americans seem to agree on these days is that the US-China relationship must enter a new era, and abandon the engagement-at-all-costs approach that defined previous administrations in favour of something considerably more hawkish.

While taking an infinitely more low-key approach, the Japanese Government has, for some time, been working in coordination with its biggest companies to decouple and diversify from China. Bilateral tensions spiked after the 2012 anti-Japanese riots in China,⁵ which led to boycotts of Japanese goods and an export ban on rare earth metals.⁶ Since then, Japan has seemed quietly determined to reduce its reliance on the Chinese market.⁷ The Japanese Government even created a financing mechanism of more than US dollars (USD) 2 billion annually to fund Japanese companies that need support either to move production from China back to Japan or to diversify into Southeast Asia.⁸

Similar trends can be seen in Europe, though in relative infancy compared to the US or Japan. When former EU President Jean-Claude Juncker delivered his 2017 State of the European Union speech, he spoke of the need for the EU to strengthen its trade agenda. "Yes, Europe is open for business," he said, "But there must be reciprocity. We have to get what we give."⁹ This signalled something of a departure from the more conciliatory approach that Europe had previously taken in its dealings with China. Since then, the tone from Brussels has continued to evolve in response to China's slow-moving economic reform agenda and what many view as an increasingly aggressive stance coming from Beijing. The EU's approach was seen to harden further in a strategic communication released in 2019, which labelled China

³ European Chamber Survey on the US-China Trade War Finds More Companies Making Difficult Strategic Changes to Adapt to the Indefinite Nature of the Tensions, European Union Chamber of Commerce in China, 10th October 2019, viewed 21st July 2020,

⁴ Wolfe, Jan, US Senators Introduce New Bill to Punish Chinese Technology Theft, Reuters, 21st June 2020, viewed 21st July 2020, ; Canada Must Toughen Stance with China, Ex-diplomats Say, US News, 23rd June 2020, viewed 21st July 2020, ; Cooper, Charlie, Britain Toughens Stance on China as it Eyes US, Politico, 13th July 2020, viewed 21st July, ">https://www.politico.com/news/2020/07/13/boris-johnson-china-huawei-359741>

⁵ Anti-Japan Protests in China, The Atlantic, 17th September 2012, viewed 20th July 2020, https://www.theatlantic.com/photo/2012/09/anti-japan-protests-in-china/100370/

⁶ Hille, Kathrin and Nakamoto, Michiyo, Anti-Japanese Protests Sweep China, Financial Times, 19th August 2012, viewed 21st July 2020, <https://www.ft.com/ content/97805eaa-e9ee-11e1-929b-00144feab49a>

⁷ Shida, Tomio, History Offers Lessons in Escaping China's Rare Earth Dominance, Nikkei Asian Review, 25th June 2019, viewed 21th July 2020, https://asia.nikkei.com/ Economy/Trade-war/History-offers-lessons-in-escaping-China-s-rare-earth-dominance2>

⁸ Abe's Right-hand Man Wants a Japan Less Reliant on China, Nikkei Asian Review, 24th April 2020, viewed 20th July 2020, https://asia.nikkei.com/Editor-s-Picks/Interview/Abe-s-right-hand-man-wants-a-Japan-less-reliant-on-China

⁹ President Jean-Claude Juncker's State of the Union Address 2017, European Commission, 13th September 2017, viewed 21st July 2020, ">https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_17_3165>

as an "economic competitor" and a "systemic rival".¹⁰ A toolbox is now under development, including an investment screening mechanism, to better protect the EU Common Market from outside distortions.¹¹

Importantly, the politics of the moment have brought these three economic heavyweights together to potentially take an increasingly unified approach towards China, such as through the trilateral statements issued by the trade ministers of the EU, Japan and the US in 2019 and 2020.^{12&13} While this kind of alignment is useful, it would be even more effective if it was extended across more Organization for Economic Co-operation and Development (OECD) countries.

Several months of increasing tensions

While China and Europe have always encountered areas of friction outside the economic realm, the last couple of years has yielded an astonishing number of issues that have raised concerns and increased risk for businesses.

These include the political ramifications of the National Security Law aimed at Hong Kong,¹⁴ the extensive allegations of forced labour and internment of ethnic and religious minorities in Xinjiang,¹⁵ the insinuation of the Communist Party of China (CCP) into every aspect of civil society and even business,^{16,17&18} and the politicised nature of the narrative around the early days of the COVID-19 outbreak.^{19&20} One of these on their own would present a serious point of contention between the political leaders of Europe and China. Together, they risk creating a long-term, downward spiral in relations, as evidenced by the measures already applied by the US in response to Hong Kong and the Xinjiang allegations, which have the potential to seriously impact European companies.²¹⁸²²

China's global image has been further tarnished by the rise of 'wolf warrior' diplomacy, an approach in which Chinese diplomats embrace a 'fighting spirit' in their interactions with other countries.²³ While diplomats should of course be free to advocate for everything they see fit, the tone being adopted by some Chinese diplomats to engage with the rest of the world is, by definition, undiplomatic. This relatively new phenomenon has been widely covered in foreign media, and is turning many in Western civil society

17 Russo, Federica, Politics in the Boardroom: The Role of Chinese Communist Party Committees, The Diplomat, 24th December 2019, viewed 20th July 2020, https://thediplomat.com/2019/12/politics-in-the-boardroom-the-role-of-chinese-communist-party-committees/

¹⁰ EU-China – A Strategic Outlook, European Commission, 12th March 2019, viewed 20th July 2020, <https://ec.europa.eu/commission/sites/beta-political/files/communicationeu-china-a-strategic-outlook.pdf>

¹¹ Screening of Foreign Direct Investment, European Commission, 10th April 2019, viewed 20th July 2020, https://trade.ec.europa.eu/doclib/press/index.cfm?id=2006

¹² Joint Statement of the Trilateral Meeting of the Trade Ministers of the European Union, Japan and the United States, European Commission, 9th January 2019, viewed 21st July 2020, https://trade.ec.europa.eu/doclib/docs/2019/january/tradoc_157623.pdf

¹³ Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union, European Commission, 14th January 2020, viewed 21th July 2020, https://trade.ec.europa.eu/doc/ib/docs/2020/january/tradoc_158567.pdf

¹⁴ Lau, Stuart, European Union 'Deplores' Beijing's Move to Pass National Security Law for Hong Kong, South China Morning Post, 20th June 2020, viewed 20th July 2020, https://www.scmp.com/news/china/diplomacy/article/3091240/european-union-deplores-beijings-move-pass-national-security

¹⁵ Roth, Kenneth, Europe Needs to Stop China's Assault on the Global Human Rights System, Human Rights Watch, 11th February 2020, viewed 20th July 2020, https://www.hrw.org/news/2020/02/11/europe-needs-stop-chinas-assault-global-rights-system#

¹⁶ Stevenson, Alexandra, China's Communists Rewrite the Rules for Foreign Businesses, The New York Times, 13th April 2018, viewed 20th July 2020, https://www.nytimes.com/2018/04/13/business/china-communist-party-foreign-businesses.html

¹⁸ European Business in China Business Confidence Survey 2020: Navigating in the Dark, European Union Chamber of Commerce in China, 10th June 2020, https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>

Wang, Vivian, China's Coronavirus Battle Is Waning. Its Propaganda Fight Is Not, The New York Times, 17th June 2020, viewed 20th July 2020, https://www.nytimes.com/2020/04/08/world/asia/coronavirus-china-narrative.html
 Gan, Nectar, Hu, Caitlin & Watson, Ivan, Beijing Tightens Grip Over Coronavirus Research, Amid US-China Row on Virus Origin, CNN, 16th April 2020, viewed 20th July

 ²⁰ Gan, Nectar, Hu, Caltilin & Watson, Ivan, Beijing Tightens Grip Over Coronavirus Research, Amia US-China Row on Virus Orgin, Chin, 16 April 2020, viewed 20 July 2020, https://edition.cnn.com/2020/04/12/asia/china-coronavirus-research-restrictions-intl-hnk/index.html
 21 Issuance of Xinjiang Supply Chain Business Advisory, US Department of State, 1st July 2020, viewed 14th July 2020, https://www.state.gov/issuance-of-xinjiang-supply-chain-business-advisory, US Department of State, 1st July 2020, viewed 14th July 2020, https://www.state.gov/issuance-of-xinjiang-supply-chain-business-advisory, US Department of State, 1st July 2020, viewed 14th July 2020, https://www.state.gov/issuance-of-xinjiang-supply-chain-business-advisory, US Department of State, 1st July 2020, viewed 14th July 2020, https://www.state.gov/issuance-of-xinjiang-supply-chain-business-advisory, https://www.state.gov/issuance-of-xinjiang-supply-chain-business-advisory, https://www.state.gov/issuance-of-xinjiang-supply-chain-business-advisory, https://www.state.gov/issuance-of-xinjiang-supply-chain-business-advisory, https://www.state.gov/issuance-of-xinjiang-supply-chain-business-advisory</advisory, <a

chain-business-advisory/>
22 The President's Executive Order on Hong Kong Normalization, The White House, 14th July 2020, viewed 21st July 2020, https://www.whitehouse.gov/presidential-actions/

²² The President's Executive Order on Hong Kong Normalization, The White House, 14" July 2020, viewed 21" July 2020, https://www.whitehouse.gov/presidential-actions/ presidents-executive order-hong-kong-normalization/>

²³ Shi, Jiangtao, China Wants its Diplomats to Show More Fighting Spirit, South China Morning Post, 12th April 2020, viewed 21th July 2020, https://www.scmp.com/news/china/diplomacy/article/3079493/china-wants-its-diplomats-show-more-fighting-spirit-it-may-not

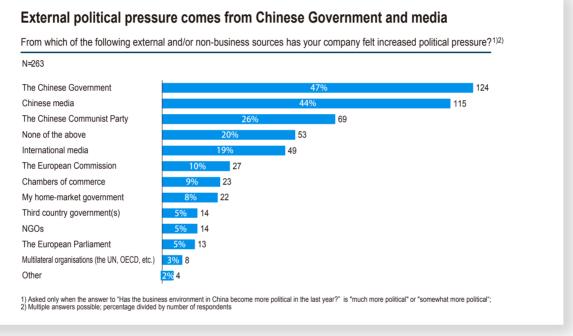


against China.²⁴ A worst-case scenario would be a continuation of this approach, leading to increased tensions and causing politicians to disengage from China.

The politicisation of business

In the European Chamber's BCS 2020, 43 per cent of members report that the business environment became increasingly politicised compared to the previous year, with just 10 per cent saying it became less so. Members indentify the Chinese Government and Chinese media as the most likely sources to increase political pressure on businesses.²⁵

Chart 1



Source: European Business in China Business Confidence Survey 2020

European companies in China can forecast economic trends, shifting consumer tastes, and the supply and demand of inputs, but they cannot predict ever-shifting political demands. Regardless of the areas where progress has been made in China's business environment over the past year—as outlined in the individual position papers of the European Chamber's working groups—companies now have even more reason to believe that they could become victims of arbitrary punishment being handed down to them due to the actions of their home-country governments.

For example, despite the signing of the EU-China Agreement on Geographical Indications (GIs)²⁶—which in theory should help protect the quality of 200 different food and beverage products (half European, half Chinese) and increase consumer confidence—it is entirely plausible that European producers and importers of these newly protected items may face sudden disruptions should they become the focus of Chinese retaliation in response to political issues:

²⁴ Westcott, Ben and Jiang, Steven, China is Embracing a New Brand of Foreign Policy. Here's What Wolf Warrior Diplomacy Means, CNN, 29th May 2020, viewed 8th July 2020, https://edition.cnn.com/2020/05/28/asia/china-wolf-warrior-diplomacy-intl-hnk/index.html; Zhu, Zhiqun, Interpreting China's Wolf Warrior Diplomacy, The Diplomat, 15th May 2020, 8th July 2020, https://thediplomat.com/2020/05/28/asia/china-wolf-warrior-diplomacy-intl-hnk/index.html; Zhu, Zhiqun, Interpreting China's Wolf Warrior Diplomacy, The Diplomat, 15th May 2020, 8th July 2020, https://thediplomat.com/2020/05/interpreting-chinas-wolf-warrior-diplomacy/

²⁵ European Business in China Business Confidence Survey 2020: Navigating in the Dark, European Union Chamber of Commerce in China, 10th June 2020, ">https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>">https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>">https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>">https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>">https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>">https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>">https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>">https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>">https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_in_Chi

²⁶ EU-China Agreement on Cooperation on, and Protection of, Geographical Indications, European Commission, 4th November 2019, viewed 20th July 2020, https://ec.europa.eu/info/sites/info/files/food-farming-fisheries/farming/documents/eu-china-gi-agreement-for-publication.pdf

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- Will Chinese state media call for boycotts of Scottish Farmed Salmon because of the United Kingdom's (UK's) stance on the National Security Law, as happened to Norwegian Salmon after the Nobel Peace Prize was awarded to Liu Xiaobo in 2010?²⁷
- Will Greek Sitia Olive Oil face a ban because of a Chinese national being arrested, as happened with canola oil imports from Canada after Meng Wanzhou was detained?²⁸
- Will Czech Žatecký Chmel Hop imports suddenly face a massive increase in tariffs if a city mayor meets with Taiwanese officials, as happened when Australian barley imports were hit with 80 per cent tariffs after Australian politicians suggested an independent inquiry into the origins of the novel coronavirus?²⁹

Meanwhile, it is highly unlikely that European countries would respond in the same way, and that Chinese producers or exporters would suddenly find themselves in the crosshairs as a result of political spats.

- When the Chinese Embassy in France published false information about elderly French left to die en masse during the COVID-19 outbreak, French leaders did not call for public boycotts of Pu'er tea.³⁰
- Sweden did not block imports on Shaoxing Yellow Wine in response to the jailing of Gui Minhai.³¹
- CGTN's suggestion that COVID-19 originated in Italy did not result in the Italian Government levying 80 per cent tariffs on Shanxi Laochen vinegar.³²

Such political interference in business is deeply disruptive, and could impact other countries' approaches towards China if not reined in.

Why do we stay?

Even as growth has slowed, both in China and globally, 39 per cent of European Chamber members reported revenue growth in 2019 of up to 20 per cent year-on-year, and 11 per cent saw even higher growth for their China operations.³³

However, just under half of European Chamber members report missing out on business opportunities as a result of market access restrictions and regulatory barriers in China, 40 per cent of whom claim those lost opportunities amount to more than 10 per cent of their annual revenue. This is a clear indicator of just how significant China's market potential is.³⁴ The revenue and profitability that could be derived from the market should it become as open and fair as China's leaders frequently claim it will,³⁵ means that this market simply cannot be missed out on.

China's economic rise follows historical norms

China has become a pivotal market for European players over its four decades of economic opening,

34 Ibid.

²⁷ Milne, Richard, Norway Sees Liu Xiaobo's Nobel Prize Hurt Salmon Exports to China, Financial Times, 15th August 2013, viewed 21st July 2020, https://www.ft.com/content/ab456776-05b0-11e3-8ed5-00144feab7de

²⁸ Vieira, Paul, Trudeao Ascribes Chinese Ban on Canadian Canola to US Trade Fight, The Wall Street Journal, 10th May 2019, viewed 21st July 2020, <https://www.wsj.com/ articles/trudeau-ascribes-chinese-ban-on-canadian-canola-to-u-s-trade-fight-11557518194>

²⁹ China Punishes Australia for Promoting an Inquiry into COVID-19, The Economist, 21st May 2020, viewed 21st July 2020, https://www.economist.com/asia/2020/05/21/china-punishes-australia-for-promoting-an-inquiry-into-covid-19

³⁰ Wintour, Patrick, France Summons Chinese Envoy After Coronavirus Slur, The Guardian, 15th April 2020, viewed 21st July 2020, https://www.theguardian.com/world/2020/apr/15/france-summons-chinese-envoy-after-coronavirus-slur

³¹ Gui Minhai: Hong Kong Bookseller Gets 10 Years Jail, BBC, 25th February 2020, viewed 21st July 2020, <https://www.bbc.com/news/world-asia-china-51624433>

³² Syam, Nilay, Water Samples Suggest COVID-19 Present in Italy Before Chinese Cases, CGTN, 20th June 2020, viewed 21st July 2020, https://newseu.cgtn.com/news/2020-06-20/Water-samples-suggest-COVID-19-present-in-Italy-before-chinese-cases-RtTMEUvgcg/index.html

³³ European Business in China Business Confidence Survey 2020: Navigating in the Dark, European Union Chamber of Commerce in China, 10th June 2020, viewed 19th July 2020, https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>

³⁵ Tang, Frank, Is China an Open Economy? Beijing Says it is but IMF Differs, South China Morning Post, 24th August 2018, viewed 20th July 2020, https://www.scmp.com/news/china/economy/article/2161265/china-open-economy-beijing-says-it-imf-differs

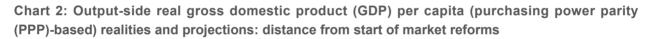


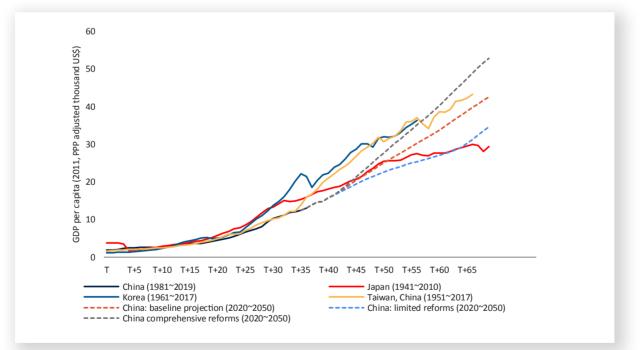
and it has the potential to follow the trends of other economic miracles predating its own. Although it is commonly stated in China that its rapid rise over the last forty years is somehow unique,³⁶ the European business community sees it as yet another example of how economies bloom when modernisation is prioritised and their development is predicated on market opening.

History repeating itself

Mass and rapid industrialisation and modernisation has been experienced by multiple economies throughout the last 150 years. China is following a path similar to the 'Four Asian Tigers' of South Korea, Taiwan, Hong Kong and Singapore. These markets transitioned from largely undeveloped economic systems/trading ports to highly developed, competitive centres for industry, innovation and finance, all over the course of around four decades.³⁷

Larger economies have historically done the same. Like many countries during the second industrial revolution at the end of the 19th century, Germany, shortly after its unification in 1871, rapidly industrialised.³⁸ An even more dramatic modernisation emerged over a similar period of time when Meiji Japan went from a feudal, chiefly agrarian economy to an economic force on par with the strongest nations of the day.³⁹ So long-lasting were the lessons of those experiences that even after the heavy bombing sustained by both countries during the Second World War, they were able to rebuild in just a few decades to become the powerhouses they are today.





Source: The World Bank

³⁶ Wang, Jiamei, China's Growth Miracle Over Past Three Decades Underlines Strategic Choice at Critical Moment, Global Times, 3rd June 2019, viewed 20th July 2020, http://www.globaltimes.cn/content/1152971.shtml

³⁷ Rabinovitch, Simon and Cox, Simon, After Half a Century of Success, the Asian Tigers Must Reinvent Themselves, The Economist, 5th December 2019, viewed 20th July 2020, https://www.economist.com/special-report/2019/12/05/after-half-a-century-of-success-the-asian-tigers-must-reinvent-themselves

³⁸ Schirm, Stefan, A., The Power and Norms in Shaping National Answers to Globalisation: German Economic Policy After Unification, Taylor & Francis Online, 8th September 2010, viewed 20th July 2020, <https://www.tandfonline.com/doi/abs/10.1080/714001318?journalCode=fgrp20>

³⁹ Atsushi, Kawai, Japan's Industrial Revolution, Nippon.com, 10th July 2019, viewed 20th July 2020, https://www.nippon.com/en/japan%E2%80%99s-industrial-revolution.html

The Chinese economy has followed similar growth trends over comparable timelines, as illustrated in the World Bank chart (Chart 2), which shows GDP per capita in PPP terms since the introduction of market reforms in respective markets. European companies are ready to play a key role in the development of yet another economic powerhouse in East Asia.

In China for China, and the world

European companies derive far more from being in other markets than just the immediate benefit of increased sales. They also benefit from the global nature of the talent they acquire, increased competition and their exposure to new forms of innovation. China is no different in this respect.⁴⁰

European companies are here to compete

The success of many of Europe's best companies comes from decades of competing with peers at home and abroad. The formation of the European Common Market paid immediate dividends as companies previously protected by borders and tariffs were suddenly forced to cut the fat or fall behind.⁴¹ The winners of that race then entered international markets as globalisation took off and the World Trade Organization (WTO) gave them access to other fields of competition, while also keeping them on their toes as their home markets welcomed new entrants.

With China remaining only partially open, and with a level playing field only reported by half of European companies operating in the Chinese market,⁴² the resulting loss of competition for both European players and China's own champions is a grievous one.

Talent the key to competition

The foreign companies that used to have their pick of China's best and brightest now face strong competition from local companies,⁴³ further underlining how necessary it is to have a presence here, as well as to be able to easily assign talent from other parts of the world to China operations. European companies are keen to send their global talent into China for them to foster new skills and gain experience that can be applied elsewhere. It also helps companies unlock synergies by bringing the best local and foreign talent together.

Unfortunately, China is far more restrictive towards foreign talent than the EU's various member states. The OECD Foreign Direct Investment (FDI) Restrictiveness Index breaks down how closed off a given market is based on four main categories. One of these is how restrictive a market is to key foreign personnel, broken down over 39 specific indicators.⁴⁴ Nearly all EU Member States score a 0.000 on the calculated average of this metric. Four exceptions stand out: France at 0.002 because of restrictions in fisheries; Italy at 0.002 because of maritime, air and transport; Lithuania at 0.003 because of fisheries and maritime; and Poland at 0.006 because of restrictions in media and telecommunications. In 38 of the 39 sectors, China holds a rating of 0.05 or higher, with its sole 0.000 rating being in real estate investment.

⁴⁰ Will China Ever be on the Cutting Edge of Global Innovation?, China Power, 27th February 2016, viewed 20th July 2020, <https://chinapower.csis.org/will-china-ever-be-oncutting-edge-of-global-innovation/>

⁴¹ Allen, Chris, Gasiorek, Michael, Smith, Alasdair, Flam, Harry and Sorensen, Peter Birch, 1998, The competition effects of the single market in Europe, Economic Policy, vol 13, no. 27, pp. 439-486.

⁴² European Business in China Business Confidence Survey 2020: Navigating in the Dark, European Union Chamber of Commerce in China, 10th June 2020, https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>

⁴³ Morarjee, Rachel, MNCs Need Sharper Edge in China Talent Wars, Reuters, 17th January 2017, viewed 20th July 2020, https://www.reuters.com/article/us-china-executives-breakingviews/mncs-need-sharper-edge-in-china-talent-wars-idUSKBN151003>

⁴⁴ OECD FDI Regulatory Restrictiveness Index, OECD, viewed 20th July 2020, https://stats.oecd.org/index.aspx?datasetcode=FDIINDEX#



This earns China an average of 0.048, eight times the score of the most restrictive EU Member State, Poland. By comparison, the most restricted OECD member in this metric is Canada, with an average score of 0.013. When including the non-OECD countries covered by the index, China ranks as the fourth most restrictive. Saudi Arabia holds a score of 0.077, and Indonesia and Peru are tied with a score of 0.05.

In the interests of creating a more competitive business environment, an important part of China's ongoing opening-up and development must therefore include reducing the restrictions currently placed on foreign talent, bringing it more in line with the EU.

China's market access lags its market potential

For many years, the European Chamber has advocated for more complete opening in China, and equal treatment for foreign enterprises. The current web of restrictions facing foreign companies trying to invest in China are extremely burdensome and actually hold back China's overall development. It will only be possible to unleash the full potential of its market by increasing foreign investment, which in turn will also strengthen competition.

Foreign companies that want to invest in China must first navigate the Foreign Investment Negative List (FINL), a table of different industries in which foreign investment is either forbidden or accompanied by conditions for entry. Restrictions include, for example, equity caps or requirements that the Chinese partner must have majority control in a joint venture (JV).

The list underwent a recent revision in late June 2020,⁴⁵ with seven items being removed, leaving 33 restricted/prohibited sectors. Most of the removed items are of limited significance, such as, nuclear fuel and nuclear radiation processing, oil and gas exploration, and pipe network facilities. However, the remaining items are composed of sectors across a broad spectrum of interest – traditional Chinese medicine production is not exactly a priority for European business, but legal and telecommunications services certainly are.

In addition to the FINL, foreign investors must also navigate the less frequently discussed Market Access Negative List (MANL).⁴⁶ This list affects all market players, not just foreign ones, which serves as a reminder that China's private companies are also subject to the onerous regulatory framework of the market. While the MANL has 130 broadly defined items—which translate into restrictions on the provision of hundreds of different goods and services—the vast bulk of these are not prohibited, but instead require various permissions.

European business leaders report being twice as likely to face such indirect barriers compared to direct ones.⁴⁷ Foreign banks, for example, were finally able to enter without JV requirements as of just a couple of years ago. However, once allowed in, they found a fully saturated market in which only a few niche opportunities in areas like cross-border services held meaningful potential. Furthermore, the requirements for obtaining an operating licence remain out of international norms by some considerable distance. To date, only a handful of foreign banks have been successful, though recent announcements from the

⁴⁵ Foreign Investment Negative List 2020, Ministry of Commerce (MOFCOM), 24th June 2020, viewed 16th July 2020, http://www.mofcom.gov.cn/article/ae/ai/202006/20200602977244.shtml

⁴⁶ MANL (2019 Version), MOFCOM Department of Treaty and Law, 22nd November 2019, viewed 12th August 2020, http://tfs.mofcom.gov.cn/article/bc/201911/20191102916059. shtml>

⁴⁷ European Business in China Business Confidence Survey 2020: Navigating in the Dark, European Union Chamber of Commerce in China, 10th June 2020, viewed 20th July 2020, ">https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>

China Securities Regulatory Commission could signal that things are moving the right direction.⁴⁸

Insurers, which have just seen their industry removed from the most recent FINL, face different, but no less burdensome, bureaucratic barriers to full entry. To offer their services nationwide, they must apply for a separate licence in each individual province, with only one application being accepted and processed at a time. With the China Banking and Insurance Regulatory Commission issuing those licences at a pace of about one a year, this means that any foreign insurance providers wanting to offer services in even just one third of the country would need at least decade to acquire them, assuming that they were all smoothly approved.⁴⁹ Meanwhile, China's biggest insurers, which have been able to easily secure their positions across the country relatively unimpeded, are able to continue to build market share before foreign competitors can even get to them.

In information, communication and technology, there are rapidly emerging sectors with plenty of market share up for grabs. Unfortunately, most telecommunications infrastructure providers are increasingly squeezed out of public procurement as China fights to support its national champions, and licences for value-added telecommunications—including cloud and virtual private network services—remain largely out of reach to foreign companies. At the same time, digital solutions developed elsewhere by European firms have to deal with the Great Firewall and its seemingly ever-growing list of blocked sites.⁵⁰

In addition to the removal of certain items, the revised FINL also now includes a provision that gives the State Council the power to supersede the restrictions on the list for any company that it selects.⁵¹ It seems likely that this is meant to allow the State Council to 'pilot' opening in certain sectors after the previous piloting model, through China's free-trade zones, failed to deliver any meaningful results.

This could be good news for foreign companies that the State Council gives the green light to. However, it also raises concerns within the European business community with respect to China's increasingly politicised business environment, as described in detail in the previous section of this paper. It is not beyond the realms of possibility that a company that is in favour one year, may suddenly fall out of favour the next if its home-country government comments on an issue that is deemed to be sensitive.

Foreign investment at the gates

If greater market access were to be granted, 62 per cent of European Chamber members stated in the BCS 2020 that they are more or somewhat more likely to increase investment in China.⁵² Of those, roughly half are ready to invest an additional five to 10 per cent of their annual revenue, while almost a third said they would invest even greater sums.

However, if the aforementioned direct and indirect access barriers are not dismantled to produce timely opportunities in relevant sectors, more parts of the market will become saturated by local champions rendering any subsequent market opening largely meaningless to foreign investors.

⁴⁸ Administrative Measures for Securities Investment Fund Custody Business, China Securities Regulatory Commission, 10th July 2020, viewed 21st July 2020, http://www.csrc.gov.cn/pub/zjhpublic/zjh/202007/l20200710_379911.htm

⁴⁹ Key Recommendation 1, Insurance Working Group Position Paper, European Business in China Position Paper 2020/2021.

⁵⁰ Chan, Tara Francis, China's Great Firewall is Taller Than Ever Under 'President-for-life' Xi Jinping, Business Insider, 25th March 2018, viewed 21st July 2020, https://www.businessinsider.com/china-great-firewall-censorship-under-xi-jinping-2018-3

⁵¹ Notice of the Two Departments on the Issuance of the Negative List of Market Access 2019, State Council, 22nd November 2019, viewed 16th July 2020, http://www.gov.cn/xinwen/2019-11/22/content_5454504.htm

⁵² European Business in China Business Confidence Survey 2020: Navigating in the Dark, European Union Chamber of Commerce in China, 10th June 2020, https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>



Procurement blues

For many that have successfully navigated China's entry requirements, they face further limitations in a public procurement market that remains largely closed to foreign players, with "regulations and policies favouring domestic over foreign goods and services".⁵³ In terms of inputs, European companies have identified some opportunities, but only to play niche roles and mostly in areas where they have a certain technology that local competition cannot replicate.

Service providers are similarly marginalised. For example, construction service providers (CSPs), long limited to only a handful of potential projects, remain tiny players within the technically open market.⁵⁴ With only four possible types of project open to foreign CSPs, it is not surprising that their market share is less than two per cent. Members of the European Chamber's Construction Working Group report that the only option they have is to play a 'consulting' role in which they do the work for a domestic CSP and receive only part of the revenue and limited recognition.

One of the main findings of the European Chamber's January 2020 report *The Road Less Travelled* is that China's procurement model is being exported via the Belt and Road Initiative (BRI).⁵⁵ BRI-related projects rarely have open procurement and tendering processes. The scant few European companies that have so far managed to become involved have almost exclusively been pulled in by an established Chinese business partner, the Chinese Government or the government of the country in which the project is being developed.⁵⁶ In the projects where this happens, European companies are, again, generally brought in to provide a certain technology, or because of their deep experience working in either the recipient countries, China or both. This sees them only playing a facilitating role.

China's splendid isolation?

Direct and indirect market access barriers aside, certain recent events have led to a growing sense that the restrictions China places on foreign companies may have a more unfavourable objective beyond just protecting its domestic companies. The European Chamber has noted a sharp increase in rhetoric and behaviour, at both government and societal levels, that has raised the question, "China seems to want our investment, our technology and our brands, but does it want us?"

Since 28th March 2020, due to the COVID-19 pandemic, China has imposed heavy travel restrictions on foreign residents stranded outside of the country.⁵⁷ These remain in place at the time of writing. This situation resulted in a huge number of European Chamber member companies being left without key personnel.

A member survey, conducted by the European Chamber's Shanghai Chapter in July 2020,⁵⁸ illustrates just how damaging this has been for business (percentages rounded up or down):

⁵³ Why China's Public Procurement is an EU Issue, European Parliament, December 2016, viewed 20th July 2020, <a href="https://www.europarl.europa.eu/RegData/etudes/ATAG/2016/593571/EPRS_ATA(2016)571/EPRS_ATA(2016)5771/EPRS_AT

⁵⁴ Regulations on the Administration of Foreign-Invested Construction Enterprises, MOFCOM, 17th January 2003, viewed 18th May 2020, http://www.mofcom.gov.cn/article/bh/200301/20030100064300.shtml

⁵⁵ The Road Less Travelled: European Involvement in China's Belt and Road Initiative, European Union Chamber of Commerce in China, 2020, https://www.europeanchamber.com.cn/en/publications-belt-and-road-initiative

⁵⁶ Ibid.

⁵⁷ Zhang, Zoey, China's Travel Restrictions due to COVID-19: An Explainer, China Briefing, 12th August 2020, viewed 12th August 2020, https://www.china-briefing.com/news/chinas-travel-restrictions-due-to-covid-19-an-explainer/

⁵⁸ Shanghai Business Environment Survey - Summer 2020, European Union Chamber of Commerce in China, 6th August 2020, https://www.europeanchamber.com.cn/en/publications-archive/823/Shanghai_Business_Environment_Survey_Summer_2020>

- 34% of companies reported that none of their foreign staff had been able to return.
- 22% of companies reported that some but not all of their foreign staff had already returned.
- 17% of companies reported that all of their foreign staff had successfully returned.
- 26% did not have staff that needed to return.

The costs of this missing talent during the intervening months have already been considerable, and continue to accumulate. According to the Shanghai Chapter survey, as of July 2020:

- 40% of companies report that sales have been negatively impacted;
- 30% of companies forecast drops in revenue;
- 29% of companies report a negative impact on research and development (R&D) and innovation;
- 18% of companies have seen staff reassigned to other markets as a result of their being unable to return; and
- 14% of companies report having to cut costs through headcount reduction to compensate for lost business.

While some companies have been able to maximise their operations through the use of digital solutions, even they have suffered from lost efficiency due to time zone differences, technological limitations and uncertainty that is becoming unbearable for some.

However, many of the foreign experts barred from re-entry have not been able to work at all, such as engineers and technicians that need to be physically present. Maintaining certain operations demands an extremely advanced skill set that would normally be provided by bringing experts into China on a rotational basis. The Shanghai Chapter survey again indicates the damage that this has already caused, with 16 per cent of companies reporting that production has been negatively affected, and another 16 per cent reporting that operational safety has been compromised due to the absence of key foreign personnel.

While the various impacts on business have been significant, they are not experienced uniformly by all companies. Large multinationals may suffer efficiency losses or a portion of their operations being down, which could mean the difference between turning a profit or bearing a loss. At the opposite end of the spectrum, SMEs tend to be more reliant on a foreign chief representative, or one or two foreign experts, that are central to their business. Their long-term absence is less a matter of profitability, and more the actual survival of the company.

The travel restrictions have had knock-on effects that threaten the long-term viability of living in China for many. At the time of writing, many international schools are missing the bulk of their teachers, and fear that these staff members will not be allowed to return in the foreseeable future. The Association of China and Mongolia International Schools surveyed international schools across China, and found that in their 10 Beijing schools alone, 769 teachers were still stuck abroad along with their dependents.⁵⁹ Online teaching, especially while teachers and students are spread across drastically different time zones, is not a sustainable option. International schools all across China are dealing with these same challenges.

As the new school year rapidly approaches, foreign residents with children are having to seriously contemplate their futures. There are also a large number of foreign nationals resident in China that sent their families out of the country during the height of the outbreak. Three months on, these divided families continue to wait for border opening that will allow their reunion.⁶⁰

⁵⁹ This data was shared by the Association of China and Mongolia International Schools, but was not made publicly available at the time of publication.

⁶⁰ Roxburgh, Helen, China's Foreigner Ban Leaves Businesses in Limbo, Asia Times, 14th June 2020, viewed 20th July 2020, https://asiatimes.com/2020/06/chinas-foreigner-ban-leaves-businesses-in-limbo/



Return flights in disarray

In early June 2020, China and Germany secured an agreement to create a 'fast-track' entry channel to facilitate charter flights and tests to allow the most 'essential' foreign experts to return to China.⁶¹ While several flights have since landed, the procedures for each flight underwent changes on a seemingly daily basis. A large number were ultimately cancelled, either due to drastic changes in procedures that could not be met within a short timeframe, or because planned flights could not be filled due to the slow processing of visas. Implementing uniform procedures for returning foreign residents and their families is urgently needed.

The lack of reciprocity in the movement of foreign legal residents between China and the EU has not gone unnoticed by the European business community. While non-essential travel was reasonably shut down on both sides of the 'border', nearly all EU Member States still allowed for essential business travel and the return of legal residents.⁶²

Silence at best, denial at worst

Found in every society, xenophobia unfortunately reared its ugly head during the COVID-19 crisis, at a time when a coming together of global communities was most needed. Across Europe, despicable language was directed at Chinese nationals, ethnic Chinese and Asians more broadly.⁶³ Within China, foreign residents were barred entry to restaurants, cafes and bars, and even their own homes. Black foreigners in particular faced vitriol across China, but nowhere worse than in Guangzhou.⁶⁴

While members of Europe's less palatable political persuasions instigated much of the xenophobic behaviour in the region, they were far outweighed by the voices of its political, social and economic leaders rightly condemning these actions.

This stood in stark contrast to the response from the Chinese Government to incidences within its own borders. At best, the government simply remained silent on the matter while long-time foreign residents were continuing to face mistreatment. At worst, official spokespeople outright denied that any discrimination existed, even as it was being widely covered.⁶⁵ The failure to adequately deal with this situation has added to fears that such xenophobic behaviour, which causes people to feel extremely unwelcome to the extent that they may leave, is not considered to be a problem at the highest levels.

The future of foreign nationals in China

In recent years, the number of foreign companies has surpassed the number of foreign workers in China, which still sits at under one million in total, or about 0.07 per cent of the population of the country.⁶⁶ By

⁶¹ China to Set up Fast Track for Foreign Business Personnel: Official, Global Times, 14th May 2020, viewed 21st July 2020, <https://www.globaltimes.cn/content/1188417. shtml>

⁶² Council Agrees to Start Lifting Travel Restrictions for Residents of Some Third Countries, Council of the EU, 30th June 2020, viewed 21st July 2020, https://www.consilium.europa.eu/en/press/press-releases/2020/06/30/council-agrees-to-start-lifting-travel-restrictions-for-residents-of-some-third-countries/

⁶³ Stolton, Samuel, COVID-19 Crisis Triggers Racism Against Asians, Rights Agency Says, Euractiv, 8th April 2020, viewed 20th July 2020, https://www.euractiv.com/section/global-europe/news/covid-19-crisis-triggers-eu-racism-against-asians-rights-agency-says/

⁶⁴ Marsh, Jenni, Deng, Shawn & Gan Nectar, Africans in Guangzhou are on the Edge, After Many are Left Homeless Amid Rising Xenophobia as China Fights a Second Wave Of Coronavirus, CNN, 13th April 2020, viewed 20th July 2020, https://edition.cnn.com/2020/04/10/china/africans-guangzhou-china-coronavirus-hnk-intl/index.html

⁶⁵ Leng, Shumei and Chen Qingqing, 'No Discrimination' Against Africans Amid Pandemic, Global Times, 14th April 2020, viewed 20th July 2020, https://www.globaltimes.cn/ content/1185521.shtml>; No Discrimination Against Foreigners: China Daily Editorial, China Daily, 8th April 2020, viewed 20th July 2020, https://www.globaltimes.cn/ content/1185521.shtml>; No Discrimination Against Foreigners: China Daily Editorial, China Daily, 8th April 2020, viewed 20th July 2020, https://www.chinadaily.com.cn/ a/202004/08/WS5e8dd64aa310e232631a4cbf.html>

⁶⁶ Xing, Yi, Shanghai Home to Largest Foreign Worker Population in China, China Daily, 16th January 2019, viewed 20th July 2020, <http://www.chinadaily.com.cn/a/201901/16/ WS5c3ed0a9a3106c65c34e4d2a.html>

comparison, Japan has 1.66 million foreign workers, just over 1.3 per cent of its total population,⁶⁷ while South Korea has 884,000 foreign workers (just under the total number in China), around 1.7 per cent of its total population.⁶⁸

Even Shanghai, Mainland China's 'international city', holds just over 200,000 foreign workers, a quarter of the country's total, which is well under one per cent of the city's 24 million residents.⁶⁹

European Chamber member companies report that some foreign nationals stuck outside of China have simply given up and are now seeking opportunities back home, or, as mentioned, are being reassigned by their companies to other markets. Those that are currently here cannot discount the possibility that they may end up indefinitely displaced if they travel abroad in the future and the Chinese Government again implements similar restrictions with a mere 24-hours' notice. These are all considerations seriously impacting the plans of foreign nationals that may be looking to settle down in China, as well as those deciding whether or not to remain here after years of calling the country home. This is doubly true for foreign residents with spouses and children that have already faced months of separation from their families throughout the first half of 2020. More specifically, this means that senior and more experienced foreign talent will be far less likely to come and settle, leaving China with a much shallower pool from which to draw.

Is China moving in the right direction?

While the development path that China selected in the '80s, '90s and especially the early 2000s consistently drove optimism in the European business community, the direction things have gone in recent years has produced mixed feelings. Asked if China is moving in the right or wrong direction economically speaking, one panellist at a recent European Chamber event succinctly nailed overall sentiment with the answer, "Both."

Rhetorically? Things couldn't be better

On paper it appears that China is opening up its economy and moving in the right direction. In recent years, the Chinese Government has continuously reiterated this narrative. The ambitious statements in President Xi's first Davos address in 2017, offered hope for a brighter future when he said that "pursuing protectionism is like locking oneself in a dark room", and that no one would emerge as a winner from a potential trade war.⁷⁰ The plans for increased opening up of the economy to foreign investment seemed apparent.

These plans were formalised through the State Council's *Notice on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment* (*State Council Document No. 5* or *Guofa* [2017] No. 5),⁷¹ released in January 2017, and the *Several Measures for Promoting Foreign Investment*

⁶⁷ Record 1.6 Million Foreign Workers in Japan in 2019, Nippon.com, 30th March 2020, viewed 20th <https://www.nippon.com/en/japan-data/h00676/record-1-66-million-foreign-workers-in-japan-in-2019.html>

⁶⁸ Expats Working in S. Korea Up Nearly 30% in 6 Years, KBS World Radio, 19th January 2019, viewed 20th July 2020, http://world.kbs.co.kr/service/news_view. htm?lang=e&Seq_Code=142394>

⁶⁹ Xing, Yi, Shanghai Home to Largest Foreign Worker Population in China, China Daily, 16th January 2019, viewed 20th July 2020 http://www.chinadaily.com.cn/a/201901/16/wS5c3ed0a9a3106c65c34e4d2a.html

⁷⁰ Full text of Xi Jinping keynote at the World Economic Forum, CGTN, 17th January 2017, viewed 8th July 2020, https://america.cgtn.com/2017/01/17/full-text-of-xi-jinping-keynote-at-the-world-economic-forum

⁷¹ Notice on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment, State Council, 17th January 2017, viewed 8th July 2020, http://www.gov.cn/zhengce/content/2017-01/17/content_5160624.htm



Growth (*State Council Document No. 39* or *Guofa [2017] No. 39*),⁷² released in August 2017. An additional positive shift in China's management of foreign investment was expected with the 2019 adoption of the Foreign Investment Law (FIL),⁷³ which came into effect on 1st January 2020. All of these had the intention of streamlining existing regulations for foreign businesses and stimulating foreign investment.

In reality, the results have lagged far behind the promises. As recognised in the European Chamber's 2018 report *18 Months Since Davos*, which analysed China's reform progress in the 18 months that followed President Xi's 2017 Davos address, there was some indication that the pace of reform had increased. However, the actual reforms resulting from the two State Council documents were found to be "still insufficient and incomplete". Although the report identified some small market openings that had taken place, as well as improvements in the R&D environment and more stringent enforcement of environmental regulations, it also found serious issues remaining in China's economy, including state-owned enterprise (SOE) domination, unfair technology transfers and a burdensome regulatory environment, among others.⁷⁴ These conclusions are still accurate more than two years since this report was published.

A recent World Bank study pinpoints a combination of macro-economic forces and policy choices that have limited China's development and resulted in untapped potential.⁷⁵ In the late '90s and early 2000s, China's productivity in diverse sectors was a major contributor to double-digit economic growth. However, the choice not to reallocate resources from sectors with traditionally low productivity, such as agriculture, towards more productive industries and services—as well as from inefficient SOEs to private firms—has resulted in a steady drop in productivity since 2007.⁷⁶

Even though weaker growth was undoubtedly exacerbated by the 2009 financial crisis, the World Bank study highlights the fact that SOEs still lagging far behind private enterprises in terms of efficiency has also played a role in this.⁷⁷ While China's growth potential still remains, its per capita income and productivity are far below advanced economies. In order to close this gap, China will need to allocate more resources to the private sector, invest more in human capital, and upgrade industrial processes and management practices.

One economy, two systems

China's failure to efficiently reallocate resources was highlighted by the European Chamber in its BCS 2020, which found that China is decisively moving towards a 'one economy, two systems' model.⁷⁸ On one side, certain industries are being opened up to foreign investment, albeit at a slow pace with sometimes few genuine opportunities resulting. On the other side, industries remain open only to SOEs, which are protected from any form of competition.

⁷² Several Measures for Promoting Foreign Investment Growth, State Council, 16th August 2017, viewed 8th July 2020, http://www.gov.cn/zhengce/content/2017-08/16/content_5218057.htm

⁷³ China Welcomes Foreign Investors with New Foreign Investment Law, PwC, February 2020, viewed 20th July 2020, https://www.pwccn.com/en/services/tax/publications/china-foreign-investment-law-feb2020.html

^{74 18} Months Since Davos: How China's Vision Became a Reform Imperative, European Union Chamber of Commerce in China, June 2018, https://www.europeanchamber.com.cn/cms/page/en/publications-18-months-since-davos/300#download-table-300

⁷⁵ Brandt, L. et al, China's Productivity Slowdown and Future Growth Potential, World Bank, Policy Research Working Paper 9298, June 2020, viewed 8th July 2020, http://documents1.worldbank.org/curated/en/839401593007627879/pdf/Chinas-Productivity-Slowdown-and-Future-Growth-Potential.pdf

⁷⁶ Ibid.

⁷⁷ Ibid.

⁷⁸ European Business in China Business Confidence Survey 2020: Navigating in the Dark, European Union Chamber of Commerce in China, 10th June 2020, https://www.europeanchamber.com.cn/en/publications-business-confidence-survey

SOE reform with Chinese characteristics

SOE reform has been on the Chinese Government's agenda for quite some time, but in recent years there appears to have been a change in the way 'reform' is now being defined. In the time of Deng Xiaoping and Jiang Zemin, reform stood for a kind of privatisation, with SOEs being broken up into smaller organisations in order to make them more efficient and responsive to market forces.⁷⁹ In the current era, the rationale for reform has undergone a complete reversal, with SOEs now being pushed to become "stronger, bigger and better" through mergers.⁸⁰ As a result, China's vibrant and productive private sector has been sidelined in many important parts of the economy, and is being starved of much needed support, with the majority of financing going to SOEs.⁸¹

China's SOEs have been further empowered through industrial policy, as outlined in the European Chamber's 2017 report *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces.* SOEs have been given the role of leading the 10 industries that the Chinese Government has identified as driving China's development over the next several decades.⁸²

With no serious competition allowed into certain areas of the economy, some SOEs are well on the way to monopolising their respective industries. The breadth of their presence in the economy is reinforced by data from the European Chamber's annual *Business Confidence Survey*. In 2019, 70 per cent of survey respondents stated that SOEs were present in their sectors, with financial services reporting that SOEs held over 50 per cent of the market share.

Furthermore, European companies report in the BCS 2020 that SOEs still hold the advantage in almost all areas of doing business, including access to financing, licences and public procurement, and the ability to influence policy. These issues have worsened over the last few years, with 48 per cent of European Chamber members expecting that the state-owned sector will continue to gain opportunities at the expense of the private sector, a seven percentage-point increase compared to 2019.⁸³

Distortions go global

The influence of China's SOEs is not limited to the domestic market. Many have grown to become international powerhouses. The 97 SOEs under the direct control of SASAC have enjoyed largely uncontested access to China's market, allowing them to singularly benefit from growth, scale and domestic innovation in their respective sectors. They are also propped up by extensive state support through subsidies, cheap financing from state-run banks, and preferential access to factors of production like land and capital. This has resulted in massive companies at a scale that could never be reached under Europe's regulatory framework, which has weeded out such monopolistic forces and prevented their return through its competition law. Considerable friction is then created when these SOEs go out to compete with European firms in third markets around the world.

This dynamic can be seen playing out under the BRI, which is being used as a mechanism to 'export'

^{79 18} Months Since Davos: How China's Vision Became a Reform Imperative, European Union Chamber of Commerce in China, 2018, https://www.europeanchamber.com. cn/en/publications-18-months-since-davos>

⁸⁰ Xi Calls for Furthering SOE Reform, Xinhua, 18th October 2017, viewed 8th July 2020, <http://www.xinhuanet.com//english/2017-10/18/c_136688444.htm>

⁸¹ Mitchell, Tom, Liu Xinning & Wildau, Gabriel, China Private Sector Struggles for Funding as Growth Slows, Financial Times, 21st January 2019, viewed 21st July 2017, https://www.ft.com/content/56771148-1d1c-11e9-b126-46fc3ad87c65

⁸² 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>

⁸³ European Business in China Business Confidence Survey 2020: Navigating in the Dark, European Union Chamber of Commerce in China, 10th June 2020, <ttps://www. europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>



SOEs, among other things. Procurement bids for projects under Beijing's flagship programme are primarily awarded to Chinese SOEs. European companies report seeing a kind of 'vertical integration' of these SOEs, whereby bids are put together that see Chinese companies providing everything from financing, project management and post-completion services at a cost that private companies simply cannot compete with. For many countries that are recipients of BRI projects, this kind of consolidated solution, combined with comparatively very low costs, is irresistible.⁸⁴ In this way, Chinese SOEs have been able to secure a strong foothold in third markets. As a result, with China keeping many sectors of its own economy restricted to foreign investment, increasing numbers of Chinese SOEs are able to provide products and services to the entire global market, while foreign companies can service all but China.

'Competitive neutrality' must prevail

The initial stagnation of SOE reform, and the subsequent reinforcement of the state-owned sector, spells disaster for innovation and competition in the market place, and for private enterprises in general if this trend continues.

'Competitive neutrality'—the principle that the government should provide equal treatment to all enterprises, regardless of ownership structure or nationality—was the main theme of the European Chamber's *Executive Position Paper 2019/2020*.⁸⁵ The paper details how implementing competitive neutrality, and the SOE reforms that would be required to achieve it, is of paramount importance for tapping into China's entrepreneurial and innovation potential.

Some hope can be taken from the fact that former and current People's Bank of China governors Zhou Xiaochuan and Yi Gang both spoke about the need to move towards competitive neutrality.^{86&87} Yi Gang even went as far as to say that China should consider applying the principle of competitive neutrality to SOEs as part of a solution to "solve the structural problems in the Chinese economy".

However, there is not a unified position within China with respect to SOE reform. For example, Peng Huagang, deputy secretary general of SASAC, has asserted that China's SOEs already "engage in fair market competition against other enterprises", and therefore should not be discriminated against "in the formation of international rules".⁸⁸ He has advanced the narrative that Chinese SOEs are being treated unfairly overseas *simply because they are state-owned* and that this goes against the spirit of competitive neutrality, which is supposed to see all companies treated equally regardless of ownership type. Mr Peng has also stated that SOEs' investments in other markets are politically neutral.⁸⁹

The consolidation of Party and state in China, as well as calls for the CCP's influence to be further

⁸⁴ The Road Less Travelled: European Involvement in China's Belt and Road Initiative, European Union Chamber of Commerce in China, 16th January 2020, viewed 20th July 2020, https://www.europeanchamber.com.cn/en/publications-belt-and-road-initiative

⁸⁵ European Business in China: Executive Position Paper 2019/2020, European Union Chamber of Commerce in China, 24th September 2019, <https://www.europeanchamber.com.cn/en/publications-archive/757/Executive_Position_Paper_2019_2020>

⁸⁶ Miles, Tom, Ex-PBOC Chief says China Must Address "Loopholes" as Part of WTO Reform, Reuters, 19th September 2018, viewed 6th August 2019, ">https://www.reuters.com/article/us-china-economy-zhou/ex-pboc-chief-says-china-must-address-loopholes-as-part-of-wto-reform-idUSKCN1LZ0XU>

⁸⁷ Antonini, Renato, Comment: Expect More on 'Competitive Neutrality' in WTO Reform Talks, Borderlex, 12th December 2018, viewed 6th August 2019, https://borderlex.eu/2018/12/12/comment-expect-more-on-competitive-neutrality-in-wto-reform-talks/

⁸⁸ Let China's State-owned Enterprises Become Independent Market Actors: SASAC, China Banking News, 2018, viewed 22nd July 2020, http://www.chinabankingnews.com/2018/10/16/let-chinas-state-owned-enterprises-become-independent-market-actors-sasac/>

⁸⁹ Chu, Daye, SOEs Face Unfair 'Bias, Roadblocks' Overseas, Global Times, 15th November 2018, viewed 22th July 2020, http://www.globaltimes.cn/content/1123082.shtml

strengthened in all areas of society and the economy, have been well documented.^{90,91&92} With many SOEs having already changed their articles of association to allow the CCP a more influential role at board level, and even private enterprises being pressured to do the same,⁹³ the assertion that SOEs are 'politically neutral' at all, let alone in terms of just overseas investments, is highly questionable. China's national intelligence law of 2017, which states that "any organisation and citizen" must support and cooperate in "national intelligence work"⁹⁴ makes this an even more difficult premise to swallow.

Until the debate is settled, and true competitive neutrality comes into practice, China's SOE-dominated sectors will remain yet another major barrier to meaningful market opening and sustainable development.

Policy miscalculations

There are a host of other factors limiting market potential and preventing meaningful opening in China. Political and economic miscalculations—as well as the increased incidences of aggressive diplomacy and a tendency to define its own forms of multilateral engagement—has seen China's international image slowly deteriorate. At the same time, a failure to establish transparent, effective and impartial institutions and a loss of talent from within its bureaucracy raises questions over China's actual capacity to implement the changes needed to establish a fair, open and competitive business environment.

Sustainable development requires sound institutions

When businesses are looking to make long-term investments, they require the high degree of certainty that solid institutions provide. If a country fails to create a sound institutional and economic framework, it will struggle to sustain its development. The resulting lack of transparency, consistency and predictability in legal and administrative processes erodes trust and can ultimately cause long-term damage to economies.⁹⁵

China's opening up measures have in some cases been highly promising. The removal of certain industries from the negative list has, in theory, paved the way for investments in previously off-limits sectors of the economy. However, as detailed earlier in this report, a host of indirect barriers prevent many companies from actually being able to fully contribute to China's development.

This approach to managing foreign investment provides no real transparency or legal certainty, and therefore makes China's market less attractive, particularly in the current climate in which companies are becoming more and more risk averse. Increasing predictability—by creating reliable mechanisms for granting licences and approvals based on transparent and measurable factors—would not only boost business confidence, it would also raise the credibility of China's government.

The need for institution-building is recognised by many in China. For example, it was a central

 ⁹⁰ Mitchell, Tom, Xi's China: The Rise of Party Politics, Financial Times, 25th July 2016, viewed 22nd July 2020, <https://www.ft.com/content/57371736-4b69-11e6-88c5-db83e98a5590a>
 91 Trofimov, Yaroslav, Has Xi Jinping Stirred a Backlash?, The Wall Street Journal, 16th August 2019, viewed 22nd July 2020, <https://www.wsj.com/articles/has-xi-jinping-

 ⁹² Tiezzi, Shannon, Xi Jinping Continues His Quest for Absolute Party Control, The Diplomat, 10th July 2019, viewed 22nd July 2020, <https://thediplomat.com/2019/07/xi-

jinping-continues-his-quest-for-absolute-party-control/> 93 Stevenson, Alexandra, China's Communists Rewrite the Rules for Foreign Businesses, The New York Times, 13th April 2018, viewed 22nd July 2020, https://www.nytimes.

com/2018/04/13/business/china-communist-party-foreign-businesses.html>
 McGregor, Richard, *How the West Got Xi Jinping Wrong on Business, Financial Review*, 11th June 2019, viewed 22nd July 2020, https://www.afr.com/world/asia/how-the-west-got-xi-jinping-wrong-on-business-20190709-p525n0>

⁹⁵ Drzeniek-Hanouz, Margareta, Why Institutions Matter for Economic Growth, World Economic Forum, 2nd January 2015, viewed 18th July 2020, https://www.weforum.org/agenda/2015/01/why-institutions-matter-for-economic-growth/>



recommendation in *China 2030: Building a Modern, Harmonious, and Creative Society*, a report jointly produced by the Development Research Council and the World Bank.⁹⁶ Chinese and international experts agreed that without strong institutions, China's development will sputter just at the time it needs additional forward momentum to escape the middle-income trap.

Efficient institutions require competent officials

The European business community has noted a steady decrease of talented government officials in China in recent years, particularly in economic bodies. Tang Yalin, a professor of public administration at Fudan University describes how, "[the] current wave of [leaving] officials is unique[...]the average age of those leaving is higher, and many have specialised skills or experience in fields like technology, finance and policymaking."⁹⁷ This loss of seasoned talent is not good for continuity or policy-making/implementation, as has been seen in a number of areas over the past few years.

One stand-out example of how a lack of government capacity resulted in a sub-optimal outcome is when Beijing made reducing pollution a seemingly at-all-costs priority, by rushing out a policy to eliminate widespread industrial and domestic use of coal in order to meet 2017 air quality targets. Households and industries were forced to rapidly switch from coal to natural gas. This resulted in a natural gas shortage that left many citizens with no heat source during extremely cold weather conditions, as their coal-fired burners had already been dismantled. Local governments were then forced to divert natural gas from industrial and commercial users to those affected, which crippled many industries in early 2018.^{988,99} This shows how well-intended policies can cause major upheaval due to poor choices within local bureaucracies. According to one report, an unnamed official from the National Development and Reform Commission said part of the problem is that local officials display a "sheep-flock" mentality, and tend to focus on individual targets without considering the wider implications.¹⁰⁰ Meanwhile, many officials still argued that there had been nothing wrong with the policy, as the objective of achieving cleaner skies and better air quality had been reached.

Another example of how poor policy implementation resulted in economic shocks is when the Chinese Government in 2019 ordered the implementation of new, tighter emission standards to reduce pollution produced by cars, through the 'China-VI' rules. This was done at such a fast pace that car dealerships were unable to clear their vast inventories of vehicles that were not compliant with the new emission rules.¹⁰¹ As a result, car sales plunged 16 per cent year-on-year in May 2019, even though dealers slashed their prices by more than 30 per cent.¹⁰²

The chemical plant explosion in Yancheng, Jiangsu Province, in March 2019, serves as further example of how a lack of capacity among local officials—in this case the inability to successfully enforce policies— can lead to devastating outcomes. In recent years, European Chamber members in the chemical industry have noted a dramatic increase in the inspection rate of their facilities, while the same has not been

⁹⁶ China 2030: Building a Modern, Harmonious, and Creative Society, World Bank, 2013, viewed 20th July 2020, https://www.worldbank.org/content/dam/Worldbank/document/China-2030-complete.pdf

⁹⁷ Tang, Yalin, Why China's Bureaucrats are Plunging into the Private Sector, Sixth Tone, 29th December 2018, viewed 21st July, 2020, https://www.sixthtone.com/news/1003383/why-chinas-bureaucrats-are-plunging-into-the-private-sector

⁹⁸ Ng, Eric, China Pollution Fight Will Lead to Record Year for Natural Gas Demand, but not Terrible Shortages and Price Spikes, Experts Say, South China Morning Post, 26th November 2018, viewed 8th July 2020, ">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight-will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight/will-lead-record-year-natural-gas-demand-not-terrible>">https://www.scmp.com/business/article/2174904/china-pollution-fight/will-lead-record

⁹⁹ Jing, Li, What Caused China's Squeeze on Natural Gas?, The Diplomat, 1st January 2018, viewed 18th July 2019, https://thediplomat.com/2017/12/what-caused-chinas-squeeze-on-natural-gas/

¹⁰⁰ Ibid.

¹⁰¹ Huang, Echo, China Paralyzed its Auto Market by Fast-tracking Stricter Car Pollution Rules, Quartz, 4th July 2019, viewed 8th July 2020, https://qz.com/1657862/chinas-new-emission-standard-has-paralyzed-the-auto-market/

¹⁰² Sun, Yilei and Shirouzy, Norihiko, Behind the plunge in China auto sales, Reuters, 2nd July 2019, viewed 8th July 2020, https://www.reuters.com/article/us-china-autos-insight/behind-the-plunge-in-china-auto-sales-chaotic-implementation-of-new-emission-rules-idUSKCN1TW388

observed at Chinese chemical plants. The March 2019 explosion was a result of the plant neglecting to follow rules regarding product safety.¹⁰³ The fact that this was still possible after the government inspection campaign that started after the devastating Tianjin chemical plant explosion in 2015, when close to 40 per cent of the factories in China were forced to shut at some point and many officials were investigated, clearly demonstrates that there is much room for improvement in regulatory enforcement.¹⁰⁴

Rapid shifts in priorities can also be to the detriment of good policy. Following the fall-out from the Yancheng explosion, radical initial proposals were introduced by provincial authorities to arbitrarily slash the number of chemical plants in the region, regardless of their safety records.¹⁰⁵ The speed and severity of the shift was such that a member of the European Chamber's Nanjing Chapter described the plans as "economic suicide". Only after intervention from Chinese and foreign business associations did the region pull back from the precipice and find a workable solution.

These examples underline the value of not only establishing sound institutions, but also working with the whole business community to form policy that is both effective and implementable.

EU must prioritise existing multilateral platforms

It is important that the EU continues to work together with China to follow through on pledges to reform the WTO. This is particularly salient given current trends: China has been increasingly engaging with the rest of the world through its own mechanisms, while the continued deterioration of US-China relations is sucking so much oxygen out of the room that there is a real danger efforts to reform the WTO may be abandoned altogether.

One example of China's homegrown form of engagement is its preference for its '17+1' initiative, instead of using the already well-established European Union and its various dialogues with neighbouring non-member states to reach the same audience.¹⁰⁶ With Europe having long upheld a 'One-China policy', it raises the question: why does China not reciprocate and implement a 'One-Europe policy'?

As already alluded to, the BRI provides another example of how China is forging its own ways to engage with the world outside of established global norms. While many third countries previously had to rely on existing multilateral organisations to fund major infrastructure projects, through the BRI China has created the circumstances that see it freely investing in these countries' strategic infrastructure, under conditions that, on the face of things, appear favourable. At the same time, the BRI is functioning as a platform to steadily introduce 'Chinese standards' outside of China, at the expense of globally-approved ones. According to the US-China Economic and Security Review Commission's *2018 Report to Congress,* "Chinese companies are seeking to define and export standards for a broad set of technological applications, which, taken together, could alter the global competitive landscape."¹⁰⁷

¹⁰³ Cause of Deadly Chemical Plant Blast in East China Revealed, Xinhua, 15th November 2019, viewed 8th July 2019, <http://www.xinhuanet.com/english/2019-11/15/ c_138558301.htm>

¹⁰⁴ Navigating the Aftermath of the Jiangsu Chemical Plant Explosion, China Business Review, 16th July 2019, viewed 8th July 2020, https://www.chinabusinessreview.com/navigating-the-aftermath-of-the-jiangsu-chemical-plant-explosion-four-months-on/

¹⁰⁵ Wang, Cong, Chinese Chemical Firms Face Regulation, Global Times, 8th April 2019, viewed 21st July 2020, http://www.globaltimes.cn/content/1145075.shtml

¹⁰⁶ The '17+1' is an initiative set up by the Chinese Ministry of Foreign Affairs to serve as a platform for diplomacy, exchange and trade and investment between China and 17 countries from Central and Eastern Europe – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, North Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia and Slovenia.

^{107 2018} Report to Congress, US-China Economic and Security Review Commission, November 2018, p. 269, viewed 18th July 2020, https://www.uscc.gov/sites/default/files/2019-09/2018%20Annual%20Report%20to%20Congress.pdf



EU poised to further protect against market distortions

The continued lack of significant and meaningful opening of China's market has increased calls within the EU for China to offer reciprocal access.¹⁰⁸ Europe must maintain its open market, but it can no longer afford to continue with a naïve approach in its dealings with Beijing.¹⁰⁹ Instead, the EU looks set to develop and deploy stronger mechanisms—including the investment screening mechanism and the International Procurement Instrument—to protect its market from non-market distortions, such as investments made with state-backed capital.¹¹⁰

The unfortunate conclusion is that former US President Bill Clinton may have been wrong when he asserted in 2000 that China would "import one of democracy's most cherished values: economic freedom."¹¹¹ Instead, it is looking more likely, at least for the time being, that Western liberal markets will need to become more like China's in order to protect themselves from the more pernicious aspects of China's economy.

European business as a transition catalyst

European companies are ready to deepen their positions in China if given the right opportunities. Ongoing investment into China from Europe's top companies means more than just numbers on a ledger. The new factories and plants currently being built by European companies are on the cutting edge, and will be among the most modern facilities in the world, integrating emerging technology, like artificial intelligence, 5G and cloud, to create operations that will set new standards. They will provide well-paid jobs that teach new skills to China's growing pool of skilled workers, laying the foundation for further industrial upgrading in China through the high-quality inputs they provide and by raising the expectations of Chinese consumers.

Complementary tech strengths

The current US administration's efforts to force decoupling from China could have a serious impact on what technology is allowed to be sold to China. Washington's push to impose export controls on American semiconductors to key Chinese companies has already revealed the potential economic damage that could be caused in areas where China is far behind, as well as the increased harm this would have on the US-China relationship.¹¹² Similarly, a US-China financial war could seriously impact China's best companies that are reliant on the USD, since China's tight control over its monetary system has left the *renminbi* with only a tiny share of global transactions.¹¹³

However, in areas where China is comparatively strong, efforts to decouple or cut-off access to American technology are likely to have a more muted impact. In some areas of technology, Chinese firms have already surpassed their American competitors. The same is true for China's internet companies, many of which are world leaders. Coupled with a robust venture capital culture, China can endure and even thrive

¹⁰⁸ Several Outlets – Trust and Reciprocity: The Necessary Ingredients for EU-China Cooperation, European Union External Action Service, 15th May 2020, viewed 20th July 2020, ">https://eeas.europa.eu/headquarters/headquarters-homepage/79355/trust-and-reciprocity-necessary-ingredients-eu-china-cooperation-high-representative-eu_en>">https://eeas.europa.eu/headquarters/headquarters-homepage/79355/trust-and-reciprocity-necessary-ingredients-eu-china-cooperation-high-representative-eu_en>">https://eeas.europa.eu/headquarters/headquarters-homepage/79355/trust-and-reciprocity-necessary-ingredients-eu-china-cooperation-high-representative-eu_en>">https://eeas.europa.eu/headquarters/headquarters-homepage/79355/trust-and-reciprocity-necessary-ingredients-eu-china-cooperation-high-representative-eu_en>">https://eeas.europa.eu/headquarters/headquarters-homepage/79355/trust-and-reciprocity-necessary-ingredients-eu-china-cooperation-high-representative-eu_en>">https://eeas.europa.eu/headquarters/headquarters-homepage/79355/trust-and-reciprocity-necessary-ingredients-eu-china-cooperation-high-representative-eu_en>">https://eeas.europa.eu/headquarters/headquarters-homepage/79355/trust-and-reciprocity-necessary-ingredients-eu-china-cooperation-high-representative-eu_en>">https://eeas.europa.eu/headquarters-homepage/79355/trust-and-reciprocity-necessary-ingredients-eu-china-cooperation-high-representative-eu_en>">https://eeas.europa.eu/headquarters/headquarters-homepage/79355/trust-and-reciprocity-necessary-ingredients-eu-china-cooperation-high-representative-eu_en>">https://eeas.europa.eu/headquarters/headq

¹⁰⁹ Blenkinsop, Philip & Emmott Robin, EU Leaders Call for End to 'Naivety' in Relations With China, Reuters, 22nd March 2019, viewed 18th July 2020, https://www.reuters.com/article/us-eu-china/eu-leaders-call-for-end-to-naivety-in-relations-with-china-idUSKCN1R31H3>

¹¹⁰ Brattberg, Erik & Le Corre, Philippe, The EU and China in 2020: More Competition Ahead, Carnegie Endowment for International Peace, 19th February 2020, viewed 20th July 2020, https://carnegieendowment.org/2020/02/19/eu-and-china-in-2020-more-competition-ahead-pub-81096>

¹¹¹ Full Text of Clinton's Speech on China Trade Bill, Institute for Agriculture and Trade Policy, 9th March 2000, viewed 18th July 2020, https://www.iatp.org/sites/default/files/Full_Text_of_Clinton's Speech_on_China_Trade_Bi.htm

¹¹² Whalen, Jeanne, U.S. Tries to Narrow Loophole That Allowed China's Huawei to Skirt Export Ban, The Washington Post, 16th May 2020, viewed 20th July 2020, https://www.washingtonpost.com/business/2020/05/15/us-closes-huawei-loophole/>

¹¹³ The Dangers of a US-China Financial War, Financial Times, 14th May 2020, viewed 21th July 2020, https://www.ft.com/content/85bca04a-9529-11ea-abcd-371e24b679ed

if deprived of American inputs in these areas.

But Chinese companies remain overwhelmingly behind Europe, Japan and the US in industrial technology. To survive decoupling with the US in this area, China would need to bring other partners closer to compensate. This would be crucial for China to boost its productivity sufficiently to escape not only the middle-income trap, but also the demographic cataclysm that could result from its rapidly ageing population.

European and Chinese technological edges are complementary, and they could together endure in a world undergoing deglobalisation. If this is to stand a chance of happening, China must develop sound institutions to create a transparent, consistent and predictable business environment, eliminate regulatory barriers and offer the EU reciprocal access to its market in a timely manner.

Recommendations

For China:

- Complete China's opening agenda by removing direct and indirect barriers that continue to bar European investment in much of the economy.
- Develop sound institutions to provide a truly level playing field between foreign and indigenous investors, and to make administrative processes transparent, consistent and predictable.
- Reverse the current trajectory of SOE reform in China, and embrace competitive neutrality to ensure that all companies operating in China are treated equally, regardless of nationality or ownership structure.
- Create a more competitive and international business environment by reducing the restrictions currently placed on foreign talent.
- Depoliticise the business environment and de-escalate 'wolf warrior' diplomacy.
- Develop a streamlined and consistent process for foreign workers and teachers, as well as their families, to return to China, and increase the number of flights between China and the EU to meet demand.
- Deepen China's involvement with and adherence to the multilateral institutions to which it belongs.
- Engage with the European Chamber to make progress on the more than 800 recommendations found in this *Position Paper*.

For the EU:

• Continue to pursue a strong and robust CAI that puts the investment relationship as close to reciprocity as possible, and refrain from committing to 'Phase One'-style half measures.



- Engage China and other partners in reforming and upgrading the WTO, including through plurilateral agreements.
- Expand on areas of shared bilateral interest with China, especially on issues like climate change, biodiversity, energy and international development (in Africa in particular).
- Strengthen investment screening to better mitigate distortions emanating from both China's stateowned economy and state-directed capital.
- Advance the International Procurement Instrument in a timely manner to either protect European procurement markets from distortions or to leverage China to open its own procurement market to European competition.
- Leverage third-market investment agreements, especially in BRI countries, to ensure that European companies are not disadvantaged by politically-favoured Chinese competitors.
- Remain fundamentally open to private investment and ensure that Chinese private investment can continue to follow market forces into the European economy.
- Build unity within Europe so that the bloc can fully leverage its collective advantage when dealing with other economies.
- Upgrade Europe's economic foundations to maintain competitiveness, including through infrastructure upgrading and market-forces-driven industrial policy.







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 1 sub-working group:

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

The Coronavirus Disease 2019 (COVID-19) pandemic has had a far-reaching impact on both the Chinese domestic economy and the overall global economy. After being the first to be hit by the outbreak, China took unprecedented public-health measures to stop the spread of the disease.¹ The restrictions China imposed—which varied both in severity and application throughout the country—hindered, or in some cases prevented, the movement of people and goods, which had a devastating effect on business operations. Companies had to halt or scale down production for weeks and supply chains were disrupted for months.² According to a survey jointly conducted by the European Chamber and the German Chamber in February 2020, every single respondent reported having suffered consequences to varying degrees.³ Even after the government had allowed gradual resumption of operations in early February, conflicting local regulations and overly-conservative implementation led to several months of disruptions.

At the time of writing, many companies were still struggling with the knock-on effects of these outbreak containment measures, with human resources (HR) departments in particular being badly affected. As of July 2020, many companies were still unable to bring their foreign employees back into China,⁴ and sudden domestic travel bans imposed due to local outbreaks—such as in Beijing in June 2020⁵ — prohibited people from travelling for necessary business.

Following the Ministry of Foreign Affairs' announcement on 26th March of the temporary suspension of entry into China of most foreign nationals holding valid visas or residence permits, many European company employees and their families, normally based in China, were left stranded abroad. Only diplomatic, service, courtesy or C-visa holders, as well as green card holders, were allowed into the country.

2 Ibid.

¹ Kubota, Yoko, Coronavirus Exposes Businesses' Dependency on China, The Wall Street Journal, 18th February 2020, viewed 27th July 2020, https://www.wsj.com/articles/coronavirus-exposes-businesses-dependency-on-china-11582035993>; Foreign Firms Struggle to Resume Operations in Virus-hit China, Naharnet, 18th February 2020, viewed 27th July 2020, https://www.naharnet.com/stories/en/269257>

³ COVID-19: The Impact on European Business in China, European Union Chamber of Commerce in China, 27th February 2020, viewed 21th July 2020, https://static.europeanchamber.com.cn/upload/documents/Survey_covid19_en_3[766].pdf#

⁴ Chow, Emily, U.S., European Trade Groups Press China to Reallow Entry, Reuters, 28th May 2020, viewed 27th July 2020, https://www.reuters.com/article/us-health-coronavirus-china-foreignworke/u-s-european-trade-groups-press-china-to-reallow-entry-idUSKBN23411

⁵ Du, Juan, New Cases Shine Spotlight on Xinfadi Market, China Daily, 19th June 2020, viewed 5th August 2020, https://www.chinadailyhk.com/article/134323#New-cases-shine-spotlight-on-Xinfadi-market

In July, the immigration ban was still in effect, with some exceptions subject to burdensome administrative procedures, which again varied depending on where the person was travelling from. In addition, limits on the number of international flights made the return—even for those who managed to obtain a new entry visa—almost impossible. These restrictions have been particularly devastating for small and medium-sized enterprises (SMEs). Their legal representatives are often foreign nationals, and/or their business model is built around foreign specialists. Unable to return, these foreign nationals were not able to manage business on the ground, including executing vital administrative tasks that require the presence of the signatory. After the central government entrusted local- and district-level authorities with the issuance of invitation letters to allow foreign nationals to apply for new entry visas, these authorities prioritised large companies, often only basing their decisions on scale of investment. These issues are discussed further in the *Inter-Chamber SME Working Group Position Paper*.⁶

The COVID-19 crisis has also laid bare the fact that many small and large companies alike are now facing a shortage of international talent in the long run, as the attraction of living and working in China has been greatly diminished, particularly for those with families. This is due not only to the short-term travel restrictions that have been imposed, but also because of certain long-term plans, including the cancellation of the non-taxable reimbursement regime for foreign expatriate employees, which is due to take effect in 2022.⁷ This will increase already exorbitant international school costs—as detailed in the *Finance and Taxation Working Group Position Paper*—and will make the assignment of senior executives who have to relocate with families more expensive, and therefore much more difficult.⁸ As of July 2020, international schools were still struggling to bring back teachers,⁹ which has raised real concerns as to whether or not they will be sufficiently staffed to be able to start the new school year in September.

Restrictions on mobility and other measures introduced to combat the pandemic have seen companies fundamentally rethink their ways of working. Social distancing requirements forced many businesses to adopt more flexible work models—including rotating office shifts and offering work-from-home options— something that many are now thinking of implementing in the long-term. However, this has merely highlighted the shortcomings of the Chinese labour legislation with regard to flexible work arrangements, an important issue that is addressed in the *Human Resources Working Group Position Paper*.¹⁰

The Foreign Investment Law (FIL),¹¹ which came into effect 1st January 2020, along with the *Regulation* on the Implementation of the Foreign Investment Law (Regulation),¹² was the legal development that received most attention from foreign companies across all industries. The law formally introduces a new 'national treatment plus negative list' administration system, which replaces the approval system under the *Catalogue for the Guidance of Foreign Investment Industries*. The latest version of the Negative List for Foreign Investment (Negative List) was issued by the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) on 24th June 2020, along with the updated Negative List for Foreign Investment for China's Free Trade Zones (FTZ Negative List).¹³ Both lists had seven items removed, bringing the Negative List down to 33 items and the FTZ Negative List down to 30 items.

10 See the Human Resources Working Group Position Paper on p. 65.

⁶ See the Inter-Chamber SME Working Group Position Paper on p. 88.

⁷ Notice on the Convergence of Preferential Policies after the Revision of the Individual Income Tax Law, State Administration of Taxation, 27th December 2018, viewed 27th July 2020, https://www.chinatax.gov.cn/n810341/n810755/c3978994/content.html

⁸ See the Finance and Taxation Position Paper on p. 55.

⁹ Kamp, Matthias, Die Grenzen Werden so Bald Nicht Aufgehen, Neue Zuercher Zeitung, 24th July 2020, viewed 27th July 2020, https://www.nzz.ch/nzz-asien/die-grenzen-werden-so-bald-nicht-aufgehen-ld.1567963#back-register>

¹¹ Foreign Investment Law, National People's Congress, 15th March 2019, viewed 16th July 2020, <http://www.gov.cn/xinwen/2019-03/20/content_5375360. htm>

¹² Regulation on the Implementation of the Foreign Investment Law, State Council, 26th December 2019, viewed 27th July 2020 http://www.gov.cn/zhengce/content/2019-12/31/content_5465449.htm

¹³ Special Management Measures for Foreign Investment Access (Negative List), MOFCOM, 24th June 2020, viewed 27th July 2020, http://images.mofcom.gov.cn/www/202006/20200624145659916.pdf>



The latest update also includes a new mechanism that allows the State Council to selectively override the Negative List and allow specific foreign investors into the market upon their approval. As with many other regulations, this leaves a high degree of discretion to the implementing authority. These irregular approvals could be used in a positive way as a tool to pilot new areas of opening up, but the transparency and predictability of such a system is also highly questionable.

The FIL is an attempt to address some of the biggest challenges faced by foreign businesses, such as intellectual property rights (IPR) protection and participation in standards-setting activities. These are issues that are discussed in the Intellectual Property Rights¹⁴ and the Standards and Conformity Assessment¹⁵ working group position papers. However, both the FIL and the *Regulation* still lack clear and cohesive implementation measures at the national and local levels, and the changes to other areas of the Chinese legislation that are needed to cement the rights and liabilities of companies are yet to materialise. Businesses cannot directly invoke the articles of the FIL and therefore the law remains merely a list of policy goals rather than an actual normative act. Issues and recommendations surrounding the FIL's implementation can be found in the Legal and Competition¹⁶ and Investment¹⁷ working groups' position papers.

The European business community had high hopes for the 22nd EU-China Summit that was held via video conference on 22nd June 2020, after the two parties had pledged at the 21st EU-China Summit in April 2019 to conclude the Comprehensive Agreement on Investment (CAI) by the end of 2020. Unfortunately, the 2020 event failed to even produce a joint communiqé. The EU strongly emphasised the need to advance negotiations towards an agreement that addresses the current asymmetries in market access and ensures a level playing field.¹⁸ However, progress with regard to the dominance of China's state-owned enterprises (SOEs), transparency on subsidies and rules for tackling forced transfers of technology remains slow.

A new three-year government action plan, approved on 30th June 2020, aimed at further enhancing the role of SOEs, which were declared 'key pillars' of the Chinese economy,¹⁹ has raised new concerns among the European business community. It has led many to question the Chinese Government's intention of creating a truly open market with a level playing field for European and Chinese private companies, and China's SOEs. The Investment Working Group remains hopeful that the CAI negotiations will continue, and reiterates its recommendation to introduce the concept of reciprocity in the agreement,²⁰ guaranteeing European businesses that have invested in China the same rights as Chinese businesses that have invested in the EU. The working group also repeats its recommendation that the CAI address issues related to transparency of licensing and authorisation procedures, and ensures that a high level of protection for European investors in China is provided by the Chinese authorities.²¹



This icon

represents the number of years the working group has been making this recommendation.

- 14 See the Intellectual Property Rights Working Group Position Paper on p. 75.
- 15 See the Standards and Conformity Assessment Working Group Position Paper on p. 128.
- 16 See the Legal and Competition Working Group Position Paper on p. 109.

- 18 EU-China Summit: Defending EU Interests and Values in a Complex and Vital Partnership Press Release by President Michel and President von der Leyen, European Council, 22nd June 2020, viewed 27th July 2020, https://www.consilium.europa.eu/en/press/press-releases/2020/06/22/eu-china-summit-defending-eu-interests-and-values-in-a-complex-and-vital-partnership/>
- 19 Tang, Frank, China Approves Plan to Boost Prominence of State Firms, Despite Complaints from Trade Partners, South China Morning Post, 8th July 2020, viewed 27th July 2020, https://www.scmp.com/economy/china-economy/article/3092339/china-approves-plan-boost-prominence-state-firms-despite
- 20 See the Investment Working Group Position Paper on p. 99.

21 Ibid.

¹⁷ See the Investment Working Group Position Paper on p. 99.

Compliance and Business Ethics Working Group

Key Recommendations

- 1. Ensure a Uniform Approach to Anti-bribery Legislation and Enforcement that Parallels International Standards (1)6
 - Refer to international standards and other jurisdictions, such as the United Kingdom's *Bribery Act* and United States' *Foreign Corrupt Practices Act (FCPA)*, for best practices.
 - Increase cooperation and joint enforcement actions with foreign and international investigatory agencies.
- 2. Increase the Clarity of Anti-bribery Legislation, Including the Establishment of Clear Criteria to Determine Whether a Certain Act Constitutes an Act of Commercial Bribery or is a Legitimate Business Practice ()6
 - Clarify who should be considered a recipient of a bribe, as listed in the Anti-unfair Competition Law, by utilising case studies and examples.
 - Provide investigation manuals to law enforcement bodies at all levels to ensure the consistent and uniform enforcement of the law.
 - Clarify the rights of companies and employees in the face of corruption charges, and allow sufficient time to respond to any allegations.

3. Raise Compliance Standards in Collaboration with Companies 16

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

4. List Compliance Professional as a New Official Profession in China

- List compliance professional as a new official profession in China
- Cultivate compliance professionals by creating systemic curricula in universities and training
 programmes in law firms
- Establish a compliance professional qualification certification and management system



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 stateled 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

Amendments to the Anti-unfair Competition Law (AUCL) After being first amended in 2017, the second amendments to the AUCL took effect on 23rd April 2019.¹ The new AUCL emphasises trade secret protection and enhances liabilities for unfair competition acts. The working group welcomes the revisions made to the law, including the monitoring of internet/online business behaviour, increased clarity on what constitutes commercial bribery and the introduction of severer forms of punishment.

Amendments to the Anti-monopoly Law (AML)

The State Administration for Market Regulation (SAMR) issued the draft *Amendment to the Anti-Monopoly Law* on 2nd January 2020. The draft reinforced the AML's deterrent effect on monopolistic behaviour, and significantly increased penalties. It also refined the investigation and enforcement regulations

and strengthened the investigation power of AML enforcement agencies, including stipulating that public security organs shall assist during investigations. The working group welcomes the revisions, including the new regulations for merger review, definition of control rights, the 'stop-watch' system for review time limits, and responsibility for reporting false information, among others. However, while the State Council's AML enforcement agencies are more powerful with great discretion on penalties, the working group calls for a clear definition of the implementation regulations and measures to prevent the abuse of power. For more on the European Chamber's position regarding the AML, please refer to the *Legal and Competition Working Group Position Paper*.

Compliance Management Guidelines and Standards

The former General Administration of Quality Supervision, Inspection and Quarantine $(AQSIQ)^2$ and the Standardisation Administration of China (SAC) published the *GB/T 35770-2017 Compliance Management Systems – Guideline*, which came into effect on 1st July 2018.³ This references international compliance standards, such as those issued by the International Organization for Standardization (ISO) and the International Electrotechnical Commission.

The Shenzhen City Government has been piloting its anti-bribery management system, which is based on the ISO 3700, since 2017. The Shenzhen system requires the implementation of a series of measures, such as an anti-bribery policy, the appointment of someone to oversee policy compliance, the vetting and training of employees, the undertaking of risk assessments on projects and business associates, the implementation of financial and commercial controls, and the instigation of reporting and investigation procedures.⁴

The State Administration for Market Regulation (SAMR) issued a public consultation on the *Anti-monopoly Compliance Guidelines for Operators (Draft for*

¹ Amendments to Eight Laws by the Standing Committee of the National People's Congress, National People's Congress, 23rd April 2019, viewed 18th June 2019, http://www.npc.gov.cn/npc/xinwen/2019-04/23/content_2086193.htm)

² After the government restructuring in March 2018, the AQSIQ was dissolved, and its functions merged with the newly created SAMR.

³ GB/T 35770-2017 Compliance Management Systems – Guidelines, SAMR and the SAC, 2017, viewed 19th April 2019, <http://www.gb688.cn/bzgk/gb/newGbInfo?hcno=D7 DDF05AABC6F235C3E6F1C986923C78>

⁴ Notice of Shenzhen Municipal Market Supervision Administration on Issuing the Anti-Bribery Management System, Shenzhen Administration of Market Regulation, 19th June 2017, viewed 7th July 2020, <http://amr.sz.gov.cn/xxgk/qt/tzgg/content/post_7353081. html>



Comment) on 28th November 2019.⁵ The Compliance and Business Ethics Working Group submitted comments on this draft, asking for further clarification regarding the anti-monopoly compliance reporting system as well as on the rewards for law-abiding companies and penalties for companies suspected of monopolistic behaviour. On 26th December 2019, the Shanghai Municipal Market Supervision Administration released the Anti-monopoly Compliance Guidelines for Shanghai Operators, while the Zhejiang Provincial Market Supervision and Administration Bureau issued the Guidelines for Competitive Compliance of Zhejiang *Enterprises* on 9th July 2019.⁶ The creation of voluntary standards and guidelines at both national and local levels shows the Chinese Government is paying more attention to corporate compliance issues.

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

State Market Regulatory Administration

A consolidated state market regulator, the SAMR, was established in accordance with the institutional restructuring plan submitted by the State Council and approved by the National People's Congress (NPC) in March 2018. Responsibilities of the administration include comprehensive market supervision and management, market entity registration and market order maintenance.⁷ The antitrust enforcement units formerly separately incorporated within the National Development and Reform Commission, the State Administration for Industry and Commerce (SAIC) and the MOFCOM have been consolidated into the SAMR. Since its formation, the SAMR has brought more than 20 enforcement actions, signalling its commitment

to curtail bribery, fraud and unfair competition across the country. This restructuring of the anti-bribery and anti-trust enforcement apparatus had been discussed and requested by various governmental agencies and scholars for years, and the working group hopes that with this unified and streamlined regulator, the efficiency and consistency of business compliance enforcement will increase.

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 to be implemented by 2020.⁸ The SAMR published the amended draft of the *Measure for Lists of Heavily Distrusted Market Entities* on 10th July 2019, and the State Council released the *Guiding Opinion on Accelerating the Building of the Social Credit System* and the *Guiding Opinion on Accelerating Building a Credit-based Monitoring System* on 16th July 2019.⁹

Currently, the ministries and departments of the central and local governments are maintaining decentralised credit systems to cover their own administration for example, Administrations for Market Regulations, taxation bureaus, customs, courts, the Ministry of Emergency Management (MEM)¹⁰ —though they may refer to the scorings in other evaluation systems. Some commercial big data platforms authorised by the government, such as Qichacha, Tianyancha, Credit China, also have the capability to synchronise the data of most of these scoring systems, including the operation status of a company, and provide a comprehensive credit score.

⁵ Anti-monopoly Compliance Guidelines for Operators (Draft for Comment), SAMR, 28th November 2019, viewed 12th June 2020, <http://www.samr.gov.cn/hd/zjdc/201911/ t20191128 308890.html>

⁶ Guidelines for Competitive Compliance of Zhejiang Enterprises, Zhejiang Provincial Market Supervision and Administration Bureau, 9th July 2019, viewed 12th June 2020, ">https://mp.weixin.qq.com/s/M_cctJ1tNm-tcl_ckvDdiQ>

⁷ China to Form State Market Regulatory Administration, Xinhua, 13th March 2018, viewed 21st April 2019, http://www.xinhuanet.com/english/2018-03/13/c_137035669.htm

⁸ 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>

⁹ Measure for Lists of Heavily Distrusted Market Entities (Revised Draft for Comment), State Administration for Market Regulation, 10th July 2019, viewed 23rd April 2020, <http://www.samr.gov.cn/hd/zjdc/201907/t20190710_303312.html>; Guiding Opinion on Accelerating the Building of the Social Credit System and Building a Credit-based Monitoring System, State Council, 16th July 2019, viewed 23rd April 2020, <http://www. gov.cn/zhengce/content/2019-07/16/content_5410120.htm>

¹⁰ Key Points for Construction of the Transportation Credit System in 2019, Ministry of Transport, 3rd April 2019, viewed 23rd April 2020, <http://xxgk.mot.gov.cn/jigou/zcyjs/201904/120190412_3186987.html>; Notice of the General Department of the National Energy Administration on Clarifying the Work Related to the Management of the List of Targets for Joint Disciplinary Actions in the Power Sector, State Council, 22rd April, 2019, viewed 23rd April 2020, <http://www.gov.cn/xinwen/2019-05/12/content_5390800. html>



These measures and their associated risks and rewards have motivated companies to look more closely at their own internal compliance procedures and 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 government efforts at reform. In the case of compliance regulations, such ambiguity increases the risk of unintentional infractions and can incentivise noncompliance in businesses.

Key Recommendations

1. Ensure a Uniform Approach to Anti-bribery Legislation and Enforcement that Parallels International Standards (1)6

Concern

Anti-bribery legislation in China often diverges from international standards, increasing the compliance burden for foreign enterprises as they adopt to local requirements.

Assessment

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

In this context, the divergence of Chinese anti-bribery legislation from international standards adds additional strain to multinational companies' daily activities, as globally-implemented compliance programmes need to be adapted to local circumstances. The Compliance and Business Ethics Working Group, therefore, encourages Chinese authorities to introduce and implement regulations that align with international standards. Replicating best practices laid out in foreign legislation will not only contribute to the clarity of China's domestic regulatory process and governmental investigations, but will also contribute to the efficiency and development of international trade. A regulatory environment that is effective, predictable and transparent will promote foreign investment in China and increase trust in Chinese companies among non-Chinese parties. It will also help increase Chinese investment abroad, as Chinese companies will be better prepared to meet foreign stakeholders' expectations.

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

Recommendations

- Refer to international standards and other jurisdictions, such as the UK's *Bribery Act* and the US' *FCPA*, for best practices.
- Increase cooperation and joint enforcement actions with foreign and international investigatory agencies.
- 2. Increase the Clarity of Anti-bribery Legislation, Including the Establishment of Clear Criteria to Determine Whether a Certain Act Constitutes an Act of Commercial Bribery or is a Legitimate Business Practice (1)

Concern

Neither in the AUCL issued in 1993, nor in its subsequent amendments in 2017 and 2019, did China clearly distinguish between commercial bribery and the carrying out of legitimate business, which resulted in related laws and sanctions being implemented in a non-transparent manner.

Assessment

The Compliance and Business Ethics Working Group is pleased that comprehensively advancing the rule of law in China was a central topic of the Fourth Plenum of the 18th Communist Party of China's Central Committee and that China's campaign against corruption has continued to advance since then. The working group acknowledges the significant efforts made by various government authorities over the years: (i) defining 'commercial bribery' in the *Interim Provisions on Banning Commercial Bribery*; (ii) providing policy guidelines in the *Opinions Concerning*

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Correctly Mastering Policy Lines in the Special Tasks for Handling Commercial Bribery Cases; iii) clarifying what constitutes as corruption in the Interpretation of the Supreme People's Court and the Supreme People's Procuratorate on Several Issues Concerning the Specific Application of Law in the Handling of Criminal Cases of Offering Bribes;¹¹ and (iv) limiting the scope of commercial bribery in the 2017 revision to the AUCL.

The AUCL (2017 amendment) prohibits a business operator from using cash, property or other means to seek a competitive advantage by bribing any of the following entities or individuals: (i) employees of a transaction counterparty; (ii) entities or individuals entrusted by a transaction counterparty to handle any relevant affairs; or (iii) entities or individuals that use their authority or influential power to influence a transaction. The law retained the provisions permitting incentives to be provided in the form of discounts to the counterparty or commissions to intermediaries, provided that such discounts or commissions are faithfully recorded in both parties' respective accounts.

The Compliance and Business Ethics Working Group acknowledges the legislature's efforts in providing clearer guidance on the scope of commercial bribery. However, from the working group's perspective, much still needs to be done to clarify this aspect. For example, uncertainties and ambiguities still surround certain categories of bribery under the AUCL.

It remains possible that a counterparty to a transaction may be considered a bribe recipient in certain circumstances, even if the counterparty does not fall into one of the above-mentioned three categories. According to senior officials from the Anti-Monopoly and Anti-unfair Competition Bureau of the former SAIC, whether a party is a counterparty is viewed on a de facto basis. For example, if a school purchases uniforms from a supplier, the students are the de facto purchasers and users. The school is considered to have been entrusted by the students to make the purchase and therefore can potentially be considered to be the recipient of a bribe.

Similar issues are also present in cases involving

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

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

Recommendations

- Clarify who should be considered a recipient of a bribe, as listed in the AUCL, by utilising case studies and examples.
- Provide investigation manuals to law enforcement bodies at all levels to ensure the consistent and uniform enforcement of the law.
- Clarify the rights of companies and employees in the face of corruption charges, and allow sufficient time to respond to any allegations.

3. Raise Compliance Standards in Collaboration with Companies (3)6

Concern

Companies setting and operating under high compliance standards are not rewarded for their efforts.

¹¹ Interpretation of the Supreme People's Court and the Supreme People's Procuratorate on Several Issues Concerning the Specific Application of Law in the Handling of Criminal Cases of Offering Bribes, Supreme People's Procuratorate, 2012, viewed 24th April 2019, http://www.spp.gov.cn/fifg/sfjs/201301/t20130101_52307.shtml>



Assessment

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

Article 7 of the AUCL states that an employee's bribery activity shall be considered company activity—a form of liability known as vicarious liability—except when the company has evidence to prove the activity does not relate to the business operator's objective of obtaining a specific business transaction or some other form of competitive advantage. A senior official from the SAIC's Anti-Monopoly and Anti-unfair Competition Bureau said a company can put up a defence against vicarious liability if it can demonstrate that it has adopted proper compliance policies and measures, has implemented effective measures to supervise and control its employees' activities and did not indulge either openly or in a disguised form in the bribery activity.¹²

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

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

The defence of adequate procedures will depend on

the circumstances of the offence, including the scale and complexity of the organisation and any risks the potential act of bribery exposed the company to. Antibribery procedures are expected to be proportionate to the risk.

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

The 'adequate procedures' concept covers the following six principles:

1) Proportionate procedures

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

2) Top-level commitment/tone from the top

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

3) Risk assessment

Depending on the nature of its business and its size, each organisation will need to introduce a form of risk assessment, which covers bribery, in order to limit the effects of bribes and undertake precautionary measures

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to prevent a risk of recurrence. Such assessments should include both external risks (e.g. country, market, transaction, business opportunity and business partnerships) and internal risks (e.g. deficiencies in training, incentives, governance or financial controls).

Risk assessments will need to be carried out on a regular basis in order to keep up with the quickly changing economic environment. Accurate and appropriate documentation on risk assessment is an important element of assessing risk and contributes to organisational transparency.

4) Due diligence

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

5) Communication

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

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

6) Monitoring and review

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

The Compliance and Business Ethics Working Group is pleased to see that the Chinese authorities are

making efforts to promote and encourage companies to adopt internal compliance systems. The working group notes that the Shenzhen Administration for Market Supervision issued the local standard *Anti-bribery Management Systems (Shenzhen Standard)* on 12th June 2017.¹³ The *Shenzhen Standard* references the *Anti-bribery Management System (ISO 37001)* and other internationally recognised best practices that include the six principles of 'adequate procedures'. As previously mentioned, the working group also welcomes multiple compliance guidelines that have been issued by several central government agencies over the past two years.

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

Recommendations

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

4. List Compliance Professional as a New Official Profession in China

Concern

Compared with developed countries, the majority of people in China know little about compliance

¹³ Anti-bribery Management Systems (No. SZDB /Z 245—2017), Market Supervision Administration of Shenzhen Municipality, 2017, viewed 18th April 2019, <http://www. sz.gov.cn/cn/xxgk/zfxxgj/tzgg/201706/P020170619418093153663.pdf>



professionals, as there is no systematic compliance talent cultivation and management mechanism in China.

Assessment

In recent years, several central government departments, including the SAMR and MOFCOM, have issued regulations and guidelines on compliance management. More Chinese enterprises and institutions are beginning to pay attention to compliance management systems. With the continuous increase of external monitoring pressure by both domestic and oversea regulatory bodies (i.e. Department of Justice in the US) and internal development needs, the corresponding growth in demand for qualified compliance professionals in China is not being met. However, in China there is no systematic curriculum in university for compliance at the moment. Most compliance professionals come from legal, risk management or finance backgrounds. Therefore, China should adopt compliance professional as a new official profession. Establishment as an official profession will encourage systematic compliance talent cultivation and establish a compliance professional qualification and management system, which jointly will contribute to the establishment of a robust and sustainable compliance culture and ecosystem in China.

Recommendations

- List compliance professional as a new official profession in China.
- Cultivate compliance professionals by creating systematic curriculum in universities and training programmes in law firms.
- Establish a compliance professional qualification certification and management system.

Abbreviations

| AML | Anti-monopoly Law |
|--------|-----------------------------------|
| AUCL | Anti-unfair Competition Law |
| AQSIQ | General Administration of Quality |
| | Supervision, Inspection and |
| | Quarantine |
| FCPA | Foreign Corrupt Practices Act |
| ISO | International Organization for |
| | Standardization |
| MFA | Ministry of Foreign Affairs |
| MOFCOM | Ministry of Commerce |
| | |

| NDRC | National Development and Reform |
|------|---------------------------------------|
| | Commission |
| NPC | National People's Congress |
| PBOC | People's Bank of China |
| SAC | Standardisation Administration of |
| | China |
| SAFE | State Administration of Foreign |
| | Exchange |
| SAIC | State Administration for Industry and |
| | Commerce |
| SAMR | State Administration for Market |
| | Regulation |
| SCS | Social Credit System |
| UK | United Kingdom |
| US | United States |

Environment Working Group

Key Recommendations

- 1. Increase the Transparency and Predictability of Corporate Social Credit Evaluation and Enforcement of Environmental Protection (1)2
 - Enforce the Environmental Protection Law and related regulations in a transparent fashion and incorporate it into the 14th Five-year Plan.
 - Evaluate the effectiveness of existing air pollution management measures and take more targeted actions, presenting results transparently, and revise the initiatives outlined in the *Three-year Action Plan for Winning the Blue Sky War* if needed.
 - Communicate environmental enforcement plans well in advance of the 2020/2021 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.
 - Support companies' efforts to become compliant and/or go beyond existing standards by investing in the latest technology for exhaust gas cleaning and emission reduction.
 - Install direct communication channels for companies to notify central government authorities of any issues/irregularities related to 'one-cut' approaches or other unreasonable environmental enforcement.
 - Promote further investment in clean technologies by providing tax benefits or low mortgage loans.
 - 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 2
 - 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 by China and the EU.
 - Define an overall strategy for circular economy development, with a mid- and long-term legislation framework, including targets and roadmaps.
 - Implement a number of circular economy pilot projects, particularly with joint involvement of both Chinese and EU companies, to create a circular economy ecosystem.
 - Address the long-existing informal scrap recycling system to ensure post-consumption recyclable material is of the highest possible quality and reduce secondary pollution in the current downcycling 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 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 including products generated 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. Bring Wastewater and Hazardous Waste Treatment Under the Management of the National Public Health System

In the short-term:

- Add public environmental service companies dealing with wastewater treatment, waste treatment, hazardous and medical waste treatment, and sanitation to the list of Essential Companies of Anti-COVID-19 to ensure that such companies enjoy supportive policies and continue operations safely.
- Accelerate the approval and payment of environmental service fees to reduce accounts payable and ease the financial burden for environmental service companies.

In the long-term:

• Consider environmental service facilities as part of the broader public health system so that, in cases of public health emergencies, such facilities can be equipped and mobilised in a more effective way to function as part of the country's public health response.

4. 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 (1)5

- 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.



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

For European companies, complying with environmental protection laws and regulations is a commitment 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 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, environmental consultants and lawyers are also active members of the working group.

The working group serves as a channel for government stakeholder engagement, particularly with the National Development and Reform Commission (NDRC), the Ministry of Ecology and Environment (MEE),¹ the Ministry of Water Resources 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

China's economy is now well into the process of shifting from high-speed development to high-quality development. Pollution prevention and control, as well as environmental governance, are major aspects that must be included to ensure a higher quality of life for all.

On 19th May 2018, President Xi Jinping spoke about ecological and environmental protection during a tonesetting meeting on national environmental protection in Beijing. President Xi stated that China would work towards developing an "ecological civilisation" and would channel more energy into resolving environmental issues.³ This commitment, that the protection of the ecological environment and the development of the economy are fundamentally integrated and mutually reinforcing, was reaffirmed at the annual sessions of the National People's Congress (NPC) and Chinese People's Political Consultative Conference held in 2019 and 2020.⁴

In the 2020 Government Work Report, Chinese Premier Li Keqiang also emphasised the need for China to improve the effectiveness of its ecological environment management, strengthen pollution prevention and step up the construction of sewage and garbage treatment facilities, as well as building an ecological civilisation.⁵

On 28th April 2019, the world's largest international horticultural exhibition opened in Beijing. At the opening ceremony, President Xi Jinping expressed his hope that the green development concept embodied by the exposition would be spread to "every corner of the world". The following principles to help China become an "ecological civilisation" were outlined:

- Humanity and nature should be in harmony.
- Green prosperity should be pursued.
- Lifestyles should reflect a love of nature.
- A sound ecological environment is necessary for people's well-being.
- Scientific governance of the ecological system should be adopted.

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 Xi Vows Tough Battle Against Pollution to Boost Ecological Advancement, Xinhua, 19th May 2018, viewed 16th April 2020, <http://www.xinhuanet.com/ english/2018-05/19/c_137191441.htm>

⁴ Implementation of the Spirit of the Two Sessions and the Strengthening of the Construction of Ecological Civilization, Xinhua, 5th June 2020, viewed 5th June 2020, <http://www.xinhuanet.com/2020-06/05/c_1126075883.htm>

^{5 2020} Government Work Report, State Council, 22nd May 2020, viewed 5th June 2020, <http://www.gov.cn/premier/2020-05/29/content_5516072.htm>



- Mountains, rivers, forests, farmlands, lakes and grasslands are all connected.
- It is important to work together on cultivating an ecological civilisation globally, to engage in global environmental governance and to work together with other countries to tackle climate change.⁶

Within the past few years, China has efficiently overhauled and established a new legislative framework for environmental protection. The NPC has put in place the Environmental Protection Law (updated in 2014),⁷ the Law on Soil Pollution Prevention and Control (passed in 2018),8 the Law on Water Pollution Prevention and Control (updated in 2017),⁹ the Law on the Prevention and Control of Atmospheric Pollution (updated in 2018)¹⁰ and the Law on Solid Waste Pollution Prevention and Control (updated in 2016).^{11&12} In terms of standards, the MEE and other relevant ministries have introduced the Risk Control Standard for Soil Contamination of Agricultural Land (GB 15618-2018),¹³ the Risk Control Standard for Soil Contamination of Development Land (GB 36600-2018),¹⁴ and the Control Standards of Pollutants in Sludge for Agriculture Use (GB 4284-2018).¹⁵ In 2019, a number of important catalogues were drafted and announced, such as the Poisonous and Harmful Air Pollutants List (2018)¹⁶ and the Catalogue of Construction Projects for the Approval of Environmental Impact Assessment Documents by

- 6 Full text of President Xi Jinping's speech at the Opening Ceremony of the China World Horticultural Exposition 2019 Beijing, Xinhua, 28th April 2019, viewed 15th April 2020, http://www.xinhuanet.com/politics/leaders/2019-04/28/ c 1124429816.htm>
- 7 Environmental Protection Law, MEE, 25th April 2014, viewed 6th April 2020, https://jjjcz.mee.gov.cn/djfg/gjflfg/fl/201404/t20140401_444481.html
- 8 Law on Soil Pollution Prevention and Control, State Council, 31st August 2018, viewed 6th April 2020, <http://www.gov.cn/zhengce/content/2016-05/31/ content_5078377.htm>
- 9 Law on Prevention and Control of Water Pollution, MEE,1st January 2018, viewed 6th April 2020, <http://www.mee.gov.cn/ywgz/fgbz/fl/200802/t20080229_118802. shtml>
- 10 Law on the Prevention and Control of Atmospheric Pollution, MEE, 13th November 2018, viewed 6th April 2020, http://fgs.mee.gov.cn/ft/201811/t20181129_676290. shtml>
- 11 Law on the Prevention and Control of Environmental Pollution by Solid Waste, MEE, 7th November 2016, 6th April 2020, <http://fgs.mee.gov.cn/fl/201811/ t20181129_676273.shtml>
- 12 The draft Solid Waste Environmental Pollution Prevention and Control Law (Revised Draft) is currently under public consultation.
- 13 Risk Control Standard for Soil Contamination of Agricultural Land (GB15618-2018), MEE,1st August 2018, 6th April 2020, <http://www.mee.gov.cn/ywgz/fgbz/ bz/bzwb/trhj/201807/t20180703_446029.shtml>
- 15 Control Standards of Pollutants in Sludge for Agriculture Use (GB4284-2018), MEE, 1st March 1985, viewed 6th April 2020, <http://www.mee.gov.cn/ywgz/fgbz/ bz/bzwb/gthw/gtfwwrkzbz/198503/19850301_82013.shtml>
- 16 Poisonous and Harmful Air Pollutants List, MEE, 23rd January 2019, viewed 15th April 2020, http://www.mee.gov.cn/xxgk2018/xxgk/xxgk01/201901/t20190131_691779.html

*the Ministry of Ecology and Environment (2019).*¹⁷ The *Guideline Catalogue of Green Industries* is currently being drafted as well.

At the beginning of 2020, Coronavirus Disease 2019 (COVID-19) struck the world with unprecedented ferocity, bringing a series of severe social and economic consequences. The virus has had both positive and negative impacts on the environment sector in China. It is encouraging that water supply, wastewater treatment and solid waste (especially hazardous solid waste) treatment have all received more attention than ever, as these issues are related to controlling the spread of the virus and ensuring people's well-being. However, the subsequent decreased market demand for waste treatment has negatively impacted businesses, and payments from local budgets are even more difficult to secure than before, as local governments facing up to the severe economic downturn are tasked with prioritising virus control and prevention.

European businesses in China are also affected by the prevailing economic climate and policy changes. Thus, the Environment Working Group calls for clear, transparent, consistent and predictable enforcement by the relevant government authorities at all levels on these issues. If China is to successfully realise the aforementioned principles, as set out in the various environmental protection policies, the public, industry associations, domestic and foreign enterprises alike must all be allowed to contribute.

Key Recommendations

 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 scores in environmental protection.



¹⁷ Catalogue of Construction Projects for the Approval of Environmental Impact Assessment Documents by the Ministry of Ecology and Environment, MEE, 27th February 2019, viewed 15th April 2020, <http://www.mee.gov.cn/xxgk2018/xxgk/ xxgk01/201903/t20190301_694114.html>

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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. It also has led to environmental enforcement sometimes unexpectedly impacting companies that comply with relevant regulations, because of the so-called 'one-cut' approach.

To address the frequent occurrence of severely polluted air in some parts of the country, the Chinese Government has taken special measures to control emissions and curb air pollution in an attempt to protect the health of its population. The State Council released the Three-year Action Plan for Winning the Blue Sky War on 27th June 2018,¹⁸ setting air pollution prevention as a high priority. Since the release of this plan, many relevant initiatives have been implemented in different areas. One well-known example is in the Beijing-Tianjin-Hebei area, where air pollution control measures were applied from 1st October 2019 until 31st March 2020.¹⁹ 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 help reduce emissions. At the same time, setting production limits put these companies under enormous pressure, with some unable to deliver client orders to which they had already committed.

Another important development related to environmental inspections is the introduction of China's Corporate Social Credit System.²⁰ Since 2013, several official documents have been issued, including a trial version of the Administrative Measures for Corporate Environment Credit Evaluation,²¹ the Guideline on Improvement of the

Corporate Environment Credit System Development,²² and the Joint Sanction Memorandum of Understanding (MoU) of Illegal and Untrusted Production Units in the Environmental Protection Field.²³ 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. The guideline is planned to be officially launched nationwide by the end of 2020.²⁴

While the system could be seen as a sign of mature development of environmental enforcement, at the same time, it will profoundly impact 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 bidding lists.

In reality, many European companies report that they encounter unexpected requirements to reduce their environmental impact, 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 comply with applicable regulations, adhering to the highest standards, these unexpected requirements bring exactly the kind of business uncertainty that 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 and happy community 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 to drive improvements and address relevant environmental challenges. The working group believes

²⁴ European Chamber Meeting with MEE on the Corporate Environmental Protection Credit Rating System, 12th December 2019, viewed 15th April 2020, ">https://www.europeanchamber.com.cn/en/lobby-actions/3809/Meeting_with_Ministry_of_Environment_and_Ecology>



¹⁸ Three-Year Action Plan for Winning the Blue Sky War, State Council, 27th June 2019, viewed 15th April 2020, <http://www.gov.cn/zhengce/content/2018-07/03/ content 5303158.htm>

^{19 192019-2020} Comprehensive Control & Management Plan on Beijing-Tianjin and Hebei and Surrounding Areas, MEE, 25th September 2019, viewed 15th April 2020, http://www.mee.gov.cn/xxgk2018/xxgk/xxgk03/201910/t20191016_737803. http://www.mee.gov.cn/xxgk2018/xxgk/xxgk03/201910/t20191016_737803.

²⁰ Plan for Establishing a Social Credit System (2014–2020), State Council, 27th June 2014, viewed 6th May 2020, <http://www.gov.cn/zhengce/content/2014-06/27/ content_8913.htm>

²¹ Administrative Measures for Corporate Environment Credit Evaluation, State Council, 18th December 2013, viewed 15th April 2020, http://www.gov.cn/gongbao/content/2014/content_2667624.htm>

²² Guideline on Improvement of Corporate Environment Credit System Development, State Council, 27th November 2015, viewed 15th April 2020, http://www.gov.cn/gongbao/content/2016/content 5059107.htm

²³ Joint Sanction MoU of the Illegal and Untrusted Production Units in Environment Protection Field, State Council, 20th July 2016, viewed 15th April 2020, <http:// www.gov.cn/xinwen/2016-08/19/content_5100687.htm>



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.

With the government's 14th Five-year Plan under development, the Environment Working Group proposes the inclusion of a chapter on transparent enforcement of environmental protection laws. Maintaining transparency and predictability at all levels is crucial to business operations, particularly with companies now facing increasingly uncertain times due to the worldwide COVID-19 outbreak.

Another area where the working group would like to see improvements in the environment 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 enhancement of alternative dispute resolution (ADR) processes, in particular mediation. Currently there are three ADR options available to all types of companies operating in China: people's mediation, administrative mediation and judicial mediation,^{25,26&27} together with the *xinfang* or 'letters and visits' system,28 which handle the vast majority of China's environmental disputes. While these processes have played an important role in channelling and settling 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, it would be far more efficient to establish a special 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 and incorporate it into the 14th Five-year Plan.
- Evaluate the effectiveness of existing air pollution management measures and take more targeted actions, presenting results transparently, and revise the initiatives outlined in the *Three-year Action Plan for Winning the Blue Sky War* if needed.
- Communicate environmental enforcement plans well in advance of the 2020/2021 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.
- Support companies' efforts to become compliant and/or go beyond existing standards by investing in the latest technology for exhaust gas cleaning and emission reduction.
- Install direct communication channels for companies to notify central government authorities of any issues/ irregularities related to 'one-cut' approaches or other unreasonable environmental enforcement.
- Promote further investment in clean technologies by providing tax benefits or low mortgage loans.
- 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.



²⁵ People's mediation: a mechanism provided under People's Mediation Law of the People's Republic of China, which is conducted through people's mediation committees that are established by rural village committees, resident committees, enterprises, institutions or administrative organisations.

²⁶ Administrative mediation: a mechanism where administrative organs mediate civil disputes that fall within their authority.

²⁷ Judicial mediation: a mechanism integrated into litigation procedure which is conducted under the guidance of a people's court with the mediation settlement agreement having the same legal effect as a judgement.

²⁸ Xinfang or 'letters and visits' system: a mechanism where citizens, legal persons or other organizations 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.

 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 polices 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.

On 2nd December 2015, the European Commission adopted an ambitious circular economy package, creating a comprehensive framework that will truly enable the transition from linear economies.²⁹ The EU has since delivered on all of the 54 actions outlined in the package, leading the way as a trailblazer for the rest of the world. In addition, the EU rolled out its Circular Economy Action Plan 2.0 on 11th March 2020,³⁰ as one of the key priorities of the EU Green Deal. Under this, 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'³¹ will be enforced.³² This legislation will obviously affect Chinese manufacturers and exporters to the EU.

On 17th July 2018, China and the EU signed a MOU on Circular Economy Cooperation, demonstrating that the world's two largest economies stand to gain from aligning policies that can help establish global standards for the treatment and use of waste materials. Under the MOU, the two sides agreed to establish a high-priority dialogue on the circular economy to be led by high-level officials. It will feature activities such as cooperation on information exchange and research, capacity-building, training programmes, workshops and personal exchanges, with broad participation by relevant stakeholders. Bilateral cooperation and engagement between China and the EU is expected by the working group.

It is important to acknowledge that the EU's achievements relating to the circular economy during the past three years 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 legislation framework, including targets and roadmaps. This 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

²⁹ 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 20th March 2020, http://europa.eu/rapid/press-release_IP-15-6203_en.htm

³⁰ Circular Economy Action Plan 2.0, European Commission, 11th March 2020, viewed 15th April 2020, https://ec.europa.eu/environment/circular-economy/pdf/new_circular_economy_action_plan.pdf>

^{31 &#}x27;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.

³² New Circular Economy Action Plan – For a Cleaner and More Competitive Europe, European Commission, 11th March 2020, viewed 13th May 2020, ">https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1583933814386&uri=COM:2020:98:FIN>



for Plastics in a Circular Economy is the first policy framework adopting a material-specific life cycle approach.³³ China similarly sees plastic waste as one of the most pressing environmental, climate and economic challenges; however, it currently lacks a clear strategy for addressing the whole value chain.

China's NDRC and MEE jointly issued the *Opinions on Further Strengthening Plastic Waste Management*(Opinions)³⁴ on 16th January 2020, followed in April by the *Catalogue of Plastic Products Prohibited and Restricted from Production, Sale, and Use* for public comment,³⁵ with 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 has been 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 singleuse 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 results. From a circular economy point of view, processes like collection and segregation of plastics are the most important phases, since the quality of the input determines the quality of the output. For single-use plastic packaging, a deposit and return system-especially on beverage packaging-is a proven mechanism for delivering a high collection rate and high-quality material recovery. It provides accurate data to all stakeholders 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 brings 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 for 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 an increasing number of 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. The Extended Producer Responsibility (EPR)³⁶ policy approach should be adopted, in which producers pay different financial contributions to the scheme based on the endof-life costs of their products. 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 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.³⁷ Through this project, China aims to promote green lifestyles, minimise the amount of waste produced, strengthen recycling programmes and ensure that any waste released



³³ Plastics in a Circular Economy: the European Approach, Government Europa, 8th January 2019, viewed 16th April 2020, https://www.governmenteuropa.eu/ plastics-in-a-circular-economy/91767/>

³⁴ Opinion on Further Strengthen Plastic Waste Management, NDRC, 16th January 2020, viewed 15th April 2020, <https://www.ndrc.gov.cn/xxgk/zcfb/tz/202001/ t20200119 1219275.html>

³⁵ Announcement on the Public Solicitation of the Catalogue of Plastic Products Prohibited and Restricted from Production, Sale, and Use (Draft for Comment), NDRC, 10th April 2020, viewed 21st April 2020, <https://hd.ndrc.gov.cn/yjzx/yjzx_ add.jsp?SiteId=332>

³⁶ Extended Producer Responsibility, Organisation for Economic Co-operation and Development, viewed 16th April 2020, <https://www.oecd.org/env/toolsevaluation/extendedproducerresponsibility.htm>

³⁷ Work Plan for 'Zero Waste Cities' Pilots, State Council, 21st January 2019, viewed 16th April 2020, <http://www.gov.cn/zhengce/content/2019-01/21/ content_5359620.htm>

into the environment is harmless. This has a strong correlation with the circular economy, in that both promote a resource-saving and environmentally friendly consumption model. In the EU, many countries have several years' practice of building zero-waste cities, meaning there is vast amounts of experience to be shared. Therefore, the working group recommends that the EU-China MOU on Circular Economy Cooperation be expanded to include cooperation on zero-waste cities pilots, and that EU cities and enterprises be encouraged to jointly work with their Chinese counterparts on these projects.

The government would also benefit greatly from enhancing China's hazardous waste traceability system to prevent illegal treatment, which in turn will allow the recycling industry to thrive while also including products generated from hazardous waste. A specific permit system for industrial companies using recycled hazardous waste could be implemented, to ensure any such company can only accept a defined range of recycled waste, and that it has adequate facilities to do so safely and with controlled environmental 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 on the forefront, will make a decisive contribution to achieving climate neutrality by 2050 and decoupling economic growth from resource use.³⁸

Tackling climate change is an urgent challenge in China, where 78 per cent of energy consumption in 2018 was still from fossil fuels. 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,³⁹ 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 legislation framework, including targets and roadmaps.
- Implement a number of circular economy pilot projects, particularly with joint involvement of both Chinese and EU companies, to create a circular economy ecosystem.
- Address the long-existing informal scrap recycling system to ensure post-consumption recyclable material is 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, nonferrous metals and critical mineral resources.
- Involve more European companies in China's 'zerowaste 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 including products generated 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.

³⁸ Circular Economy Action Plan 2.0, European Commission, 11th March 2020, viewed 15th April 2020, <https://ec.europa.eu/environment/circular-economy/pdf/ new_circular_economy_action_plan.pdf>

³⁹ European Chamber Carbon Market Sub-Working Group Position Paper 2020/2021, Key Recommendation 2.



3. Bring Wastewater and Hazardous Waste Treatment Under the Management of the National Public Health System

Concern

During times of national emergency, like COVID-19, the efficiency of waste water and hazardous waste treatment may be compromised if environment companies are not included within the framework of national public health system management, which will have significant ramifications for public health.

Assessment

Environmental service companies providing quality sanitation, wastewater treatment, municipal waste treatment and hazardous/medical waste treatment services contribute not only to the improvement of environment quality, but also to public health. For example, dirty effluent can contaminate rivers and endanger water sources, waste can pollute soil and groundwater, and industrial activities can increase toxic particles in the air. Hence, in times of emergent public health crises, the environmental facilities that take care of these contaminated materials can prevent secondary disasters and thereby make tremendous contributions to the public health system. However, the important role that they play is often overlooked in Chinese policies.

Amid the COVID-19 outbreak in China, frontline workers in environmental facilities that offer essential public services—such as water supply, wastewater treatment, sanitation, waste and medical waste treatmentremained in their positions to ensure safe drinking water, low levels of industrial emissions like wastewater and gas, and adequate medical waste treatment. As the virus can spread via the sewage network and waste, these facilities poured investment into extra disinfection processes. According to the MEE, by 14th March 2020, medical waste treatment capacity in China reached 6,058.8 tonnes per day, an increase of 23 per cent from only two months before the outbreak had really hit. A total of 2,086 wastewater treatment plants treated virusrelated medical wastewater from clinics to meet proper safety standards.40

To help business deal with the economic hit of COVID-19, governments at all levels in China released

massive supportive policies relating to finance, tax, office rent, logistics and bank loans, among others. These also included a catalogue identifying companies considered essential to fighting the virus.⁴¹ Among other benefits, companies listed in the catalogue can enjoy significant financial support, including lower interest rates and subsidies. Unfortunately, environmental service companies are not included in this list and therefore cannot benefit from these preferential policies.

The environmental industry in China has also been hit hard and pushed to the edge amid the virus outbreak as costs were magnified. First, the abrupt cessation of all business resulted in the cost of essential raw materials, such as chemicals, sky-rocketing while supplies were drained. Second, companies had to purchase disinfection supplies for protection from the virus. Third, staff and health costs soared due to the need to purchase protective materials and provide staff subsidies. Finally, delays in accounts payable resulted in liquidity problems and high financial burdens.

In the event of comparable health crises, if the role of environmental service companies in the public health system continues to be downplayed by relevant government regulations, the efficient and safe operations of environmental infrastructure may be heavily compromised. Such a situation may seriously exacerbate the health emergency.

Recommendations

In the short-term:

- Add public environmental service companies dealing with wastewater treatment, waste treatment, hazardous and medical waste treatment, and sanitation to the list of Essential Companies of Anti-COVID-19 to ensure that such companies enjoy supportive policies and continue operations safely.
- Accelerate the approval and payment of environmental service fees to reduce accounts payable and ease the financial burden for environmental service companies.

In the long-term:

 Consider environmental service facilities as part of the broader public health system so that, in cases of public health emergencies, such facilities can be equipped and mobilised in a more effective way to function as part of the country's public health response.



⁴⁰ Treatment and Environmental Monitoring of Medical Waste and Wastewater in China, MEE, 14th March 2020, viewed 15th April 2020, https://www.mee.gov.cn/xxgk2018/xxgk/xxgk15/202003/t20200316_769151.html

⁴¹ Strengthen the Prevention and Control of Epidemic and Focus on the Financial Support of Enterprises, State Council, 7th February 2020, viewed 15th April 2020, http://www.gov.cn/zhengce/zhengceku/2020-02/07/content_5475962.htm>

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4. 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 (1)5

Concern

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

Assessment

Within the past few years, China has efficiently overhauled and established a new legislative framework for environmental protection. Two lists have since been developed to prioritise the management of certain dangerous substances: the List of Toxic and Harmful Water Contaminants (First Batch),⁴² which was released in December 2018; and the List of Toxic and Harmful Air Contaminants, released in January 2019.43 Both lists define a small group of substances that are recognised globally as toxic, including cadmium, lead, mercury, hexavalent chromium and arsenic. Also in the legislative pipeline is the new Soil Pollution Prevention and Control Law, of which Article 20 mandates the development of a list of toxic and harmful soil contaminants for priority control; however it is important that this list should be both concise and highly specific, 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* on 1st January 2020.

Meanwhile, the *Management of the Soil Pollution Control Fund*⁴⁴ was jointly published by the MEE and five other departments in March 2020, 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 on 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.*

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)*⁴⁵ 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.⁴⁶ 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

⁴⁶ For the same kind of metal, different valences lead to different bio effectiveness and poison levels.



⁴² List of Toxic and Harmful Water Contaminants (First Batch), State Council, 15th December 2018, viewed 20th March 2020, <http://www.gov.cn/ xinwen/2018-12/15/content 5349089.htm>

⁴³ List of Toxic and Harmful Air Contaminants, MEE, 25th January 2019, viewed 20th March 2020, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk01/201901/ t20190131_691779.html>

⁴⁴ Management of the Soil Pollution Control Fund, MEE, 28th February 2020, viewed 15th April 2020, http://www.mee.gov.cn/xxgk2018/xxgk/xxgk10/202002/t2020028_766623.htm)

⁴⁵ MEE and NHC Notice on Issuing the Framework Guidance on the Technical Approaches for the Environmental Risk Assessment of Chemical Substances (Trial), NHC, August 2019, viewed 15th April 2020, <http://www.nhc.gov.cn/jkj/ s5878/201909/f52216d8dc7d434d84c54038acab6ce2.shtml>



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 |
| COVID-19 | Coronavirus Disease 2019 |
| EPR | Extended Producer Responsibility |
| EU | European Union |
| GHG | Greenhouse Gas |
| MEE | Ministry of Ecology and Environment |
| MEP | Ministry of Environmental Protection |
| MNR | Ministry of Natural Resources |
| MOU | Memorandum of Understanding |
| NDRC | National Development and Reform |
| | Commission |
| NHC | National Health Commission |
| NPC | National People's Congress |
| PET | Polyethylene Terephthalate |



Finance and Taxation Working Group

Key Recommendations

- 1. Keep the Non-taxable Benefit Regime for Reasonable Reimbursements for Foreign Employees <a>2
 - Maintain or prolong the regime of non-taxable treatment for reasonable cost reimbursements, including children's education, housing and home flights.
 - Announce this prolongation of the non-taxable treatment regime in either 2020 or early 2021, in order to allow proper reflection in the assignment planning of European and other foreign enterprises.

2. Further the Implementation of Value-added Tax (VAT) Reform 15

- 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.
- 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 17

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

4. Encourage the Development of China's Technology Infrastructure to Better Enable Remote Working Practices

- Provide tax incentives for companies to invest in digital infrastructure such as hardware and software, as well as more advanced automation.
- Temporarily allow a carry-back to the 2019 tax year for losses incurred in 2020.
- Review tax filing and other financial procedures to improve the areas of the economy that can work well in the digital economy.
- Temporarily remove the limitation on deductibility of entertainment expenses and employee welfare expenses for tax years 2020 and 2021.



5. Take Alternative Steps to Further Attract Foreign Investment into China 3

- · Allow companies in China to file corporate income tax (CIT) returns on a consolidated, central basis.
- Simplify the post-administration of the preferential withholding tax (WHT) deferral system for reinvestment by replacing it with a WHT exemption plus a minimum holding period requirement (for shares obtained through re-investment).
- Improve European firms' access to investment opportunities in the Greater Bay Area (GBA) by implementing rules that make the individual income tax (IIT) incentive broadly applicable to highend talent employed by foreign entities, and minimise restrictions such as the number of applicable employees per company, job title/position, educational level and industry experience.
- Simplify the tax treatment and payment restrictions for salary cost reimbursement for assignees by the Chinese host enterprise to the overseas home enterprise.
- Ensure fair application of laws to both Chinese and foreign businesses, in particular social security contributions for foreign employees.
- Grant preferential tax policies to European companies that transfer the use right of core intellectual property rights (IPR) 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 (SAFE) rules and enable TP adjustments between local and overseas firms, including pay-in and pay-out.

Introduction to the Working Group

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

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

Recent Developments

The working group appreciates efforts made by the Chinese authorities in promulgating new regulations and

reinforcing the existing tax administration. These efforts were also reflected in the World Bank's *Doing Business 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 Despite these positive developments, China still ranks 105th out of 190 economies for ease of paying taxes.²

In 2019 and early 2020, the working group engaged with the Chinese authorities on several issues, including the implications of the 2018 individual income tax (IIT) reform on foreign expatriates, and the draft VAT Law and draft Consumption Tax Law, the latter two published in December 2019. As an example of this engagement, in August 2019, representatives of the working group had a discussion with the State Taxation Administration (STA) on the IIT reform. On the two draft laws mentioned earlier, the working group submitted detailed and extensive comments to the Ministry of Finance (MOF).

¹ Doing Business 2020, World Bank, 2020, viewed 23rd April 2020, http://documents.worldbank.org/curated/en/688761571934946384/pdf/Doing-Business-2020-Comparing-Business-Regulation-in-190-Economies.pdf>

² Doing Business 2020: Paying Taxes, World Bank, 2020, viewed 23rd April 2020, <https://www.doingbusiness.org/en/data/exploretopics/paying-taxes>



2020/2021 📑

Key Recommendations

1. Keep the Non-Taxable Benefit Regime for Reasonable Reimbursements for Foreign Employees <a>2

Concern

The cancellation of the non-taxable reimbursement regime for foreign expatriate employees, slated for 2022, will significantly deter expatriate assignments to China and may negatively impact foreign investment.

Assessment

Many foreign enterprises assign highly qualified foreign employees to China to upgrade their business operations. Subject to reasonable limitations, foreign employees and their employers still currently enjoy non-taxable treatment for certain cost reimbursements, such as children's education, housing rental and flights home. As per *Caishui [2018] No. 164*,³ all such benefits are to become fully taxable starting from 2022. This significant change will bring prohibitive extra costs to (especially European and other foreign) enterprises and, as a consequence, will heavily restrict further expatriate assignments and investments into China.

Taking children's tuition fees as an example, international schools/kindergartens⁴ commonly charge annual tuition fees in the range of Chinese yuan (CNY) 150,000 to CNY 250,000 per child, with almost no practical alternatives. As a result, tuition costs for a family with three children can reach up to CNY 750,000 per year for a typical international school, whereas in their European home country, the same family could opt for free or minimal charge tuition at, for example, public schools. For this reason, employers typically agree with their foreign assignees that the employer will bear the cost of children's education.

The table to the right illustrates that the employer's cost for such children's tuition reimbursement will nearly double (from CNY 750,000 to CNY 1,363,000) starting from 2022 when the non-taxable treatment is removed.

| | Treatment until 2021: Tuition fee as non- taxable benefit | Treatment starting from 2022: Tuition fee as taxable benefit, tax liability borne by employer |
|---|--|--|
| Annual tuition fee for three children borne by employer | CNY 750,000 | CNY 750,000 |
| Additional IIT burden borne by employer | - | CNY 613,636 (= taxable benefit CNY 1,363,636 x 45%) |
| Total cost burden for employer per year | CNY 750,000 | CNY 1,363,636 (= CNY 750,000 / [1-45%]) |

Respective calculations will also apply to other reasonable reimbursement items, such as housing and flights home, for which the cost burden will nearly double (every pre-2022 reimbursement of CNY 100,000 will lead to an extra post-2022 cost for the employer of CNY 182,000).

Global assignments are typically planned at least one year ahead to align all parties involved with relevant conditions. Given that the tax regime for non-taxable reimbursements shall be abolished by the end of 2021, this has already negatively impacted assignment decisions underway in 2020. Therefore, urgent action is recommended.

With governments around the world looking at measures to ease the tax burdens on employers due to the impact of the COVID-19 outbreak, adding such additional costs to expatriate assignments in a time of economic recovery is discouraging, regardless of the fact that the pandemic could not have been predicted at the time of drafting this law.

As a supporter and benefactor of the multilateral trading system, China can appreciate the value of both foreign investment and talent. Maintaining the non-taxable regime would help ensure the full potential of both international human and capital investments continue to flow into China.

³ Caishui [2018] No. 164, Notice on the Convergence of Preferential Policies after the Revision of the Individual Income Tax Law, STA, 27th December 2018, viewed 12th April 2020, <http://www.chinatax.gov.cn/n810341/n810755/c3978994/content.html>

⁴ In China, admission to public schools for foreign children is restricted, so more often than not expatriates have to send their children to international schools that charge high tuition fees compared to public schools. This is different from practices in Europe, where expats have the choice to send their children to a public or a private school.



These measures are necessary, as China's IIT is high compared with other countries in Asia, as well as other leading industrialised nations. Two factors are considered when assessing the overall income tax burden: the top income tax rate and the income level at which such top rates begins to apply. China is at the high-tax end in both aspects.

While many of Mainland China's Asian neighbours apply a much more favourable top income tax rate (for example, in a range of 12–42 per cent, against 45 per cent for China⁵), other industrialised countries with a similar top income tax rate to China would apply this rate only starting from a considerably higher income level (such as from CNY 1.22–CNY 3.67 million⁶ against CNY 0.96 million in China).⁷ As a result, China's IIT competitiveness significantly lags behind both its Asian neighbours and other industrialised countries. This is especially the case when looking at Mainland China's biggest Asian competitors, such as Singapore.

Together with the phasing-out of the non-taxable treatment of reasonable reimbursements, the imminent changes to China's tax environment will hit foreign enterprises hard.

Recommendations

- Maintain or prolong the regime of non-taxable treatment for reasonable cost reimbursements, including children's education, housing and flights home.
- Announce this prolongation of the non-taxable treatment regime in either 2020 or early 2021, in order to allow proper reflection in the assignmentplanning of European and other foreign enterprises.

2. Further the Implementation of Valueadded Tax Reform 15

Concern

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

Assessment

Significant changes to the Chinese VAT system have been introduced over the last few years. Since China's tax system underwent a major overhaul in 2016, the government has since been clarifying and updating VAT policies through circulars like *Caishui [2016] No. 36 (Circular 36)*.⁸ In November 2019, the MOF published a draft VAT Law that aims to further align VAT practices in China with international standards, while consolidating previous measures.⁹ Even though this step is a welcome development, measures to ensure the alignment of China's VAT practices with international standards and further encourage the international competitiveness of businesses operating in China, are still necessary. These measures are discussed below.

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 the further

⁵ For example, Hong Kong (17 per cent), Singapore (22 per cent), Malaysia (30 per cent) and Indonesia (30 per cent) all have more favourable rules.

⁶ In countries such as France, the United Kingdom, Germany and Japan

⁷ Source: Top individual income tax rates for residents in 2020 (excl. any additional local / municipal taxes or surcharges) as well as the respective annual income levels (converted to CNY); *PwC Worldwide Tax Summaries 2020, 2020, PwC, viewed* 1st July 2020, <https://www.pwc.com/gx/en/services/tax/worldwide-taxsummaries.html>

⁸ Notice on Fully Expanding the VAT Pilot Program, Caishui [2016] No. 36, STA, 23rd March 2016, viewed 1st July 2020, http://www.chinatax.gov.cn/n810341/n810755/c2043931/content.html

⁹ Call for Comments on the Value-added Tax Law of the People's Republic of China (Draft for Comments), STA, 27th November 2019, viewed 11th May 2020, http://www.chinatax.gov.cn/chinatax/n810356/n810961/c5140207/content.html

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clarification of the determination of 'consumption' in the draft VAT Law.

Additionally, it is recommended that the place of supply be clarified and that more detailed provisions be included. For example, it is recommended 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 overseas companies are not subject to Chinese VAT unless an exemption applies.

It is suggested that the main place of supply for standard business-to-customer (B2C) services 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 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.¹⁰ 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 STA), the General Administration of Customs (GAC) and the MOF) to provide clear guidance on the conditions for applying the zero per cent VAT rate, (i.e. which documentation should be available) to mitigate the administrative burden for taxpayers.

Enable Non-resident Taxpayers to Register for VAT in China

At 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 implementing the possibility for 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 treatment implemented in April 2019,¹¹ are aimed at reducing tax costs, promoting capital investment and spurring production upgrades to facilitate economic restructuring.

¹⁰ 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.

¹¹ 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 11th May 2020, <http://www.chinatax.gov.cn/ n810341/n810755/c4160283/content.html>



Companies often rely on loans for research and development (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

As of April 2019, Bulletin [2019] No. 39 stipulates that the input VAT associated with passenger transportation can be deducted.¹² 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 gualified 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 the VAT 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 Onbalance-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, assets 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 (P/L) 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 onbalance-sheet ABS is important to diversify the 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.
- 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 onbalance-sheet ABS.

3. Take Prudent Steps in Consumption Tax Reform <a>T

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 these inclusions were aligned with how excise duty was imposed in other countries.¹³ 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 2015, China introduced consumption tax to certain types of batteries and paint with a view to curb their usage, as these products could have a negative impact on the environment.¹⁴ In December 2019, the

12 Ibid.

¹³ The Interim Regulations on Consumption Tax of the People's Republic of China, State Council, 26th November 1993, viewed 11th May 2020, <http://www.fdi.gov. cn/1800000121_39_3179_0_7.html>

¹⁴ Notice on New Consumption Tax of Battery Coating, STA, 26th January 2015, viewed 11th May 2020, <http://www.chinatax.gov.cn/n810341/n810755/c1489741/ content.html>

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draft Consumption Tax Law was published.¹⁵ 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. 47¹⁶ and *Public Notice [2013] No.* 50¹⁷ levy consumption tax on refined oil products (ROPs), which risks not only crippling the competitiveness of the petrochemical industry in China, in light of how high the tax rate is (e.g. based on sales volume, the tax imposed on naphtha as of mid-2019 is CNY 2.356 per tonne, including surcharges), but also lowering tax compliance due to rising costs. Expert involvement in the clarification of the principles underpinning consumption tax on ROPs is needed, since it is international practice that hydrocarbons used as feedstock in the production of petrochemical products are consumption-tax exempt.

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 this when making purchase decisions. 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.

It is vital that there should be fair tax measurements in place if an item is to be taxed. 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 noncompliance costs (i.e. penalties) for 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 subject to consumption tax. 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.

Key Recommendations

- Involve experts in discussions on standards and measurements on pilot reforms (e.g. consumption tax purpose, tax rate, taxation point) in line with the development status of specific industries.
- Update the taxation method based on international best practices on taxpayers, tax basis, tax collection channels and credit mechanisms.
- 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.

¹⁵ Call for Comments on the Consumption Tax Law of the People's Republic of China (Draft for Comments), MOF, 3rd December 2019, viewed 11th May 2020, http://www.chinatax.gov.cn/chinatax/n810356/n810961/c5140457/content.html>

¹⁶ Notice on Consumption Tax-related Policies ([2012] No. 47), SAT, 6th November 2012, viewed 11th May 2020, <http://www.chinatax.gov.cn/n810341/n810765/ n812151/n812386/c1082513/content.html>

¹⁷ Notice on Supplementary Provisions on Issues Relating to Consumption Tax Policies ([2013] No. 50), SAT, 9th September 2013, viewed 11th May 2020, <http:// www.chinatax.gov.cn/n810341/n810755/c1148574/content.html>



4. Encourage the Development of China's Technology Infrastructure to Better Enable Remote Working Practices

Concern

Insufficient tax and fiscal measures have been introduced either to mitigate the potential economic impacts from COVID-19, or to improve China's infrastructure in preparation for a possible re-emergence of the disease or a similar occurrence.

Assessment

Earlier this year, businesses operating in China faced unprecedented challenges when responding to the COVID-19 outbreak. They have shown amazing resilience, taking immediate and compassionate action to minimise the spread of the virus. The Chinese authorities passed numerous tax measures and subsidies to assist the industries that were most greatly affected by the pandemic.

While the outbreak showed the resilience and determination of business, government and individuals, it also shed light on weaknesses in China's infrastructure and procedural issues that made it extremely challenging for companies to operate effectively while complying with government requirements. Strong action will be needed going forward, both to promote economic development in the face of impending headwinds and to better stabilise the country's infrastructure for a potential widespread re-emergence of the virus.

China has passed tax policies to support the medical system and to keep alive those industries most heavily affected by the social distancing measures taken to curb the spread of infections. Such measures constitute a welcome relief for these sectors. However, the economic effects of the pandemic are widespread and not limited to just a few industries. Most businesses have incurred significant costs to adapt to remote working arrangements, or from lost revenue due to mandatory shutdowns. With the virus also affecting other countries, these businesses will feel additional pressure from decreased demand overseas. The Chinese Government should consider similar measures to those taken by many foreign governments in order to stimulate economic recovery, particularly given that recovery is likely to take much longer than originally anticipated. Examples of such measures could be to temporarily allow a carry-back to the 2019 tax year for losses incurred in 2020 or to remove the limitation on deductibility of entertainment expenses and employee welfare expenses for tax years 2020 and 2021.

It became apparent that many aspects of the Chinese economy were ill-equipped for measures that effectively shut down many sectors of the economy. The working group recommends that fiscal support be given to businesses that invest in digital infrastructure, both for their general operations and for the benefit of their employees. Government policies for finance and taxation, for instance, can be better adapted for remote approval, reviews and payment, among other examples.

Recommendations

- Provide tax incentives for companies to invest in digital infrastructure such as hardware and software, as well as more advanced automation.
- Temporarily allow a carry-back to the 2019 tax year for losses incurred in 2020.
- Review tax filing and other financial procedures to improve and increase the areas of the economy that can work well in the digital economy.
- Temporarily remove the limitation on deductibility of entertainment expenses and employee welfare expenses for tax years 2020 and 2021.

5. Take Alternative Steps to Further Attract Foreign Investment into China 3

Concern

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

Assessment

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

To encourage further foreign investment into China, Caishui [2017] No. 88, (later replaced by Caishui



[2018] No. 102),¹⁸ introduced a preferential deferral system for dividend withholding tax (WHT) for cases in which the dividend is directly invested in investment projects in China.¹⁹ 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,²⁰ would simplify the process.

To date, relatively high IIT 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 working group welcomes the government's consideration of the issue through the promulgation of a new preferential policy that reduces IIT rates for foreign, high-end talent in the Greater Bay Area (GBA) to the corresponding tax rate of Hong Kong.²¹ To further attract investment in the region that the policy currently covers, authorities should facilitate implementation and apply these tax incentives on a broader basis and minimise restrictions such as the number of applicable employees per company, job title/ position, educational level and industry experience.

Huifa [2013] No. 30,²² and *Bulletin* [2013] No. 40,²³ allow Chinese enterprises to remit reimbursements to their overseas affiliates that relate to expatriates'

salaries, welfare and insurance costs, and travel and training expenses. In international tax practice, cost reimbursements between affiliated companies are considered a genuine measure to allocate cost to the appropriate legal entity. Since these cost reimbursements are non-service in nature, no servicetype taxation should apply. In China, however, cost reimbursements are often subject to service-type tax treatment such as CIT, VAT or local surtax. Further technical guidance should therefore be provided to the tax authorities on the reduction of administrative burdens on enterprises and the treatment of cost reimbursements, in accordance with international tax practice.

Since the implementation of the 2008 CIT Law,²⁴ 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 R&D expenses.

To optimise supply chains and global industrial production, companies should be allowed to manage their core intellectual property rights (IPR) in a flexible and economical manner, such as through non-exclusive licences. Currently, entities established by foreign companies may have only obtained the right to use core technologies through licensing agreements with their parent company. Foreign companies also grant licences to non-affiliated Chinese companies, which enable the latter to use advanced, world-class technology. Preferential tax policies could be given to European companies that transfer the use right of core IPR to local firms.

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

The working group encourages the GAC to align with SAT

¹⁸ Notice on Widening the Scope of Application of Temporary Waiver for Withholding Income Tax for Overseas Investors Using Distributed Profits for Direct Investment, SAT, 29th September 2018, viewed 18th May 2020, <http://www.chinatax.gov.cn/n810341/n810755/c3776623/content.html

¹⁹ Positive Signals to Foreign Investors: China Unveils Withholding Tax Deferral Treatment for Foreign Direct Reinvestment, PwC, December 2017, viewed 11th May 2020, https://www.pwccn.com/en/china-tax-news/dec2017/chinatax-newsdec2017-38.pdf>

²⁰ Notice on Several Issues Concerning the Treatment of Enterprise Income Tax in Enterprise Restructuring Business, SAT, 30th April 2009, viewed 11th May 2020, http://www.chinatax.gov.cn/n810341/n810765/n812166/n812637/c1188923/ content.html>

²¹ Notice on Preferential Policies for Personal Income of the Guangdong-Hong Kong-Macao Greater Bay Area, Caishui [2019] No. 31, STA, 14th March 2019, viewed 1st July 2020, <http://www.chinatax.gov.cn/n810341/n810755/c4148969/ content.html>

²² Circular on Printing and Forwarding the Regulations on Foreign Exchange Administration for Trade in Services, State Administration of Foreign Exchange (SAFE), 18th June 2013, viewed 11th May 2020, <https://www.safe.gov.cn/ en/2013/0724/737.html>

²³ Announcement of the State Administration of Foreign Exchange and the State Administration of Taxation on Relevant Issues Concerning the Filing of Tax for External Payments for Trade in Services and Other Accounts, SAFE, 9th July 2013, viewed 11th May 2020, https://www.safe.gov.cn/en/2013/0724/736.html>

²⁴ Corporate Income Tax Law of the People's Republic of China, State Council, 16th March 2007, viewed 11th May 2020, <http://www.gov.cn/flfg/2007-03/19/ content_554243.htm>



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 (see the Logistics Working Group Position Paper for more information). When, in rare cases, customs authorities do authorise such an adjustment, it has no retroactive effect and leads to a mismatch in the pricing mechanism. Some companies may turn to banks or the State Administration of Foreign Exchange (SAFE) to apply for TP compensation, but this alternative is complicated by the absence of clear SAFE rules regulating TP. Ambiguous SAFE rules, an improper TP adjustment system and a non-harmonised approach between the customs and tax authorities can cause double taxation, which significantly increases tax costs for European firms in China.

Key Recommendations

- 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).
- Improve European firms' access to investment opportunities in the GBA by implementing rules that make the IIT incentive broadly applicable to high-end talent employed by foreign entities, and minimise restrictions such as the number of applicable employees per company, job title/position, educational level and industry experience.
- Simplify the tax treatment and payment restrictions for cost reimbursement for assignees by the Chinese host enterprise to the overseas home enterprise.
- Ensure fair application of laws to both Chinese and foreign businesses, in particular social security contributions for foreign employees.
- 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 |
| GAC | General Administration of Customs |
| GBA | Greater Bay Area |
| HNTE | High and New-Technology Enterprise |
| IIT | Individual Income Tax |
| IPR | Intellectual Property Rights |
| MNC | Multinational Corporation |
| MOF | Ministry of Finance |
| OECD | Organisation for Economic Co-operation |
| | and Development |
| R&D | Research and Development |
| ROP | Refined Oil Products |
| SAFE | State Administration of Foreign |
| | Exchange |
| STA | State Taxation Administration |
| TP | Transfer Pricing |
| VAT | Value-added Tax |
| WHT | Withholding Tax |

Human Resources Working Group

Key Recommendations

- 1. Enhance Workforce Flexibility <a>6 and Improve Social Security Policies for Part-time Employees <a>4
 - Introduce clearer measures to define part-time employment based on current business needs and to regulate labour disputes that may arise when the same employee holds part-time and full-time contracts simultaneously.
 - Grant greater flexibility to employers in hiring and termination processes in order to attract talent and to allow international employees to further their career development in China.
 - Distribute social security according to income ratio and enable multiple employers to distribute social security to the same employee undertaking both part-time and full-time work.
 - Clearly adjust policies on unemployment and pension funds retrieval for foreign employees across China.

2. Simplify Visa and Work Permit Procedures and Relax Requirements on Acquiring Visas (3)

- Raise the legal working age cap to allow non-A-level foreign employees over the age of 60 to work in China.
- Provide the necessary legal framework for companies to successfully recruit foreign personnel, including interns, such as making internship visa policies clearer.
- Implement nationwide, comprehensive and uniform work permit requirements for foreigners without university diplomas or for graduates who did not study at China-defined top overseas universities or foreigners who are seconded.
- Provide information on visa and work permit policies in English in a timely manner.
- Further amend the draft *Permanent Residence (PR) Notice* by taking into consideration the comments raised by the European Union Chamber of Commerce in China and by other chambers of commerce in China.
- 3. Support the Development of Practical Knowledge and Soft Skills in the Education System ¹
 - Modernise curriculum and teaching methodologies to reach international standards.
 - Promote more international exchanges in accordance with China's goals for education and with Chinese and international connectivity strategies.
 - Facilitate access to information on available government-subsidised professional training, selforganised training, and commercial courses that ensure the development of a highly skilled workforce, increasing collaboration with universities, vocational centres, and enterprises.
 - Provide subsidies or tax-related benefits to employers that offer project-based internship positions to university students.



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

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

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

4.2 Improve the Transparency of the Disabled Persons' Employment Security Fund

- Further reduce the contributions to the Fund to alleviate the financial burden of companies.
- · Adopt a more transparent approach to the collection and use of the Fund.

Introduction to the Working Group

Talented employees are the lifeblood of most organisations. Through nurturing people and effectively managing labour relations, human resources (HR) departments play a critical role in engaging the workforce to maximise productivity and grow business capacity amid major disruptions, growth which 85 per cent of companies in Mercer's 2020 Global Talent Trends Study expect to be driven by technological transformation.¹

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 for companies to get ahead in an ever more dynamic work environment, a trend echoed in the Mercer study, which found that 98 per cent of executives plan to redesign their organisations to make them fit for tomorrow.²

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

The Coronavirus Disease 2019 (COVID-19) pandemic has had far-reaching impacts on global labour markets. To combat the spread of the disease, governments across the world, including China's, have launched unprecedented public health interventions, imposing restrictions on mobility and business operations that have had major economic knock-on effects.

Bankruptcies and unemployment levels have risen sharply, as lockdowns around the world have forced companies to scale back or shut down operations and furlough workers. According to China's Ministry of Human Resources and Social Security (MOHRSS), some 2.29 million people received unemployment insurance in January and February, with another estimated 22 million people at risk for layoffs this year.³

On 20th March 2020, the State Council issued a guideline to safeguard jobs while coping with the financial impact of the crisis.⁴ The document called for expanding job opportunities for college graduates

^{1 2020} Global Talent Trends Study, Mercer, 2020, viewed 15th June 2020, <https:// www.mercer.com/our-thinking/career/global-talent-hr-trends.html>

² Ibid.

³ Coronavirus Pandemic to Test China's Unemployment Safety Net, Reuters, 13th April 2020, viewed 27th April 2020, ">https://www.reuters.com/article/us-health-coronavirus-chinas-unemployment/coronavirus-pandemic-to-test-chinas-unemployment-safety-net-idUSKCN21U0Y0>">https://www.reuters.com/article/us-health-coronavirus-chinas-unemployment/coronavirus-pandemic-to-test-chinas-unemployment-safety-net-idUSKCN21U0Y0>">https://www.reuters.com/article/us-health-coronavirus-chinas-unemployment/coronavirus-pandemic-to-test-chinas-unemployment-safety-net-idUSKCN21U0Y0>">https://www.reuters.com/article/us-health-coronavirus-chinas-unemployment-safety-net-idUSKCN21U0Y0>">https://www.reuters.com/article/us-health-coronavirus-chinas-unemployment-safety-net-idUSKCN21U0Y0>">https://www.reuters.com/article/us-health-coronavirus-chinas-unemployment-safety-net-idUSKCN21U0Y0>">https://www.reuters.com/article/us-health-coronavirus-chinas-unemployment-safety-net-idUSKCN21U0Y0>">https://www.reuters.com/article/us-health-coronavirus-chinas-unemployment-safety-net-idUSKCN21U0Y0>">https://www.reuters.com/article/us-health-coronavirus-chinas-unemployment-safety-net-idUSKCN21U0Y0>">https://www.reuters.com/article/us-health-coronavirus-chinas-unemployment-safety-net-idUSKCN21U0Y0>">https://www.reuters.com/article/us-health-coronavirus-chinas-unemployment-safety-net-safety-n

⁴ China Rolls Out Measures to Further Ensure Employment Against COVID-19 Impact, State Council, 20th March 2020, viewed 27th April 2020, <http://english.www.gov.cn/policies/latestreleases/202003/20/content_ WS5e74af1fc6d0c201c2cbf0ec.html>

and for increasing the amount and coverage of unemployment insurance premium refunds.⁵ The working group welcomes the implementation of social protection measures pledging to support job and income security for the most vulnerable labour groups and will closely monitor actual implementation of the measures on the ground.

On 26th March, in a drastic step to curb the spread of COVID-19, the Ministry of Foreign Affairs (MFA) announced the temporary suspension of entry into China by foreign nationals holding valid visas or residence permits (with the exception of entry with diplomatic, service, courtesy or C visas, as well as legal permanent residents—green card holders).⁶ As a result, companies have had to grapple with unprecedented travel restrictions for their staff and related operational challenges, leaving many foreign employees stranded overseas unable to return to their workplace.

Remote Work

As well as immediate measures to protect employees from the risk of infection, organisations have also had to fundamentally rethink in-person HR processes to comply with physical distancing protocols. This has led enterprises to escalate business-continuity and employee-safety plans through the adoption of flexible work arrangements and by enabling remote working where possible. The COVID-19 pandemic has led to a radical transformation of labour market dynamics, one which, challenges notwithstanding, also offers an opportunity for companies to build a culture that embraces greater work flexibility. Similarly, the outbreak has exposed certain long-standing inequalities confronting working mothers, who have had to shoulder bigger childcare and domestic loads with the closure of schools and kindergartens. Changes for the better are ever more possible in a post-COVID society; radical action to achieve gender equality in the workplace should be at the centre of the pandemic response, too.

Online Education

On 31st January 2020, the Ministry of Education (MOE) announced the postponement of the start of the spring

semester to prevent the spread of COVID-19.⁷ The MOE then set up a national cloud learning platform to help students study at home through class broadcasting. Following the postponement of the school semester, the government issued instructions on the deployment of higher education institutions (HEI) online teaching to enable students to resume their studies remotely.⁸ On 31st March 2020, the MOE further announced the postponement of China's national college entrance exam, also known as the *gaokao*, by a month to 7th and 8th July, due to the COVID-19 pandemic.⁹

With declining case numbers in many areas since the start of the outbreak, schools across the country began a phased reopening from late March 2020, with special infection containment measures in place to ensure the safety of teachers and students through the class resumption process.¹⁰

Key Recommendations

1. Enhance Workforce Flexibility and Improve Social Security Policies for Part-Time Employees

Concern

The current Labour Law,^{11&12} Labour Contract Law,^{13&14} and related social security policies do not provide clear guidelines and fair regulations on hiring employees in flexible, part-time ways, resulting in slower business development and financial burdens for employers as well as employees.

Assessment

Flexibility in the workplace has long been a subject of debate, yet the Chinese Government and businesses

- 10 China Endeavours to Ensure Safe Classes Resumption Amid COVID-19, Xinhua, 26th April 2020, viewed 28th April 2020, <http://www.xinhuanet.com/ english/2020-04/26/c_139009812.htm>
- 11 Labour Law Issued in 1994 and amended in 2018.
- 12 China Employment Law Update April 2018, Bird & Bird, 25th April 2018, viewed 28th April 2020, https://www.twobirds.com/en/news/articles/2018/china/china-employment-law-update-april-2018
- 13 Labour Contract Law implemented as of 2008.
- 14 Labour Contract Law of the People's Republic of China, The Central People's Government of the People's Republic of China, 29th June 2007, viewed 28th April 2020, <http://www.gov.cn/flfg/2007-06/29/content_669394.htm>

⁵ Ibid.

⁶ Ministry of Foreign Affairs of the People's Republic of China National Immigration Administration Announcement on the Temporary Suspension of Entry by Foreign Nationals Holding Valid Chinese Visas or Residence Permits, MFA, 26th March 2020, viewed 8th May 2020, https://www.fmprc.gov.cn/mfa_ eng/wjbxw/t1761867.shtml>

⁷ MOE Opens Online Learning Platform to Facilitate Home Study, MOE, 31st January 2020, viewed 28th April 2020, http://en.moe.gov.cn/news/press_ releases/202002/t20200201_417275.html>

⁸ MOE Issues Instructions for Deployment of HEI Online Teaching, MOE, 7th February 2020, viewed 28th April 2020, http://en.moe.gov.cn/news/press_ releases/202002/t2020028_419136.html>

⁹ China's National College Entrance Exam Postponed for One Month, MOE, 1st April 2020, viewed 24th April 2020, <http://en.moe.gov.cn/news/media_ highlights/202004/t20200402_437546.html>



across the board have shown little enthusiasm for adopting flexible working models over the past few years, whether out of perceived complexity, scepticism, or concerns over reduced productivity. However, nationwide lockdowns and social distancing caused by COVID-19 have brought flexible work into the spotlight again. *Vis-à-vis* this shift toward a more agile workplace, the Human Resources Working Group urges specific laws and related social security policies that provide clear guidelines to regulate employment behaviours at the present time.

Although current regulations do not forbid employees to sign full-time and part-time contracts at the same time, a legal framework designed to regulate disputes between employers in this context is still missing. Introducing such measures would protect all parties' rights and grant greater work flexibility to employers and employees alike.

To safeguard employees' interests, the current Labour Contract Law also sets stringent rules regarding contract termination by the employer. The Law's very implementation remains inconsistent across China, not only causing unfairness in the labour market, but posing considerable legal and financial risks for employers.¹⁵ The working group sees the need to ease current policies regulating employee dismissal to lower employment costs and raise employment rates, so that companies can react to changes in the market more efficiently. This is especially pressing for foreign workforce employment, where the working group observes a significant lack of flexibility: strict requirements imposed by the labour authority on the flexible working hour system application lead to lengthy and complex approval processes.

Furthermore, working group members report that foreign employees exploring job opportunities outside of their current area of expertise encounter difficulties in renewing their visas, while they do not face obstacles when looking for positions that require the same hard skills as their previous occupation. The working group calls for more detailed and practical regulations to attract, retain and help foreign talent pursue a longterm career in China, which will be beneficial for companies and the economy as a whole. In this regard, enabling flexible working can both expand participation of different demographics in the labour market and make 'agile' contracts more attractive to high-calibre professionals.

Social Security

Current social security policies for part-time and foreign employees are not adequately or fairly regulated, resulting in financial burdens for employers and employees. For example, while working for multiple companies has become more and more common, especially in the wake of COVID-19, only one employer can cover the employee's social insurance under current laws in China.¹⁶ To ease the regulatory burden, the working group maintains that changes should be made that allow for a fair distribution of social security costs among employers, based on the amount of time spent at the company.

Pension Funds

Foreign employees are required to pay for unemployment and pension insurance. However, current policies in many cases do not allow for retired or unemployed foreigners to reside in China. While bilateral agreements between China and several European countries regulate pension and unemployment insurance, most foreign employees cannot enjoy welfare benefits.17 The working group suggests that MOHRSS adjusts the system for retrieval of unemployment and pension funds. Where retrieval is not possible, it is recommended that regulations be issued which allow foreigners to stay in China for a period of time corresponding to the amount of funds deposited. This would allow foreigners to look for new employment opportunities while putting their funds to use. It is in China's interest to retain top foreign talent by helping them to be more flexible in their professional life.

Recommendations

- Introduce clearer measures to define part-time employment based on current business needs and to regulate labour disputes that may arise when the same employee holds part-time and full-time contracts simultaneously.
- · Grant greater flexibility to employers in hiring and

¹⁵ Labour Contract Law of the PRC, Central Government of the People's Republic of China, 29th June 2007, viewed 27th May 2020, <http://www.gov.cn/fifg/2007-06/29/content_669394.htm>

¹⁶ Opinions on Certain Issues Concerning Part-time Employment, State Council, 30th May 2003, viewed 29th April 2020, http://www.gov.cn/gongbao/content/2003/content-62263.htm

¹⁷ Measures on Participation in Social Insurance for Foreigners Employed in China, State Council, 8th September 2011, viewed 10th July 2020, http://www.gov.cn/gzdt/2011-09/08/content_1943787.htm

termination processes in order to attract talent and to allow international employees to further their career development in China.

- Distribute social security according to income ratio and enable multiple employers to distribute social security to the same employee undertaking both part-time and full-time work.
- Clearly adjust policies on unemployment and pension funds retrieval for foreign employees across China.

2. Simplify Visa and Work Permit Procedures and Relax Requirements on Acquiring a Visa 18

Concern

With the adoption of the Foreigners' Work Permit (FWP) system, the application requirements have become more complex for non-A-level talent.

Assessment

On 1st April 2017, the FWP came into force as a unified application system for foreigners applying for work permits in China.¹⁸ The FWP system grades foreign workers on an 'ABC' scale based on their qualifications. Higher-level talent who obtain A-level status under the FWP system are entitled to enjoy certain benefits, including exemption from age, educational, or work experience requirements. Unfortunately, these benefits do not apply to most foreigners, who not only contribute to China's economic growth, but also continue to be very much needed by international and local companies alike. In this regard, the FWP system should be developed further to widen the labour pool and to improve its overall efficiency.

The Human Resources Working Group nevertheless acknowledges that some developments toward optimising the application procedures of work permits have taken place in recent months. These include measures announced specifically to deal with the COVID-19 outbreak; the 2019 update on S2-visa policies for internships that extends their application nationwide;¹⁹ and the announcement of the draft *Notice on the People's Republic of China (PRC) Administration of Permanent Residence of Foreigners* ('PR Notice') for public discussion,²⁰ which constitutes considerable progress in the policies regulating permanent residence by foreigners in China.

Working Age

The Human Resources Working Group notes that, under the FWP system, the upper working age limit for non-A-level talent is 60. However, the average retirement age in most European Union countries is 65. This means that experienced employees who are eligible to work in their home countries cannot be employed by foreign-invested enterprises in China. Senior personnel are highly valued for the expertise they bring to the workplace. Yet due to such limitations, senior employees on non-A level visas cannot continue to contribute to China's growth after they reach 60. The working group also notes that the situation has improved in Beijing-where non-A level talent over 60 years of age can extend their work and residence permits-and suggests that this practice be applied nationwide.

Internship Visa

When China eliminated the F-visa category for interns in 2013,²¹ overseas university students could then only undertake an internship in China by either participating in internship programmes between governments or by obtaining an S2-visa (whose validity period could then be as short as three months) at the port of entry, plus an 'internship' remark—a special note that officials at the port of entry make on the passport of foreigners coming into China to pursue an internship—to pursue the programme upon invitation from businesses located in government-designated regions.

In a welcome development in July 2019, the State Immigration Bureau decided to apply the S2-visa internship policies that previously applied to specific localities only nationwide.²² Upon invitation by 'famous' enterprises and institutions in China, overseas university students can now obtain an S2 visa with validity of up to one year for internship purposes in the country. While

¹⁸ Notice on Full Implementation of Foreigner's Work Permit System, SAFEA, 28th March 2017, viewed 9th May 2020, http://www.safea.gov.cn/content.shtml?id=12749533>

¹⁹ National Immigration Administration Announces Twelve Facilitation Policies on Immigration and Entry-exit, State Council, 17th July 2019, viewed 27th May 2020, <http://www.gov.cn/xinwen/2019-07/17/content_5410623.htm>

²⁰ Notice on Administrative Regulation on Foreigners for Permanent Residence (Draft for Comments), Ministry of Justice, 27th February 2020, 27th May 2020, <http://www. moj.gov.cn/government_public/content/2020-02/27/657_3242533.html>

²¹ China Releases Final Draft of New Visa and Residence Permit Regulations for Foreigners, China Briefing, 25th July2013, viewed 8th July 2020, https://www.china-briefing.com/news/china-releases-final-draft-of-new-visa-and-residence-permit-regulations-for-foreigners/>

²² Convenient Immigration and Exit and Entry Policies of Free Trade Zones to be Applied and Promoted Nationwide, State Immigration Bureau, 17th July 2019, viewed 9th May 2020, http://www.gov.cn/xinwen/2019-07/17/content_5410623. with>



the working group acknowledges that the nationwide adoption of the policy enables more university students to intern in China, the inviting parties are limited to 'famous' enterprises and institutions, and the Chinese Government still sets limitations on which university the applicant should be affiliated with. Given how varied the higher-education system is in Europe, the working group advocates that the Chinese Government provides for more companies with the qualifications required of the inviting party, as well as for students from more universities and colleges to have the opportunity to undertake an internship in China.

Qualification Requirements

The FWP sets a bachelor's degree as the educational threshold to qualify for a B-level visa. However, some EU countries have successfully adopted a dual education system for decades, combining vocational education and apprenticeship. In Germany, for instance, students enrolled in the vocational education and training system do not receive a bachelor's degree, but rather a certificate issued by the local chamber of industry and commerce. This model has proven to be very effective in filling skill-gaps in the German workforce, as people equipped with professional acumen and experience are well positioned to develop into high-level managers. Although the Shanghai government has sought to accept some types of vocational education certificates issued by certain countries, this still does not apply universally across localities.

Secondment

The new FWP allows foreigners to work in China by means of being seconded from their overseas headquarters, requiring the applicant to submit a secondment letter instead of a local employment contract. However, this policy only applies in some locations, such as Beijing and Shanghai. The working group thus recommends that the government adopts a uniform standard nationwide that enables the seconded employee to take up the assignment without having to submit a local employment contract

Furthermore, the Foreign Expert Bureau requires that the secondment letter be issued only by the shareholders of the Chinese subsidiary. The working group remarks that this is not feasible, especially for multinationals overseeing complex operational systems in which personnel flows among affiliates. The working group advocates for allowing the secondment of personnel to China from affiliates within one company group.

Lack of Official English Translations of Regulations Affecting Foreign Employees

The online Service System for Foreigners Working in China has been operating for several years now, with the website becoming the most important platform for policy updates on foreigners working in China.²³ With the exception of the Shanghai local government, however, the policies are only available in the Chinese language, which is inconvenient for the great majority of foreign employees. The working group urges the central government and other local authorities to provide an English version of the website so that the non-Chinese speaking workforce can have prompt access to critical regulatory information as well as official translations of other relevant policy updates.

More Efficient Approval Procedures

The new FWP simplifies the application procedures for foreigners' work permits. That being said, foreigners who change employers are not able to directly transfer their work permits from the original employer to the new employer, but must go once again through the entire work permit application process. The working group noticed that certain cities, including Beijing and Shanghai, can waive some paperwork with Z visa application procedures, depending on when the foreigner changing employers files for the new work permit. These measures are very helpful as the Chinese Government works toward shortening the time of approval procedures. However, the two procedures of first cancelling the original work permit and then applying for a new one, which foreign employees must go through to finalise the job transfer, remain rather time-consuming. The working group recommends setting up a specific procedure whereby foreign employees can directly swap a work permit when transferring from one job to another.

Moreover, during the COVID-19 pandemic, the Chinese authorities have issued special measures that facilitate faster online applications. The authorities now allow Band C-class foreign employees to apply for work permit



²³ Service System for Foreigners Working in China, State Administration of Foreign Expert Affairs, viewed 9th May 2020, http://fwp.safea.gov.cn/ IhCmsArticleDisController.do?cmsArticleContentPage&artId=bb7f31e65b7c463 2015b809057fb0d5a>

Section Two: Horizontal Issues

notification letters as well as for work permit extensions online, instead of being required to submit paper documents in person. Previously, online applications were only available to A-class foreign workers. In Shanghai, the local government is currently working on combining work permit and residence permit application procedures. The Human Resources Working Group welcomes these measures and will monitor any future developments.

Permanent Residence

On 27th February 2020, the Chinese Government published the draft *PR Notice* for public consultation.²⁴ This major draft regulation aims at encouraging foreign talent to reside in China for a longer time. Laying out the administrative process and related qualification criteria, the draft streamlines existing practices and offers a framework for implementation by the authorities. However, the working group sees that the draft regulations still contain a large number of vague definitions, and that decisive factors for applicants to consider-especially tax treatment-remain to be clarified or are still subject to local implementation. The working group therefore suggests that the authorities amend the draft PR Notice further by taking into consideration the comments raised by the European Chamber and national chambers.

Recommendations

- Raise the legal working age cap to allow non-Alevel foreign employees over the age of 60 to work in China.
- Provide the necessary legal framework for companies to successfully recruit foreign personnel, including interns, such as making internship visa policies clearer.
- Implement nationwide, comprehensive and uniform work permit requirements for foreigners without university diplomas or for graduates who did not study at China-defined top overseas universities or foreigners who are seconded.
- Provide information on visa and work permit policies in English in a timely manner.
- Further amend the draft *PR Notice* by taking into consideration the comments raised by the European Union Chamber of Commerce in China and by other chambers of commerce in China.

Support the Development of Practical Knowledge and Soft Skills in the Education System (2)

Concern

China's quality of education still lags behind the country's own development goals and that of market demand.

Assessment

Initiated in 2010, China's *National Outline for Medium and Long-term Education Reform and Development* is set to end by the end of 2020,²⁵ yet much remains to be done to align the country's quality of education and skilled labour force with its development goals and market demands, a gap which companies are left to fill by spending considerable amounts of resources on employee training. Despite ambitious attempts by the Chinese Government to transform the education system from a 'learn-by-rote model' to a quality-oriented one, there is little evidence that over a decade of reforms has had much significant impact on teaching and learning in China, or on improving the talent market in the country.

21st Century Skills

The Chinese Government sees building a powerful education system as a key foundation for the country's goal of becoming a fully developed nation by 2049.²⁶ In February 2019, the Central Committee of the Communist Party of China and the State Council issued China's Education Modernisation 2035 plan to further improve the education sector and to develop a more creative society in line with the country's national modernisation development strategy.²⁷ As well as fulfilling China's commitments under the United Nations 2030 Sustainable Development Agenda, the 2035 plan also demonstrates China's active participation in global education governance. For example, the plan features the dispatch of research teams to multiple localities to engage with relevant stakeholders and gather advice

²⁴ Draft Notice on the People's Republic of China Administration of Permanent Residence of Foreigners, Ministry of Justice, 27th February 2020, viewed 9th May 2020, http://www.moj.gov.cn/government_public/content/2020-02/27/657_3242533.html

²⁵ National Outline for Medium and Long-term Education Reform and Development (2010–2020), Central Government of the PRC, 29th July 2010, viewed 8st May 2020, <http://www.gov.cn/jrzg/2010-07/29/content 1667143.htm>

²⁶ China's Ambitions for Education Development: Key Takeaways from the 19th Party Congress, British Council, 3rd November 2017, viewed 7th July 2020, <https://education-services.britishcouncil.org/insights-blog/chinas-ambitionseducation-development-key-takeaways-19th-party-congress>

²⁷ Zhu, Y., New National Initiatives of Modernising Education in China, ECNU Review of Education 2(3), 353–362, 2019, viewed 8th May 2020, <https://doi. org/10.1177/2096531119868069>



on enhancing the country's overall talent capacity.28

In July 2019, moreover, the Chinese Government announced a new set of guidelines to encourage schools to cultivate the cognitive and critical thinking ability of students through activities that de-emphasise rote-learning while promoting qualitative approaches to pedagogy instead.²⁹

In this regard, educational scholars Fernando Reimers and Connie K. Chung have argued that global educators should equip students with intrapersonal, interpersonal, and cognitive competencies that empower them to navigate the complexities of the 21st century.³⁰ These competencies include the social and emotional ability to work with people from diverse cultures; the creativity to develop sustainable solutions to complex problems: and the confidence that individuals can, and shall, make a difference beyond national borders. To be globally competent, students will thus need to cultivate such abilities as creativity, critical thinking, intercultural literacy, and cooperation.³¹ For Chinese policymakers, working toward this goal will entail paying far greater attention to teaching methodologies, given that the objectives of designing flexible curricula and nurturing a culture of independent thinking in the country have yet to be fully met.

International Exchanges and Cooperation

Furthering EU-China cooperation goals and the people-to-people dialogue endorsed by the European Commission in 2018,³² it is ever more crucial to step up efforts that foster mutual understanding and global citizenship. Education plays a critical role here: by forging cultural bonds and deepening cross-country cooperation, international exchanges enhance the very

social and economic relationship between Europe and China.³³

One compelling example of international cooperation *vis-à-vis* the COVID-19 crisis can be found in the *Handbook on Facilitating Flexible Learning During Educational Disruption: The Chinese Experience in Maintaining Undisrupted Learning in COVID-19 Outbreak.* This describes several e-learning strategies that the Chinese Ministry of Education has adopted under the Disrupted Classes, Undisrupted Learning initiative to provide flexible online learning to over 270 million students in their homes.³⁴ The publication exemplifies how cooperation between Europe and China can produce best-practice solutions that help build the longer-term resilience of global education systems.

Although the number of Chinese students abroad is expected to decline due to COVID-19 mobility restrictions, international exchanges will remain the key catalyst for cultural understanding and innovative channels for global talent to develop the skills of the future, which is hoped will engender a greater integration of international curricula into the domestic market.

Subsidies and Tax-related Benefits

Companies in China are still confronted with a lack of needed talent, which they seek to address by spending considerable amounts of time and money on training employees, despite high turnover rates and wage-level challenges.³⁵ To address the current imbalance between the demand for talent and the talent pool available, the Human Resources Working Group maintains that subsidies should be granted to companies enabling training programmes for their employees. The free online vocational training programme launched by MOHRSS during the outbreak in April 2020 constitutes a promising initiative in this regard that the working

²⁸ China Issues Plans to Modernise Education, State Council, 23rd February 2019, viewed 8th May 2020, http://english.www.gov.cn/policies/latest_ releases/2019/02/23/content_281476535024192.htm>

²⁹ Westcott, Ben and Giolzetti, Don, Beijing Education Reforms Aim to Help China's Over-worked, Over-tested Students, CNN, 17th July 2019, viewed 8th May 2020, <https://edition.cnn.com/2019/07/16/asia/china-education-reformintl-hnk/index.html>

³⁰ Beasley Doyle, H., *How to Thrive in the 21st Century*, 22nd November 2016, viewed 8th May 2020, <">https://www.gse.harvard.edu/news/uk/16/11/how-thrive-21st-century>

³¹ Ibid.

³² Joint Communication to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank, European Commission, 2018, viewed 8th May 2020, <https://eeas.europa.eu/sites/eeas/files/joint_communication_-connecting_ europe_and_asia_-building_blocks_for_an_eu_strategy_2018-09-19.pdf>

³³ Cai, Y., Chinese Higher Education Reforms and Tendencies: Implications for Norwegian Higher Education in Cooperating with China, 2011, viewed 8th May 2020, <https://www.academia.edu/1964278/Chinese_higher_education_ reforms_and_tendencies_Implications_for_Norwegian_higher_education_in_ cooperating_with_China>

³⁴ Huang, R.H., Liu, D.J., Tlili, A., Yang, J.F. et al., Handbook on Facilitating Flexible Learning During Educational Disruption: The Chinese Experience in Maintaining Undisrupted Learning in COVID-19 Outbreak, UNESCO Institute for Information Technologies in Education, 2020, viewed 8th May 2020, <https://iite. unesco.org/news/handbook-on-facilitating-flexible-learning-during-educationaldisruption/>

³⁵ European Business in China Business Confidence Survey 2019, European Union Chamber of Commerce in China, 2019, http://www.europeanchamber.com.cn/en/publications-business-confidence-survey

group hopes can be maintained beyond COVID-19 times.³⁶ Nevertheless, the working group observes that most vocational programmes tend to be of limited scope and difficult to access, and that they often favour large firms over small and medium-sized enterprises. It is therefore recommended that the authorities facilitate a consistent, large-scale implementation of skill-training initiatives in the near future.

At the same time, the working group also notes that previous asks for project-based internships specifically aimed at students did not see fruition. Both international and Chinese students struggle to find internship opportunities or receive ad-hoc professional training in China, as local companies sometimes lack the resources to onboard students new to the profession. The working group therefore recommends offering subsidies or taxrelated benefits to employers that provide project-based internship positions, with the adoption of a targeted mechanism to evaluate such positions and distribute funds appropriately.

Recommendations

- Modernise curricula and teaching methodologies to reach international standards.
- Promote more international exchanges in accordance with China's goals for education and with Chinese and international connectivity strategies.
- Facilitate access to information on available government-subsidised professional training, selforganised training, and commercial courses that ensure the development of a highly skilled workforce, increasing collaboration with universities, vocational centres, and enterprises.
- Provide subsidies or tax-related benefits to employers that offer project-based internships to university students.
- Implement a Fairer System to Employ and Include People with Disabilities
 3
- 4.1 Support Companies in their Efforts to Hire and Include Employees with Disabilities

Concern

Companies face multiple challenges when it comes to identifying and hiring disabled people.

Assessment

Companies in China lack effective support in hiring people with disabilities. In 2007, the country adopted a mandatory pro rata system for hiring people with disabilities, whereby companies are obliged to proportionally hire disabled individuals so that they make up no less than 1.5 per cent of total staff. Most businesses are willing to hire people with disabilities, yet they find it difficult to do so in practice. Employers often struggle to find suitable candidates as, in many cases, disabled job applicants without substantial professional training are yet to develop the skills required of the workplace. Further, whether companies must directly hire disabled employees or can hire them through HR agencies is not yet clear. In December 2019, the China Disabled Persons' Federation and five ministries jointly announced an its 'Overall Plan' to establish a mechanism for sharing information about the employment of disabled persons. The aim is to improve the quality of occupational training for disabled employees, and to formulate policies for the integration of disabled hires.³⁷ The Human Resources Working Group is monitoring the implementation of this plan.

Recommendations

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

4.2 Improve the Transparency of the Disabled Persons' Employment Security Fund

Concern

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

Assessment

The Fund has been levied by local governments since the issuance of the *Methods on Levying, Use and*

³⁶ China Launches Free Online Vocational Training Program, Xinhua, 9th April 2020, viewed 8th May 2020, <http://www.china.org.cn/china/2020-04/09/ content_75910201.htm>

³⁷ 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 9th May 2020, <http://www.gov.cn/zhengce/ zhengceku/2019-12/30/content_5465191.htm>



Management of the Disabled Persons Employment Security Fund ('Methods') in 2015.³⁸ Companies unable to meet the quota for employees with disabilities must make contributions to the Fund on the basis of their employees' average annual salaries from the previous year.

The Chinese Government has focussed on reducing the contribution amount payable to the Fund, which is currently capped at two times the average annual salary of employees from the previous year. Recently, the Ministry of Finance (MOF) announced that, from 1st January 2020 until 31st December 2022, if the ratio of hiring disabled employees of a company reaches one per cent or more, the contribution amount payable by the company can be reduced by 50 per cent. If the ratio is lower than one per cent, the contribution amount can be reduced by 10 per cent. Small companies with no more than 30 employees are exempted from paying contributions to the Fund. The Human Resources Working Group welcomes these policies. However, while the greater integration of persons with disabilities into the labour force remains the prime objective underpinning the Fund system, the contributions represent a major financial burden for employers, especially considering the widespread cashflow distress caused by COVID-19.39 The working group advocates for the adoption of measures that further reduce this burden. Shenzhen, for example, in 2018 reduced the contribution basis of the Fund to 60 per cent of the average annual salary of employees for the previous year.40 It is recommended that this reduction be rolled out nationwide.

According to the *Methods*, the Fund can be used for occupational training and education or for the recovery of expenses incurred from hiring employees with disabilities. Subsidies can also be allocated to companies that hire persons with disabilities for expenses incurred from purchasing facilities, undergoing renovation work or providing other supporting services to meet the needs of disabled hires. Specifically, the Overall Plan mentions that the Fund's use prioritises supporting the employment of people with disabilities; finance departments at county, city and province levels are to duly announce the details of the Fund's collection and use, the employment status of people with disabilities, and shall accept supervisions. The working group is monitoring the implementation of this plan.

Recommendations

- Further reduce the contributions to the Fund to alleviate the financial burden of companies.
- Adopt a more transparent approach to the collection and use of the Fund.

Abbreviations

| COVID-19 | Coronavirus Disease 2019 |
|----------|-----------------------------------|
| FWP | Foreigner's Work Permit |
| HR | Human Resources |
| MFA | Ministry of Foreign Affairs |
| MOE | Ministry of Education |
| MOF | Ministry of Finance |
| MOHRSS | Ministry of Human Resources and |
| | Social Security |
| MPS | Ministry of Public Security |
| PRC | People's Republic of China |
| SME | Small and Medium-sized Enterprise |
| STA | State Taxation Administration |



³⁸ Methods on Levying, Use and Management of the Disabled Persons' Employment Security Fund, State Taxation Administration, 9th September 2015, viewed 8th May 2020, <http://www.chinatax.gov.cn/n810341/n810755/c1810262/ content.html>

³⁹ Announcement of the MOF about Adjustment of Policies on Levy of Employment Security Funds for People with Disabilities, MOF, 31st December 2019, viewed 9th May 2020, http://szs.mof.gov.cn/zhengcefabu/202001/t20200102_3453991.htm>

⁴⁰ Shenzhen Administration Methods on Use of Employment Security Fund of People with Disabilities, Shenzhen China, 10th April 2018, viewed 8th May 2020, <http://www.sz.gov.cn/zfgb/zcjd/content/post_4981685.html>

Intellectual Property Rights Working Group

Key Recommendations

1. Patents

- 1.1 Accept Post-filing Data for Patent Filing, Patent Invalidation and Judicial Proceeding
 - 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.
 - Ask the Supreme People's Court to issue juridical interpretation to codify the standard, especially Article 11 in the latest SPC's draft juridical interpretation regarding post-filing data.
- 1.2 Exclude Chinese Patent Applications or Patent Assignments from Technology Exports and Simplify the Procedures
 - Amend the Regulations on the Administration of the Import and Export of Technology to exclude the Chinese patent application or patent assignment from technology export by deleting "patent assignment" and "patent application assignment".
 - Amend the China National Intellectual Property Administration *Guidelines for Patent Examination* to exclude the Chinese patent application or patent assignment from technology export.

2. Civil Litigation

- 2.1 Expand the Scope of Written Submissions, and Set Evidence Exchange Proceedings Well in Advance of Hearings (2)
 - Adjust civil procedures to become essentially written procedures, with a hearing to orally discuss only the main arguments and evidence.
 - Adopt a rule that courts only have to make a decision on arguments that have been put in writing.
 - Exchange all written submissions between litigants before the hearing.
 - Introduce a formal timeline after the hearing for the judgment to be issued.
- 2.2 Ensure Consistency and Uniformity in Intellectual Property (IP) Decisions Throughout the Entire Judicial System by Asking IP Courts to Provide Clear Guidelines on IP Decisions to all Courts, and by Publishing Court Decisions (3)
 - Ask the IP Appellate Court or IP Courts to provide ordinary courts with clear, uniform guidelines and, by publishing decisions, generally spread knowledge to the local courts.
 - Consider publishing more cases in a free, online database maintained by the IP Tribunal of the Supreme People's Court, so that best practices can be disseminated and promptly adopted.
- 2.3 Further Define Scope of Evidences Required to Obtain Compensation Based on Damages as Suffered in Infringements Cases; Implement a System that Privileges Proportionate Compensations rather than Statutory Damages
 - Implement a mechanism that favours the awarding of proportional compensation over statutory damages in IP infringement matters:
 - Revise legislation to clarify the scope of evidences needed in order to prove 'illicit profits' or 'illegal gains' and/or 'actual damages' (and similar concepts) in infringement cases;
 - Issue relevant opinions, interpretations and/or guidelines in order to clarify the scope of evidence



needed for compensation as above, lower the burden of proof on the right holder and better define the scope of *prima facie* evidence.

- Make satisfactory compensation more attainable by right holders:
 - Modify relevant legislation or issue relevant opinions to better clarify that "the expenses to curb the infringement" to be liquidated in favour of the right holders shall also include "reasonable expenses for investigation";
 - Revise provisions within each relevant piece of legislation regarding statutory damages including multiples in order to more reasonably determine the amount to be liquidated, using Article 63 of the Trademark Law as a model;
 - Raise the threshold for statutory damages, especially regarding the relevant provisions of Article 49 of the Copyright Law, to at least as equal to the threshold set forth by other equivalent provisions on similar matters.

3. Trademarks

- 3.1 Create a Mechanism to Stay Proceedings until Invalidations, Oppositions and Non-use Cancellations are Dealt With
 - Create a procedure to stay trademark application examination procedures until all oppositions, cancellations and invalidations are dealt with.
- 3.2 Create a Right to Request the Cancellation of a Trademark that Becomes Infringing after Transformation in Practical Use (3)
 - Amend Article 49.1 of the Trademark Law so any person has the right to apply to the CNIPA to cancel a registered trademark if it becomes infringing after transformation.
 - Lower the threshold for a registered trademark to sue another registered trademark, and specify that an action may be based on Article 7 of the Trademark Law.
- 3.3 Allow the Applicant to Question and Reply on the Evidence Provided by the Trademark Registrant During the Revocation Examination Stage <a>2
 - Allow applicants to question and reply on the evidence provided by the trademark registrant during the revocation examination stage.
- 3.4 Take into Account the Size of the Inventory of Infringing Goods when Calculating the Amount of Damages in Trademark Infringement Cases (3) 2
 - Take into account the size of the inventory of infringing goods when calculating damages in trademark infringement cases.
- 3.5 Consider Internet Activity and Accessibility by the Chinese Market in the Determination of Pre-emptive Registration in Bad Faith
 - Consider internet activity and accessibility by the Chinese market in determining pre-emptive registration in bad faith.

4. Online IP Protection

- 4.1 Clarify the Liability for E-commerce Platforms on Intellectual Property Rights Infringement With Legislation 3
 - 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.

- Remove the 15-day limit for commencing formal actions against infringers specified in Article 43.
- Allow only one shop under one ID per person/company, upon whom lies the burden of proof that there is no IP infringement history.
- Require e-commerce platforms to establish an infringers blacklist, and ban those blacklisted from reopening shops.
- 4.2 Encourage E-commerce Platforms to Allow Proof of IP Other Than Chinese IP Certificates
 - Accept international trademark registration as sufficient proof of ownership of the trademark in e-commerce infringement proceedings.
 - · Apply an IP right established from one case to be used across all other cases immediately.

5. Trade Secrets

- 5.1 Clarify That "Serious Loss", as a Criminal Threshold for Initiating Criminal Enforcement of Trade Secrets or Confidential Information, is not Limited to Direct Loss or Actual Loss
 - Issue guidance providing more options to calculate the losses from the Supreme People's Procuratorate and the Ministry of Public Security.
 - Publish demonstration cases (with confidential information removed) showing how to calculate the losses in a criminal case by referring to the development costs invested by the right holder the amount of illegal income to be anticipated by the infringer, and a reasonable royalty fee from the People's Procuratorate and the High Court at provincial levels.
- 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 is involved.
- 5.3 Clarify the Standard for 'Prima Facie Evidence' in Civil Litigations under the Anti-Unfair Competition Law
 - Provide guidance to clarify the standards for *prima facie* evidence and rules of burden of proof transfer through judicial interpretation and sample cases.

6. Technology Transfer

- 6.1 Abolish the Overseas IPR Transfer and Review Pilot in order to Create a Fair Level Playing Field for European and Chinese Businesses
 - Abolish the overseas IPR transfer and review pilot in order to create a level playing field for European and Chinese businesses.
 - Elaborate on the current definitions of national security and national interest and give detailed explanations of the system of checks and balances in order to create a transparent system.
 - Provide for the Ministry of Commerce to give an overview of the process and the elaborated reasons based on the law to the European company on the reasons for blocking a takeover and/or technology transfer.



Introduction to the Working Group

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

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

Recent Developments

Opinions on Strengthening IP Protection

On 24th November 2019, the General Office of the Central Committee of the Communist Party of China (CPCCC) and the General Office of the State Council issued the *Opinions on Strengthening Intellectual Property Protection (Opinions)*.¹ This is the first time that the State Council in conjunction with the CPC issued such a declaration to call for improving IP protection. The *Opinions* urge for many things, including accelerating the revision of the Patent Law and the Copyright Law, improving Geographical Indications (GIs) legislation and implementing punitive damages.

2020 Implementation Plan

On 20th April 2020, the China National Intellectual Property Administration (CNIPA) issued its 2020–2021 Implementation Plan, which includes a list of 133 specific actions—including deadlines for many actions—to be taken to amend China's IP legislation and practice.² The highlights include recommendations to:

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- 1. Amend the Criminal Law to strengthen trade secret protection and strengthen law enforcement on trade secrets infringements.
- 2. Release a judicial interpretation by the end of August 2020 addressing online infringements.
- Issue new provisions of the Supreme People's Court (SPC) regarding the trial of administrative cases related to patent authorisation and confirmation by the end of August 2020;
- 4. Continue amending the Patent Law, to enable patent term extension, strengthen the protection of pharmaceutical patents and revise the *Patent Examination Guidelines*.
- Establish regular dialogues with chambers of commerce and conduct research on IP protection for foreign enterprises.

The European Chamber welcomes the initiative of this detailed action plan of the CNIPA and looks forward to the implementation of the items on the plan.

Legislative Developments

China's amended Trademark Law became effective on 1st November 2019.³ The new amendments include a crackdown on bad faith filings and raised statutory and punitive damages.

On 23rd April 2019, the Anti-Unfair Competition Law became effective, a positive development for trade secret protection.⁴ The amendments broadened the scope of infringing activities, expanded the definition and amount of liabilities, and shifted the burden of proof to the defendant.

The fourth revision of the Patent Law is still pending. The working group hopes to see the promulgation of the amended Law by the end of 2020.

Key Recommendations

1. Patents

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

Opinions on Strengthening Intellectual Property Protection, Central Government of the People Republic of China, 24th November 2019, viewed 26th April 2020, http://www.gov.cn/zhengce/2019-11/24/content_5455070.htm

^{2 2020-2021} Promotion Plan for Implementing 'Opinions on Strengthening Intellectual Property Protection', CNIPA, 20th April 2020, viewed 28th April 2020, http://www.sipo.gov.cn/zscqgz/1147678.htm

³ Trademark Law, National People's Congress (NPC), 7th May 2019, viewed 30th July 2019, <http://www.npc.gov.cn/zgrdw/npc/xinwen/2019-05/07/ content 2086832.htm>

⁴ Anti-Unfair Competition Law, NPC, 7th May 2019, viewed 30th July 2019, <http:// www.npc.gov.cn/npc/c30834/201905/9a37c6ff150c4be6a549d526fd586122. shtml>



Concern

Under the current practice in China, the patent office has very strict criteria for accepting post-filing data submitted by the 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 CNIPA's attitude towards post-filing data, reflected in the Patent Examination Guidelines, has been inconsistent.⁵ The current requirement for acceptance of post-filing data is much stricter compared to other countries/regions like the United States (US) or the European Union (EU). Although the latest version of the Guidelines recommend considering post-filing data, in practice, such data is rarely accepted in patent examination proceedings, patent invalidation proceedings or judicial proceedings.6&7 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. And it 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 than nowadays, which in turn will discourage patent owners from making further innovations.

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.
- · Ask the SPC to issue juridical interpretation to codify the standard, especially Article 11 in the latest SPC's draft juridical interpretation regarding post-filing data.
- 1.2 Exclude Chinese Patent Applications or Patent Assignments from Technology Exports and Simplify the Procedures

Concern

Current Chinese patent applications or patent assignments are categorised as a technology export 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 of the People's Republic of China on the Administration of the Import and Export of Technology, technology export means transfer of technology from China overseas through trade, investment or economic and technical cooperation. While Chinese patent applications or patent assignments are currently dealt with by the authorities as a technology export, they do not meet the requirements of the technology export because when a Chinese patent is transferred from a Chinese company to a foreign company, this patent 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 the 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 as a technology import. This non-equivalence causes confusion on technology export and import.

⁵ Announcement on Amending the Patent Examination Guidelines (No. 343), CNIPA, 31st December 2019, viewed 4th June 2020, <http://www.cnipa.gov.cn/ zfaa/1144989.htm>

⁶ 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 unconsularisated foreign evidence), which is unfair for innovative multinational companies

⁷ Provisions on Several Issues Concerning the Trial of Administrative Cases with Respect to Granting and Confirmation of Patent Rights (I) (Draft for Comment), Supreme People's Court, 28th April 2020, viewed 11th May 2020, <http://www. court.gov.cn/zixun-xiangging-227631.html>



Recommendations

- Amend the Regulations on the Administration of the Import and Export of Technology (Article 2.2) to exclude the 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.

2. Civil Litigation

2.1 Expand the Scope of Written Submissions, and Set Evidence Exchange Proceedings Well in Advance of Hearings

Concern

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

Assessment

IP enforcement by means of civil litigation reached a new all-time high in 2019. Chinese courts decided on 394,521 first instance civil IP cases, an increase of almost 40 per cent year-on-year.⁸ However, this significant increase in litigation has not been accompanied by an equivalent increase in judicial resources, meaning that courts in some jurisdictions have only a single day to conduct both the evidence exchange and the hearing on the merits. This clearly does not offer sufficient time to consider the often-complex issues arising in IP cases, and especially patent cases. Adjusting civil procedures to mainly written form will dramatically increase the efficiency.

Recommendations

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

2.2 Ensure Consistency and Uniformity in IP Decisions Throughout the Entire Judicial System by Asking IP Courts to Provide Clear Guidelines on IP Decisions to all Courts, and by Publishing Court Decisions (3)

Concern

While the expertise of China's IP court system is highly regarded, the same is not shared among the wider group of courts in China.

Assessment

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

Recommendations

- Ask the IP Appellate Court or IP Courts to provide ordinary courts with clear, uniform guidelines and, by publishing decisions, generally spread knowledge to the local courts.
- Consider publishing more cases in a free, online database maintained by the IP Tribunal of the Supreme People's Court, so that best practices can be disseminated and promptly adopted.
- 2.3 Further Define Scope of Evidences Required to Obtain Compensation for Infringement Based on Damages as Suffered and Implement a System that Privileges Proportionate Compensations rather than Statutory Damages

Concern

The law privileges the obtainment of compensation based on the degree of the IP infringement as perpetrated and/or damage as suffered instead of merely awarding statutory damages, yet, in practice, the scope of evidence to be presented is not clearly defined, the burden of proof on the right holder is high and practical difficulties in evidence collection may impair the right to obtain fully satisfactory compensation.

Assessment

Due to lack of clarity on the scope of evidence to be

⁸ Intellectual Property Protection by Chinese Courts (2019), Chinacourt Net, 21st April 2020, viewed 6th May 2020, <https://www.chinacourt.org/article/detail/2020/04/id/5049570.shtml>

presented and practical difficulties in collecting the same, judgments often award statutory damages rather than damages calculated on that suffered. In the legislation, the scope of evidence needed in order to prove 'illicit profits' or 'illegal gains' and/or 'actual damages' and so on, should be better detailed and specified.

Furthermore, a more reasonable application of the rules on the transfer of burden of proof must be implemented, in consideration of the difficulties to collect certain types of evidence, especially when the infringer operates in an abnormal way. Compensation as liquidated is proportionally lower if compared with the damages caused by the related violation. In addition, several expenses related to collecting the evidence are not fully accounted for. *Prima facie* evidence should be also better defined, and the SPC should guide this process through opinions, interpretations and guidelines. Relevant legislation should also be revised accordingly.

Due to the vague scope of evidence and difficulties in collection, the right to obtain satisfactory compensation is often impacted. In addition, statutory damages as set forth in the related laws are not sufficiently high. Even after recent amendments, statutory damages are still particularly low in cases of copyright infringement.⁹ Moreover, the maximum amount is not often awarded. Revision of the legislation should include determination of fixed criteria providing for multiples in awarding statutory damages upon certain conditions, to further standardise calculation and generally increase amounts as awarded in a more equal way. In this respect, Article 63 of the amended Trademark Law may serve as a model.

Recommendations

- Implement a mechanism that favours the awarding of proportional compensation over statutory damages in IP infringement matters:
 - Revise legislation to clarify the scope of evidences needed in order to prove 'illicit profits' or 'illegal gains' and/or 'actual damages' (and similar concepts) in infringement cases.
 - Issue relevant opinions, interpretations and/or guidelines in order to clarify the scope of evidence needed for compensation as above, lower the

burden of proof on the right holder and better define the scope of *prima facie* evidence.

- Make satisfactory compensation more attainable by right holders:
- Modify relevant legislation or issue relevant opinions to better clarify that "the expenses to curb the infringement" to be liquidated in favour of the right holder shall also include "reasonable expenses for investigation";
- Revise provisions within each relevant piece of legislation regarding statutory damages including multiples in order to more reasonably determine the amount to be liquidated, using Article 63 of the Trademark Law as a model;
- Raise the threshold for statutory damages, especially regarding the relevant provisions of Article 49 of the Copyright Law, to at least as equal to the threshold set forth by other equivalent provisions on similar matters.

3. Trademarks

3.1 Create a Mechanism to Stay Registration Proceedings Until Invalidations, Oppositions and Non-use Cancellations are Dealt With

Concerns

The registration time for trademark applications has been accelerated, whilst the time for invalidations/ cancellations has not, so when trademark applicants need to re-apply for trademarks, there is a possibility of someone else filing rejection appeals and lawsuits causing additional time and work for trademark applicants.

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.^{10&11} 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

⁹ Under Article 49 of the Copyright Law, the right holder may receive up to Chinese yuan (CNY) 500,000 in compensation. The recent draft amendments to the Copyright Law raised that amount to CNY 5 million.

¹⁰ 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>

¹¹ *Trademark Law*, SAMR, 20th April 2019, viewed 15th May 2020, <http://gkml. samr.gov.cn/nsjg/tssps/202004/t20200420_314426.html>



registration. When the examination time for registration was nine months, there was no problem, as 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.

In order to change this process, 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.

Recommendation

- Create a procedure to stay trademark application examination procedures until all oppositions, cancellations and invalidations are dealt with.
- 3.2 Create a Right to Request the Cancellation of a Trademark that Becomes Infringing after Transformation in Practical Use 3

Concern

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

Assessment

A solution for cancelling a trademark that becomes infringing after transformation is to sue the transformed trademark in court. However, this option is challenging due to two SPC judicial interpretations – Article 1.2 of the Provisions of the Supreme People's Court on Issues Concerned in the Trial of Cases of Civil Disputes over the Conflict between Registered Trademark or Enterprise Name with Prior Right and Article 11 of the Interpretation of the Supreme People's Court on Several Issues Concerning the Application of Law to the Trial of Cases of Civil Disputes over the Protection of Famous *Trademarks*.¹²⁸¹³ These articles provide that, where a registered trademark wishes to sue another registered trademark, it should seek the other's invalidation first unless under special conditions, such as in cases where the transformation of the trademark changes its distinctive character, or if it is a well-known trademark. Another obstacle is that Article 7 of the Trademark Law, which provides for the principle of good faith in filing and using trademarks, is considered only as a general principle which cannot serve as the sole basis for taking legal action.

Recommendations

- Amend Article 49.1 of the Trademark Law so any person has the right to apply to the CNIPA to cancel a registered trademark if it becomes infringing after transformation.
- Lower the threshold for a registered trademark to sue another registered trademark, and specify that an action may be based on Article 7 of the Trademark Law.
- 3.3 Allow Applicants to Question and Reply to Evidence Presented by the Trademark Registrant During the Revocation Examination Stage <a>2

Concern

When revocation is filed for an unused registered trademark, the CNIPA does not allow applicants to review the evidence of trademark use, which often results in cases being referred to the administration's Trademark Office for a second round of examination and prolonging the procedure.

Assessment

Many trademarks are filed without any intention of actually using them. This creates obstacles for those who wish to protect identical or similar trademarks, hence applications for trademark revocation are filed frequently to cancel these unused trademarks. However, during the revocation examination stage, current legislation does not support cross-examination of the evidence, leading to cases going to a second round of

¹² Provisions of the Supreme People's Court on Issues Concerned in the Trial of Cases of Civil Disputes over the Conflict between Registered Trademark or Enterprise Name with Prior Right, PKU Law, 18th February, 2008, viewed 10th June 2019, http://www.pkulaw.cn/fulltext_form.aspx?Db=chl&Gid=102085>

¹³ Interpretation of the Supreme People's Court on Several Issues Concerning the Application of Law to the Trial of Cases of Civil Disputes over the Protection of Famous Trademarks, Supreme People's Court, 10th February 2010, viewed 10th August 2020, <http://www.court.gov.cn/zixun-xiangqing-62>

examination, unnecessarily prolonging procedures.

Recommendation

- Allow applicants to question and reply to the evidence provided by the trademark registrant during the revocation examination stage.
- 3.4 Take into Account the Size of the Inventory of Infringing Goods when Calculating the Amount of Damages in Trademark Infringement Cases (3) 2

Concern

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

Assessment

In most IP infringement cases, the calculation of damages only takes into consideration the products sold by the infringer. The inventory is mostly not considered because it is argued that infringers do not make profit from it and the right holders do not suffer loss since the goods have not entered the market. However, in most cases, infringers claim that no products have been sold, even after being caught with a large inventory of infringing goods. While it is extremely hard for trademark holders to prove the amount of goods that have already entered the market, the size of the inventory actually reflects the sales amount in a certain way: if not caught, goods from the inventory would likely have entered the market.

Recommendation

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

3.5 Consider Internet Activity and Accessibility by the Chinese Market in the Determination of Pre-emptive Registration in Bad Faith 1

Concern

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

Assessment

Under Article 4 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. 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, Taking the case of MUJI in 2019 as an example,¹⁴ 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 Chinese Trademark Law, a trademark that is wellknown 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 32 of the Trademark Law could be expanded 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.

4. Strengthen Online IP Protection

4.1 Clarify Liability for E-Commerce Platforms on IPR Infringement Through Legislation (1)3

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 IP rights holders to notice and takedowns with e-commerce

¹⁴ 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 wellknown in China.



platforms in case of infringement on their platforms.¹⁵ However, Article 43 heavily reduces the liability of the platforms – the e-commerce platform's obligation is only passing on the information between both parties during an infringement complaint.¹⁶ 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 within 15 days.

In addition, Article 9 of the E-commerce Law outlines the liabilities of e-commerce business operators to display their business licence information. Article 10 exempts individuals conducting small deals from the liability of displaying a business licence. Article 17 outlines the responsibilities of e-commerce business operators to provide comprehensive and accurate information of the goods and services they provide. However, despite this, it is not easy for IP owners to either obtain this information or to locate repeat infringers, because, in order to protect their users' privacy, e-commerce platforms are unwilling to disclose such information in case legal action is taken. 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.

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.

- Remove the 15-day limit for commencing formal actions against infringers specified in Article 43.
- Allow only one shop under one ID per person/ company, upon whom lies the burden of proof that there is no IP infringement history.
- Require e-commerce platforms to establish an infringers blacklist, and ban them 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.¹⁷

Copyright, according to the Berne Convention, exists the moment a work is made, and China has created a copyright registration system in order to declare the holders of copyright recognised by the Chinese authorities, the China Trademark Office (CTMO) and the Trademark Review and Adjudication Board (TRAB), 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.

Recommendations

- Accept international trademark registration as sufficient proof of ownership of the trademark in e-commerce infringement proceedings.
- Apply an IP right established from one case to be used across all other cases immediately.

17 Chinese trademark certificates must be applied for separately after the trademark has officially already been registered in China.

¹⁵ E-commerce Law, MOFCOM, 31st August 2019, viewed 15th May 2019, <http:// www.mofcom.gov.cn/article/zt_dzswf/deptReport/201811/20181102808398. shtml>

¹⁶ 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 to relevant competent authority or bring a lawsuit before a People's Court. If the e-commerce platform operator has not received any notice within fifteen days as of the arrival of the forwarded statement at the IPR holder that the right holder has filed a complaint or lawsuit, it shall immediately stop the measures it has taken.

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5. Trade Secrets

5.1 Clarify That 'Serious Loss' as a Criminal Threshold for Initiating Criminal Enforcement of Trade Secrets or Confidential Information, is not Limited to Direct Loss or Actual Loss

Concern

Limiting 'serious loss' to direct and actual loss has made it extremely challenging for an IP right owner to request a criminal investigation or further indictment of trade secret theft in situations where the stolen production know-how has been used to make products not yet available in the market.

Assessment

Article 219 of the Criminal Law stipulates that whoever engages in activities that encroach upon commercial secrets and brings "significant losses" or "particularly serious consequences" to the right holders of the commercial secrets is to be sentenced to imprisonment, criminal detention, and/or fine.¹⁸ Under the *Regulations on Prosecution Standards for Economic Crimes (Regulations)* of the Supreme People's Procuratorate (SPP) and the Ministry of Public Security (MPS), a loss of more than CNY 500,000 triggers a criminal investigation.¹⁹

However, local enforcement agencies views on whether the loss should be limited to actual loss and how an IP right owner should prove amount differ. Under the *Regulations*, "direct losses of more than CNY 500,000" were confirmed as the threshold for prosecution.²⁰ However, in 2004, this threshold was replaced by "causing losses of more than CNY 500,000", where the word "direct" was dropped. Hence, under the existing law, the losses in criminal cases should include 'direct' and 'indirect' losses.

Although the definition of losses has broadened since 2004, in practice, the police or the procuratorate tend to focus only on direct losses. Such narrow reading of the losses as a criminal threshold contributes to severely insufficient protection of IP right owners. For trade secret theft cases involving production know-how or configuration of production equipment, it is difficult to show actual loss when the infringer started to use the know-how to build a plant or set up equipment to produce goods but has not yet sold any infringing products. The working group urges the SPP and the MPS to clarify that the loss as a criminal threshold is not limited to actual loss.

Recommendations

- Issue guidance providing more options to calculate the losses from the SPP and the MPS.
- Publish demonstration cases (with confidential information removed) showing how to calculate the losses in a criminal case by referring to the development costs invested by the right owner, the amount of illegal income to be anticipated by the infringer, and a reasonable royalty fee from the People's Procuratorate and the High Court at provincial levels.
- 5.2 Encourage the Public Security Bureau (PSB) to Take Active Measures Against Trade Secret Infringement and Allocate More Resources for Such Cases

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 holders are usually required to provide information on where the suspected infringer stores the trade secrets, which can be very difficult for the right owner. In addition, the PSB often delays or is reluctant to accept cases due to the complexity of trade secrets infringement case and the lack of resources.

The theft and misuse of trade secrets can lead to huge losses for the right owners, who mainly base their business on know-how. Such cases usually involve a former employee of the right holder. 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 work ethics in the society.

¹⁸ Criminal Law, MOJ, 14th February 2020, viewed 15th May 2020, <http://www.moj. gov.cn/subject/content/2020-02/14/1449_3241661.html>

¹⁹ Notice on Issuing the Provisions of the Supreme People's Procuratorate and the Ministry of Public Security on the Standards for Filing Criminal Cases under the Jurisdiction of the Public Security Organs for Investigation and Prosecution, Lawinfochina.com, 7th May 2010, viewed 15th May 2020, <http://www. lawinfochina.com/display.aspx?lib=law&id=8252&CGid=>

²⁰ Supreme People's Procuratorate, Ministry of Public Security Provisions on Prosecution Standards for Economic Crime Cases, Invest in China, 18th April 2001, viewed 15th May 2020, http://www.fdi.gov.cn/1800000121_23_67945_0_7. http://www.fdi.gov.cn/1800000121_23_67945_0_7. http://www.fdi.gov.cn/1800000121_23_67945_0_7.



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 where a former employee is involved.
- 5.3 Clarify the Standard of 'Prima Facie Evidence' in Civil Litigations under the Anti-Unfair Competition Law

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, but what "*prima facie* evidence" means is yet to be clarified and up for different interpretation by different courts and judges.²¹ 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 infringements, and the legality of such information 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 for prima facie evidence and rules of burden of proof transfer through judicial interpretation and sample cases.

6. Technology Transfer

6.1 Abolish the Overseas IPR Transfer and Review Pilot in order to Create a Fair Level Playing Field for European and Chinese Businesses

Concern

IP takeover review and technological transfer measures are unfair to European businesses.

Assessment

The State Council issued measures regarding a formal IP takeover review mechanism in March 2018.22 The Working Measures for Outbound Transfers of IPR (Pilot) (Measures) widen existing restrictions and impose a mandatory review by the Ministry of Commerce (MOFCOM) and the relevant authority when an IP transfer takes place. Since 2002, China has restricted technology imports and exports. However, the 2018 Measures subject IP to a security review in cases of merger and acquisition by a foreign party in China. The *Measures* assess the impact of tech transfers and acquisitions on China's national security and the national interest. Further clarification is needed on what constitutes the Chinese interest or a national security concern. At the moment, these Measures could allow China to potentially block the acquisition of Chinese companies by European companies on IP grounds.

European companies remain uncertain about how China will respond to a European company's IP. It is important to realise that China-based wholly foreignowned enterprises (WFOE) and joint ventures are both understood to be Chinese companies. As such, European companies that carry out research and development in China may not be able to transfer intellectual property (including patents and software) and technology to their European parent company.

Under the measures, MOFCOM can review all intellectual property-related takeovers, and can potentially stop a takeover from happening based upon national security and/or the national interest.

The working group is worried about these recent developments. It is currently difficult for a European company to take over a Chinese company, whereas the other way around is more straightforward. The *Measures* now make it even more difficult as an extra formal layer of protection is added.

The European Chamber welcomes the State Council announcement on 18th March 2019 that, in *Administrative Order 701*, the *Technology Import and Export Regulations (TIER)* was amended and Article 24.3, Article 27 and Article 29 were removed. It is, therefore, surprising that these pilot measures are now still formally

²¹ Anti-unfair Competition Law, NPC, 7th May 2019, viewed 12th May 2020, http://www.npc.gov.cn/npc/c30834/201905/9a37c6ff150c4be6a549d526fd586122.shtml

²² Working Measures for Outbound Transfers of Intellectual Property Rights (Pilot), State Council, 29th March 2018, viewed 15th May 2020, http://www.gov.cn/zhengce/content/2018-03/29/content 5278276.htm>

placed with a review of the relevant IP transfer.

The working group hopes China will avoid any protectionism in implementing the measures. Abolition of the regulations would be preferred by European businesses. In case abolition is not feasible, then clear and detailed implementation rules are necessary.

Recommendations

- Abolish the overseas IPR transfer and review pilot in order to create a level playing field for European and Chinese businesses.
- Elaborate on the current definitions of national security and national interest and give detailed explanations of the system of checks and balances in order to create a transparent system.
- Provide for MOFCOM to give an overview of the process and the elaborated reasons based on the law to the EU company with regard to the reasoning of blocking a takeover and/or technology transfer.

Abbreviations

| CNIPA | China National Intellectual Property |
|-------|--------------------------------------|
| | Administration |
| CNY | Chinese Yuan |
| CPCCC | Central Committee of the Communist |
| | Party of China |
| CTMO | China Trade Mark Office |
| EU | European Union |
| GI | Geographical Indication |
| IP | Intellectual Property |
| IPR | Intellectual Property Rights |
| MPS | Ministry of Public Security |
| NPC | National People's Congress |
| PRB | Patent Re-examination Board |
| PSB | Public Security Bureau |
| SAMR | State Administration for Market |
| | Regulation |
| SPC | Supreme People's Court |
| SPP | Supreme People's Procuratorate |
| TIER | Technology Import and Export |
| | Regulations |
| TRAB | Trademark Review and Adjudication |
| | Board |
| US | United States |
| WFOE | Wholly Foreign-Owned Enterprises |



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 16
 - Enhance the implementation of lending strategies to assist all SMEs—both European and Chinese—operating in China.
 - Increase incentives for the purpose of encouraging commercial banks to grant short-term overdrafts to SMEs facing temporary cash shortages.
 - Publish specialised credit risk assessment procedures or systems for providing both local and international SMEs with loans.
 - Encourage China to establish national funds for financing partnerships between European and Chinese SMEs.
 - Remove regulatory obstacles that limit SMEs', especially FIEs', access to credit financing by relaxing foreign exchange debt quota requirements.
- 2. Promote Coordination Between Different Administrative Departments and Improve the Transparency, Clarity and Integrity of All Relevant Regulations for SMEs 166
 - 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.
- 3. Reduce the Financial Burden of SMEs to the Greatest Extent Possible, Including Through Measures Like Ensuring Reasonable Payment Terms and Enforcing Timely Payments ()6
 - Issue guidelines and implement effective industry supervision measures to ensure that state-owned enterprises (SOEs) and private sector players respect contractual payment terms when dealing with SMEs.
 - Set a maximum payment term that is lawfully allowed to be included in contracts.
 - Encourage SOEs to sign contracts with SMEs that have reasonable payment terms.
 - Improve legal debt collection procedures.
 - Develop further implementing measures to encourage banks to provide financing solutions to SMEs based on accounts receivable.
 - · Continue to develop targeted measures that reduce the financial burden of SMEs.

- Promote the Value of Intellectual Property Rights (IPR) Protection and Enforcement Mechanisms at the Consumer, Business and Local Government Levels (1)5
 - Involve the general public and business community in awareness-raising campaigns to promote respect for IPR.
 - Strengthen enforcement of geographical indications (GIs) by the State Administration of Market Regulation (SAMR).
 - · Strengthen enforcement and consistency in the notice-and-take-down procedures.
 - Engage local enforcement agencies, customs and local courts to take effective action against counterfeiting.
 - Improve online access to IPR-related agencies in order to make it easier for SMEs to enforce their rights in a more affordable way.
 - · Further consolidate the Specialised Intellectual Property Court Pilot Programme.

Introduction to the Working Group

The Inter-Chamber Small and Medium-sized Enterprise (SME) Working Group was established in 2014 as a new 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 faced 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 greater than EUR 43 million.⁴ According to the European Commission's *Annual Report on European SMEs 2018/2019*, SMEs constitute the backbone of the EU's economy. In the non-financial business sector, they account for 99.8 per cent of the total number of businesses throughout the EU and 66.6 per cent of the sector's employment, as well as generating 56.4 per cent of the bloc's added value.⁵

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".⁶ 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 mediumsized 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.⁷

EU SME Projects in China Implemented by the European Chamber

The EU SME Centre (Phase Two) ran from July 2014 to April 2020. Its main objectives were: assisting European SMEs in establishing and developing a commercial presence in the Chinese market by providing EU addedvalue support services; improving corporate synergies and increasing best practice-sharing at the national and regional EU business association levels, with the

¹ About EU SME Centre, EU SME Centre, viewed 25th April 2020, http://www.eusmecentre.org.cn/about-centre>

² The Inter-Chamber SME Working Group Position Paper presents the recommendations of SMEs from all EU Member States, regardless of their membership status with the European Chamber.

³ EU SME Centre implementation partners and EU 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 2020, ">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eurouropa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eurouropa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32003H0361&from=EN>">http://eurouropa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:3203H0361&from=EN>">http://eurouropa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:3203H0361&from=EN/TXT/HTML/?uri=CELEX:3203H0361&from=EN/TXT/HTML/?uri=CELEX:3203H0361&from=EN/TXT/HTML/?uri=CELEX:3203H0361&from=EN/TXT/HTML/?uri=CELEX:3203H0361&from=EN/TXT/HTML/?uri=CELEX:3203H0361&from=EN/TXT/HTML/?uri=CELEX:3203H0361&from=EN/TXT/HTML/?uri=CELEX:3203H0361&from=EN/TXT/HTML/?uri=CELEX:3203H0361&from=SU0361&f

⁵ European Commission et al., Annual Report on European SMEs 2018/2019, European Union, November 2019, p. 11, https://op.europa.eu/en/publication-detail/-publication/ b6a34664-335d-11ea-ba6e-01aa75ed71a1/language-en/format-PDF/source-search>

⁶ Law of the People's Republic of China on the Promotion of Small and Mediumsized Enterprises, National People's Congress, 2017, viewed 26th April 2020, http://www.npc.gov.cn/zgrdw/npc/xinwen/2017-09/01/content_2027929.htm

⁷ Statistical Criteria for the Classification of Large, Medium, and Small Microenterprises (2017) [CN], National Bureau of Statistics, 1st March 2018, viewed 22nd April 2020, <http://www.stats.gov.cn/tjsj/tjbz/201801/t20180103_1569357.html>



ultimate goal of benefitting EU SMEs intending to do business in China; and strengthening advocacy efforts on behalf of the EU business community to help create a better business environment.⁸ In February 2020, the European Commission published a call for tenders for a new phase. It is expected that implementation of the new phase will start in the third quarter of 2020.

Another notable EU SME project in China is the China IPR SME Helpdesk, which supports European SMEs to both protect and enforce their intellectual property rights (IPR) in or relating to Mainland China, Hong Kong, Macao and Taiwan, through the provision of free information and services.⁹

Recent Developments

SMEs in China

SMEs play a very important role in China's economic and social development. Not only do they represent more than 99 per cent of all companies in China but they contribute to more than half of the country's 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.¹⁰

The highest numbers of European SMEs either investing, exporting or operating in China (or planning to do so) are from the food and beverage, commercial services, education, information and communication technologies (ICT) and healthcare sectors.

European Business in China Business Confidence Survey 2020

The European Business in China Business Confidence Survey (BCS 2020) is one of the European Chamber's key publications. The BCS 2020 was completed by a total of 626 European Chamber members, out of which 53 per cent had less than 250 employees in China. While the survey was taken in the early stages of the COVID-19 outbreak, and thus reflects the views of members before the crisis really hit, responses show that even then European SMEs were getting the short end of the stick compared to larger companies. They were the most negatively impacted by the economic slowdown in 2019, with only 46 per cent seeing increased revenue and 40 per cent experiencing higher earnings before interest and tax, compared to 56 per cent and 47 per cent of multinational companies (MNCs). Financing and market access issues and market access issues remain top concerns for SMEs, with only 36 per cent having benefitted from subsidies throughout 2019. Furthermore, almost half report having encountered unfavourable treatment by the government compared to domestic firms.

The 10th EU-China SME Policy Dialogue

On 25th July 2019, European Chamber and EU SME Centre representatives joined the 10th EU-China SME Policy Dialogue. Chaired by Kristin Schreiber, director of the European Commission's Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (DG GROW) and Zhang Feng, chief engineer, Ministry of Industry and Information Technology (MIIT), the dialogue touched upon recent policy developments relevant to both European and Chinese SMEs, including access to financing, late payments, innovation and SME internationalisation.

Regulatory Updates

· SMEs in China's key policy documents

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

• 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 2018.¹¹ The working group contributed with feedback throughout the entire drafting process of this law, and was pleased to note that some comments were incorporated into the final version. Throughout 2018 and 2019, a number of supporting regulations emerged.

⁸ About Us, EU SME Centre, viewed 12th April 2020, <http://www.eusmecentre.org. cn/about-centre>

⁹ About Us, China IPR SME Helpdesk, viewed 18th April 2020, <http://www.chinaiprhelpdesk.eu/content/about-hd>

¹⁰ Guo, Linmao, and Ma, Xianghui (Editors), People's Republic of China Small and Medium-sized Enterprises Promotion Law: Guidebook, China Democracy and Legal System Publishing House, Beijing, 2017, pp. 15–19.

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After the 2019 'Two Sessions',¹² the State Council issued the *Guiding Opinions on Promoting the Healthy Development of Small and Medium-sized Enterprises* on 7th April, in which topics such as improving the overall market environment, easing financing constraints for SMEs, strengthening financial and tax support for SMEs, encouraging SME innovation and improving service support were tackled.¹³ Additionally, in early 2019, stock-taking exercises for the implementation and enforcement of the SME Promotion Law were launched by both the MIIT and the National People's Congress (NPC). A special inquiry on the implementation of the Law took place on 28th June 2019,¹⁴ which looked into the progress made so far and pinpointed the areas where more work needed to be done.

COVID-19 and policies to support SMEs throughout the outbreak

The first months of 2020 were marked by the outbreak and spread—first in China and then globally—of COVID-19. The containment efforts carried out by China and other countries led to a number of unintended negative consequences, including supply chain disruptions, decrease in demand and forced interruption of production, among others. Predictably, SMEs were among the hardest hit groups.

European SMEs consulted in mid-February as part of a wider survey on the impact of COVID-19 on SMEs¹⁵ indicated that some of their main issues included a reduction in client orders, supply chain disruptions (especially with smaller suppliers) and liquidity/financing issues. Feedback from businesses in the service sector, such as consultancies, was particularly discouraging, with some projecting a 50 per cent reduction in their operating income compared to the same period in 2019. Surveys by Tsinghua and Peking universities in early February and April conducted on a wider sample of companies, as well as the information provided through government agencies such as the China Centre for the Promotion of SMEs, also painted a bleak picture for smaller companies—with one third of respondents unable to survive more than a month in the current circumstances—and largely coincided with the feedback from European SMEs.¹⁶ As the months go by, SMEs continue to fare worse than larger companies. For instance, data from mid-April 2020 showed that the rate of work resumption for SMEs was consistently lower than for MNCs.¹⁷

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 and financial support were rolled out and implemented through corresponding measures at the local level. Given the particular difficulties of smaller businesses, 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 Common *Problems*,¹⁸ which touched upon the following areas: encouraging financial and financing support; promoting the digitalisation and innovative development of SMEs; and improving public support initiatives for smaller business .

Key measures rolled out at the local level include the following:

- A reduction of tax and payment burdens through: delayed tax payments; an extension of preferential value-added tax (VAT) policies until 2023; the development of social security and welfare subsidies and preferential policies like prolonging the social security insurance payment period, or returning 50 per cent of unemployment insurance for 2019; and the suspension of enterprise charges.
- The development of financing support through: the establishment of preferential interest rates and discounts for special loans; the reduction of the guarantee rate; and the strengthening of rapidresponse mechanisms for financial institutions.

¹² The annual plenary meetings of the National People's Congress and the Chinese People's Political Consultative Conference.

¹³ Guiding Opinions on Promoting the Healthy Development of Small and Mediumsized Enterprises, State Council, 7th April 2019, viewed 17th April 2020, http://www.gov.cn/zhengce/2019-04/07/content_5380299.htm?mc_cid=9c9e233ad4&mc_eid=51671cb827>

¹⁴ 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/c30834/20190 6/58bef89b23b5468e8c647197365ba66c.shtml>

¹⁵ Questionnaire Survey for the Impact of New Coronavirus on Small and Mediumsized Enterprises, MIIT, 2nd February 2020, viewed 6th July 2020, http://www.miit. gov.cn/newweb/n1278117/n1648113/c7664045/content.html>

¹⁶ 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 2020, <https://www.mbachina.com/html/tsinghua/202002/214377.html>

¹⁷ Coronavirus: Getting China Back to Work, Trivium China, last updated 3rd June 2019, https://triviumchina.com/2020/03/07/coronavirus-getting-china-back-to-work/>

¹⁸ Notice on Responding to the Novel Coronavirus Epidemic Situation and Assisting SMEs to Resume Work, Re-produce and Resolve Common Problems, MIIT, 9th February 2020, viewed 22nd April 2020, <http://www.miit.gov.cn/n973401/ n7647394/n7647399/c7669722/content.html>



- Support for employment through: the provision of cash subsidies to institutions providing stable employment; and the subsidisation of training during the shutdown period.
- Reduced operational costs through: a three-month exemption of rent for facilities leased by state-owned stakeholders; rent subsidies or exemptions; and price reductions for electricity and gas for SMEs.

Additionally, the *2020 Work Report* set a series of targets and policies aiming at further supporting small businesses in the aftermath of the outbreak, ranging from extensions of tax exemptions to financing policies, most of which signalled a degree of continuity with previous measures.¹⁹

Recommendations

1. Provide European SMEs in China with Better Access to Financing 66

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. It is well-known that SMEs face different challenges when accessing financing compared to larger companies. China's slowing economic growth, coupled with the fact that European SMEs are facing increasingly fierce competition, China's slowing economic growth coupled with the fact that European SMEs are facing increasingly fierce competition, situations which have worsened as a result of the COVID-19 crisis, means that financing now plays an even larger role in business operations. 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 domestic companies tend to be preferred because of their closer relationships with local banks

The *Survey on the Access to Finance of Enterprises*,²⁰ published by the European Central Bank in May 2020, broke down the financing sources for European SMEs. Contrary to the situation in China, results show that access to financing was not a key issue for SMEs in Europe, even in the context of the COVID-19 outbreak. In fact, the survey showed it was the least of the respondents' concerns (only eight per cent of surveyed companies listed it as an issue).²¹ Furthermore, although less than a third of SMEs in the EU actually applied for a bank loan during the survey period, out of those that did, 67 per cent reported being successful in obtaining the full amount requested.

Compared to the variety of financial tools available to SMEs in the EU, China has limited options. For instance, in spite of the fact that China still dominates in online alternative financing, according to the Organisation for Economic Cooperation and Development 's (OECD's) report Financing SMEs and Entrepreneurs 2020, out of the seven stated policy instruments for SME and startup financing support. China has so far implemented four, while at the European level, there is an average of six.²² In the case of foreign SMEs based 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' this is 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 in theory possible, is extremely difficult for FIEs. Furthermore, data from the BCS 2020 shows that only 36 per cent of SMEs reported having benefitted from subsidies, highlighting the limited access of international businesses to Chinese Government financing.

The working group is aware of the steps taken by the Chinese authorities to tackle issues with SMEs' access

¹⁹ Report on the Work of the Government, Delivered at the Third Session of the 13th National People's Congress of the People's Republic of China, Caixin, 22nd May 2020, viewed 25th May 2020, <https://www.caixinglobal.com/upload/2020government-work-report.pdf>

²⁰ Survey on the Access to Finance of Enterprises, October 2019 to March 2020, European Central Bank, 8th May 2020, viewed 12th May 2020, 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 2020, <https://www.oecd-ilibrary.org/finance-andinvestment/financing-smes-and-entrepreneurs-2020_95dfdf1e-en>

to financing in the recent past. Throughout 2018, 2019 and 2020, multiple measures aimed at improving access to financing for small companies were released. These included increasing loans to SMEs by 40 per cent in 2020, postponing principal and interest repayments on loans,²³ repeated targeted cuts to reserve requirements for banks that are lending to SMEs, expanding the scope of refinancing policies and increasing tolerance for nonperforming loans.^{24&25} However, these measures have met with very limited success in the case of foreign SMEs.

The is an increasingly urgent need for more efficient means to promote access to financing for small companies due to the COVID-19 crisis. Data from the joint Tsinghua-Peking universities survey shows that a third of respondents were only able to last up one month in the circumstances, and 85.1 per cent would not survive more than three months.²⁶ Despite multiple efforts to step up financing support measures for SMEs throughout the crisis—efforts that were also reflected in the 2020 Government Work Report—400,000 companies closed permanently in the first quarter of 2020.²⁷ This is yet another clear indication of the need to improve existing measures and channels to support SMEs' access to financing, and perhaps to even consider developing new or alternative methods.

Recommendations

- Enhance the implementation of lending strategies to assist all SMEs—both European and Chinese operating in China.
- Increase incentives for the purpose of encouraging commercial banks to grant short-term overdrafts to SMEs facing temporary cash shortages.
- · Publish specialised credit risk assessment procedures

or systems for providing both local and international SMEs with loans.

- Encourage China to establish national funds for financing partnerships between European and Chinese SMEs.
- Remove regulatory obstacles that limit SMEs', especially FIEs', access to credit financing by relaxing foreign exchange debt quota requirements.
- 2. Promote Coordination Between Different Administrative Departments and Improve the Transparency, Clarity and Integrity of All Relevant Regulations for SMEs (6)

Concern

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

Assessment

The approval of the business scope for FIEs in China is subject to extensive scrutiny, being examined by the Administration of Market Regulation, the Ministry of Commerce (MOFCOM), and even more specific departments if special licensing is required. This timeconsuming process is especially difficult for smaller enterprises to navigate and can create additional costs for them, such as office rental. 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.

Case study: the HR Licence in South China

The application process for the HR License 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. On 31st December 2019, the Ministry of Human Resources and Social Security issued the *Decision on the Revision of*

²³ Report on the Work of the Government, Delivered at the Third Session of the 13th NPC of the PRC, Caixin, 22nd May 2020, viewed 25th May 2020, <https://www.caixinglobal.com/upload/2020-government-work-report.pdf>

²⁴ Guiding Opinions on Promoting the Healthy Development of Small and Mediumsized Enterprises, State Council, 7th April 2019, viewed 28th April 2020, <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 2020, http://english.gov.cn/premier/ news/2019/04/17/content_281476614548532.htm?mc_cid=d7c9acefac&mc_eid=51671cb827>

²⁶ Zhu Wuxiang, Liu Jun, 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 2020, https://www.mbachina.com/html/tsinghua/202002/214377.html

²⁷ Leng, Sidney, Coronavirus: Nearly Half a Million Chinese Companies Close in First Quarter as Pandemic Batters Economy, South China Morning Post, 6th April 2020, viewed 25th April 2020, https://www.scmp.com/economy/china-economy/ article/3078581/coronavirus-nearly-half-million-chinese-companies-closefirst?mc_cid=7e820f78bf&mc_eid=51671cb827>



Several Regulations (2019) (Decision),²⁸ which is supposed to lower entry barriers for wholly foreignowned enterprises (WFOEs) to obtain HR licences. However, on-the-ground research enquiries with relevant authorities in Shenzhen revealed that no authority is currently actively working on implementing this regulation.

According to the regulation in place before the publication of the *Decision*, it is almost impossible for a foreign-invested SME to apply for a HR Licence, as one of the requirements is 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.

To deal with such issues, more hotlines for public consultation should be opened. These hotlines must be operational, and the operator should be familiar with the processes or be able to redirect enquiries to relevant counterparts. Furthermore, an online application system would facilitate and accelerate the process. It is also important that such a system is mature, stable and responsive. 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 (instead of different procedures and requirements for each district and sub-district) is also necessary to 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 post-COVID-19. Thanks to a multiplicity of measures to improve the business environment rolled out in the past few years, foreign SMEs have reported experiencing an improvement in areas such as the shortening of the time required for registration and closing-down operations. These efforts to reduce the administrative burden of private enterprises have been acknowledged at an international level through China's considerable rise in the ranks of the World Bank's index on the ease of doing business in economies.²⁹ Nonetheless, according to the feedback of service providers and SMEs, the time required to set up a business is still longer than the targets set by the Chinese Government in 2018, let alone 2019 and 2020. These processes also take longer for foreign businesses than for domestic companies, partly because of additional requirements and partly because of the configuration of some of the systems, which do not take into account the specific situation of foreign business representatives.

The COVID-19 outbreak has not only brought to light inefficiencies that in the past might have gone unnoticed, it has created added difficulties for foreign companies. A case in point is the situation of SMEs' employees unable to return to China due to travel restrictions during the outbreak. Aside from the difficulties related to managing the activities of a company with employees or managers themselves unable to return to China, administrative procedures for which the offline presence of a legal representative or signatory is required are also rendered practically impossible. The inability to use online tools that are blocked in China only adds to these difficulties. This situation already has forced a sizeable number of European SMEs to close down their China operations. Although policy documents like the 2020 Government Work Report do provide for the relaxation of location restrictions on SME business registrations and the simplification of registration requirements for entrepreneurs, these measures only address part of the problem. The reality is that in most cases, foreign SMEs that have made the decision to leave China will not be able to take the risk to return in the short or mid-term. The working group therefore encourages the Chinese Government to take these challenges derived from or intensified by COVID-19-some of them specific to foreign companies-into account and act to enhance efficiency and prevent them reoccuring 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

²⁸ Decision of the Ministry of Human Resources and Social Security on Amending Some Regulations, Ministry of Human Resources and Social Security, 31st December 2019, viewed 22nd April 2020, <http://www.mohrss.gov.cn/gkml/zcfg/ bmgz/201912/t20191231_350233.html>

²⁹ Doing Business in China, World Bank, viewed 26th April 2020, <https://www. doingbusiness.org/en/data/exploreeconomies/china>

for SMEs by reducing the number of government approvals required and simplifying the remaining approval and filing procedures.

 Reduce the Financial Burden of SMEs to the Greatest Extent Possible, Including Through Measures Like Ensuring Reasonable Payment Terms and Enforcing Timely Payments ()6

Concern

It has become increasingly challenging for European SMEs to shoulder the financial burdens associated with doing business in China, which are exacerbated by liquidity problems due to an absence of maximum contractual payment terms, non-negotiable payment terms with SOEs or private sector players, and late/nonpayments from clients.

Assessment

Since access to financing is limited for SMEs in general, and international SMEs in particular, substantial reserve assets are a prerequisite for business operations in China. Usually, SMEs have limited bargaining power during negotiations for payments, which often result in customers imposing onerous contractual payment terms. In addition, many customers 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 that can be included in contracts (e.g. 30 calendar days if the customer is a public authority or state-owned company, or 60 days if the customer is a privately-owned company, subject to certain exceptions).³⁰ 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,³¹ and in the Supreme Court's *Interpretation on the Adjudication of Contract Disputes*,³² and relate to liquidated damages).

Debt collection services are available, but these are often not practical given the length of time it takes, and, most importantly, the high costs involved. China's Civil Procedure Law contains well-intended, lowcost summary proceedings for undisputed debts, but contains several flaws and is therefore seldom used in practice.33 In the past, well-intended articles in laws and regulations, such as the SME Promotion Law or in the various measures for optimising the business environment released at the national and local level, 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, indicating that SMEs are entitled to claim arrears and demand compensation from parties that pay late or default. However, 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 last among 19 countries surveyed in terms of payment delays. Another clear example of this lack of bite in regulations on late payments is the fact that, despite measures such as the creation of a platform where SMEs can report payment defaults from the government or SOEs,34 cases of late payments by SOEs continued to be reported by European SMEs.

However, this situation has changed in 2020. With regards to late payments by governmental entities, Premier Li Keqiang announced in the 2020 Government Work Report that a deadline would be set for government bodies to make overdue payments to SMEs. More importantly, Premier Li announced on 1st July that the State Council had approved a draft regulation aiming at tackling the issue of late payments. Among other things, the draft regulation sets standardised requirements on the payment period, specifies conditions that cannot justify refusing or delaying payments and addresses issues like contract signing, funding provision and means of payment for government departments, public institutions and large enterprises when dealing with

³⁰ For fixed payment periods in the EU, 30 calendar days are referenced when customers are a public authority and 60 calendar days are referenced when the customer is another company; this is done to determine when late interest payments can be claimed. The EU has further clarified this by publishing a table with the statutory interest rates for late payments, by country. *Late Payments Directive*, EUR-Lex, 16th February 2011, viewed 18th April 2020, https://eurlex.europa.eu/legal-content/EN/TXT/?qid=1413903005068&url=CELEX:32011L0007

³¹ 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 2019, http:// www.gov.cn/jrzg/2007-06/29/content_667720.htm>

³² 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>

³³ The major flaw is that while the debtor may not dispute the debt, they may refuse to pay and bring any claim that doesnot 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.

³⁴ Platform for SMEs to Report on Default Payments from Government Agencies and SOEs, MIIT, 3rd June 2019, viewed 22nd April 2020, <http://www.miit.gov.cn/ n1146290/n1146402/n1146440/c6987274/content.html>;companies can register for this platform through the following link: <http://www.sme-service.org.cn/>;companies can also register their complaints about arrears at the local level through local channels (for more information see <http://www.miit.gov.cn/n1146290/n1146440/c n1146440/c68837360/content.html>;additionally, it is recommended to directly address complaints to the State-owned Assets Supervision and Administration Commission.



SMEs. Additionally, the draft regulation also provides for the establishment of a public information disclosure system for late payments to SMEs.³⁵

Given the paramount importance of ensuring the cash flow of SMEs in the wake of the COVID-19 crisis, the working group welcomes this positive development in terms of developing specific measures to address late payments. Additionally, the working group notes that effective implementation to accompany clear and welldeveloped regulations will be key.

With regards to reducing the financial burden of small businesses—especially during the outbreak— European SMEs report that actions taken by the Chinese Government, such as the temporary suspension of enterprise charges, reductions or exemptions for tax payments and social welfare, and prolongation on social insurance payment periods, have been beneficial. Given the future challenges small companies will face due to the economic situation, the working group encourages the Chinese authorities to continue developing SMEspecific measures aimed at reducing their financial burden.

Recommendations

- Issue guidelines and implement effective industry supervision measures to ensure that SOEs and private sector players respect contractual payment terms when dealing with SMEs.
- Set a maximum payment term that is lawfully allowed to be included in contracts.
- Encourage SOEs to sign contracts with SMEs that have reasonable payment terms.
- · Improve legal debt collection procedures.
- Develop further implementing measures to encourage banks to provide financing solutions to SMEs based on accounts receivable.
- Continue to develop targeted measures that reduce the financial burden of SMEs.
- 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.³⁶

Assessment

The challenges related to protecting IP and the generally negative international perception associated with IPR in China deter many European SMEs from entering the Chinese market. Difficulties related to navigating the Chinese IP system pose a significant challenge for many European companies, as they struggle to uphold their reputation and return on investment for innovation in an environment where counterfeit products are sold online and offline, and bad-faith registrations of IPR are still commonplace. These phenomena not only discourage European investment in China but also cast a dark shadow over China's reputation. They can also prevent promising business relations between Chinese and foreign enterprises from developing further. For European SMEs, these challenges are further intensified due to their lack of knowledge on how the system operates and the scant amount of resources available to many.

Measures that can produce a general shift in the perception of IPR protection and enforcement are therefore recommended. Effectively enforcing IPR protection also creates a transparent environment for business transactions to take place and nurtures EU-China business relations through licensing, technology transfers and joint research and development activities. Effective enforcement of IPR not only protects companies, but also serves as a quality and safety guarantee for consumers.

One of the most positive developments related to IP in recent years was the establishment of the Specialised IP Courts Pilot Project and IP tribunals in various provinces in China. On 1st January 2019, an IP tribunal at the appellate level was officially established by the Supreme People's Court (SPC), which will centralise jurisdiction over appeals involving patent infringement/invalidation and other high-tech or antitrust IP disputes.³⁷

35 Premier Li urges timely payments for SMEs, State Council, 3rd July 2020, viewed

WS5efe70b4c6d05a0f8970691f.html>

6th July 2020, <http://english.www.gov.cn/premier/news/202007/03/content_

³⁶ For more information on IP issues affecting European businesses, please refer to the Intellectual Property Rights Working Group Position Paper.

³⁷ Ni, Zhenhua, China Established a Centralized IP Appellate Tribunal, China Law Insight, 15th January 2019, viewed 26th April 2020, https://www.chinalawinsight.com/2019/01/articles/intellectual-property/china-established-a-centralized-ip-appellate-tribunal/>

The establishment of internet courts in Hangzhou, Beijing and Guangzhou—which are able to process cases in connection to internet copyright ownership and infringement disputes—also has the potential to facilitate some IP-related dispute processes. In June 2018, the Hangzhou Internet Court for the first time accepted blockchain as a way of fixing copyright,³⁸⁸³⁹ and on 6th September 2018, the SPC confirmed that blockchain can be used—along with other means like electronic signatures—as a way of validating evidence.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.

In general, China's push for innovation and entrepreneurship has led to a significant improvement in IPR enforcement, as perceived by European companies. On the political front, there have also been a number of high-level statements regarding the protection of IP 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, go some way to addressing this by broadening the definition of an administrative body to include any "organisation empowered by any law or regulation to administer public affairs".43 However this is still far from an outright ban. Meanwhile, in the 2019 EU-China Summit Joint Declaration, both sides agreed that

"there should not be forced transfer of technology."⁴⁴ The working group expects that such a high-level statement will be followed by effective enforcement.

The EU-China Agreement on Geographical Indications (GIs), concluded in November 2019 and to be signed in the second half of 2020, marked an important step for the protection of GIs within the Chinese market, covering 100 key GIs. Although 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, research suggests that only a handful of EU GIs are likely to be affected.⁴⁵ Strengthening enforcement of GIs by the SAMR will be crucial to the success of the Agreement.

The E-Commerce Law, which came into effect on 1st January 2019, strengthens enforcement on e-commerce platforms by imposing joint liability of 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 don't consider the certificate as a basis to commence procedures, while in some cases bad faith copyright registration certificates facilitate trade mark infringements. Furthermore, the notice-and-take-down procedures allow for bad faith online sellers to provide a statement of not having committed an offense. Such statements mandate the platforms to end the measures taken against the seller unless the claimant starts administrative or legal actions within 15 days, imposing significant costs on the rights holders. These issues are further exacerbated by the consumers' and sellers' increased reliance on e-commerce due to the COVID-19 outbreak.

Trademark protection has been strengthened by the new Trademark Law which came into force on 1st November

³⁸ Tang, Shihua, Hangzhou Court Uses Blockchain-Based Evidence for First Time, Yicai Global, 30th June 2018, viewed 26th April 2020, https://www.yicaiglobal.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, China Court.org, 8th September 2018, viewed 22nd April 2020, <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 2019, http://tech.chinadaily.com.cn/a/201904/19/WS5cba56daa310e7f8b1577bf4.html

⁴² Foreign Investment Law, NPC, 18th March 2019, viewed 19th April 2020, <http:// www.npc.gov.cn/npc/c30834/201903/61017a8cf4d045ca9796990106b4406c. shtml>

^{43 &}quot;Administrative agencies (including an organisation empowered by any law or regulation to administer public affairs) and their staff members shall not force, whether explicitly or in a disguised form, foreign investors and foreignfunded enterprises to transfer technologies by administrative means such as administrative licensing, administrative inspection, administrative punishment, and administrative compulsion." *Regulation for Implementing the Foreign Investment Law of the People's Republic of China*, 31st December 2019, viewed April 26th 2020, <https://www.pkulaw.com/en law/bb7e08ee6f9a35f4bdfb.html>

⁴⁴ Joint Statement of the 21st EU-China Summit, EEAS, 10th April 2019, viewed 29th April 2020, <https://eeas.europa.eu/delegations/china_sk/60836/Jointper cent20statementper cent20ofper cent20theper cent2021stper cent20EU-Chinaper cent20summit>

⁴⁵ GIs identified as potentially problematic: Perigord, Szegedi teliszalami/Szegedi szalami, Prosciutto Toscano, Fontina, Munster, Nurnberger Bratwurste, 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 2020, <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 of the PRC, NPC, 31st August 2018, viewed 25th May 2020 http://www.npc.gov.cn/zgrdw/npc/lfzt/rlyw/2018-08/31/content_2060827.htm



2019, banning bad faith applications.⁴⁷ However, with evolving legislation, infringers have become more sophisticated, highlighting the need for more effective enforcement at state and local government levels.

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

Recommendations

- Involve the general public and business community in awareness-raising campaigns to promote respect for IPR.
- · Strengthen enforcement of GIs by the SAMR.
- Strengthen enforcement and consistency in the notice-and-take-down procedures.
- Engage local enforcement agencies, customs and local courts to take effective action against counterfeiting.
- Improve online access to IPR-related agencies in order to make it easier for SMEs to enforce their rights in a more affordable way.
- Further consolidate the Specialised Intellectual Property Court Pilot Programme.

Abbreviations

| BRI | Belt and Road Initiative |
|---------|------------------------------------|
| DG GROW | Directorate-General for Internal |
| | Market, Industry, Entrepreneurship |
| | and SMEs |
| EU | European Union |
| EUR | Euro |
| FIE | Foreign-invested Enterprise |
| FIL | Foreign Investment Law |
| GI | Geographic indication |
| | |

47 Trademark Law of the PRC, NPC, 7th May 2019, viewed 25th May 2020, <http:// www.npc.gov.cn/npc/c30834/201905/dacf65eec798444e821a1e06a347f3ee. shtml>

| ICT | Information and Communication |
|------|--------------------------------------|
| | Technology |
| IP | Intellectual Property |
| IPR | Intellectual Property Rights |
| MIIT | Ministry of Industry and Information |
| | Technology |
| MNC | Multinational Company |
| 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 |
| SOE | State-owned Enterprise |
| SPC | Supreme People's Court |
| VAT | Value-added Tax |

Investment Working Group

Key Recommendations

- 1. Ensure that the European Union (EU)-China Comprehensive Agreement on Investment (CAI) Guarantees Reciprocity (3)4
 - Enshrine the notion of reciprocity in the EU-China CAI, guaranteeing European businesses that have invested in China the same rights as Chinese businesses that have invested in the EU.
 - Address issues related to transparency, licensing and authorisation procedures, and provide a high level of protection for European investors in China, along with their investments.
- 2. Deliver Consistent and Proper Implementation of the New Foreign Investment Regime and Adhere to the Principle of National Treatment Across Government Levels
 - Continue to decrease 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, such as the adoption of the debt-to-equity ratio when procuring debt financing from overseas.
 - Permit FIEs to freely use or increase their registered capital to make domestic investments.
 - 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.

3. Enhance Market Competitiveness and Further a Level Playing Field, Including Overseas (1)4

- Acknowledge the decisive role that markets and private enterprises play in resource allocation.
- Draft and enforce rules that do not distinguish between state-owned and private entities.
- Ensure that state-owned enterprises (SOEs) act in accordance with commercial considerations such as price, quality and resource availability and do not discriminate on the basis of nationality, except when SOEs make a public service available pursuant to government mandates and in a non-discriminatory manner.
- Realise competitive neutrality across the country to break a system that favours state-owned enterprises over private enterprises.
- Ensure that the BRI becomes an open, transparent, and international initiative.

4. Streamline the Mergers and Acquisitions (M&A) Process for Inbound and Outbound Deals

- Reduce red tape throughout the M&A process.
- Grant foreign-invested enterprises (FIEs) national treatment in order to create a fair and level playing field for their investments in China.



5. Further Open China's Capital Market to Foreign-invested Enterprises 17

- 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

According to the World Investment Report 2019 issued by the United Nations Conference on Trade and Development (UNCTAD), China remains the world's second largest foreign direct investment (FDI) recipient after the United States (US) and before Hong Kong.¹ Data released by the Ministry of Commerce (MOFCOM) further shows that FDI into Mainland China surged 5.8 per cent year-on-year to Chinese yuan (CNY) 941.5 billion in 2019;² over 40,000 new foreigninvested enterprises were established in the country in 2019, while the number of foreign-funded projects with investment of at least US dollars (USD) 100 million reached 834, up 15.8 per cent year-on-year.³ Foreign investment continues to play a key role as one of the core contributors to China's economic growth, its integration in global value chains, and the creation of quality jobs.

The Investment Working Group's prime objective is to obtain beneficial change in China's investment environment for European business in terms of regulation and access, encompassing all kinds of foreign direct and portfolio investment. The working group's membership is comprised of mergers and acquisitions(M&A) professionals in large European corporations, private

3 Ibid.

equity and venture capital firms, and investment specialists involved in an advisory capacity.

Recent Developments

Foreign Investment Law (FIL)

On 15th March 2019, the FIL was approved by the National People's Congress and, on 1st January 2020, it came into force along with the *Regulation on the Implementation of the Foreign Investment Law (Regulation).*⁴ Although the final version of the law did take into consideration some of the feedback that the European Chamber provided during public consultation, concerns remain over vague wording and enforcement in practice.

The Investment Working Group acknowledges that the FIL plays an important role in formalising the legal foundation for the shift from the old foreign investment catalogue to the new-market access system based on a negative list, which is hoped will provide increased certainty for European businesses. At the same time, the working group maintains its original stance that there should be no legal distinction between foreign and local companies, unless it is to provide exceptions for legitimate reasons (for example, specific national security concerns). Since such a distinction has unfortunately come into effect with the FIL on 1st January 2020, the working group expects a clear work plan and timeline on



¹ World Investment Report 2019, UNCTAD, 12th June 2019, viewed 13th May 2020, https://unctad.org/en/PublicationsLibrary/wir2019_en.pdf>

² China Remains Key Destination for Investment, State Council Information Office, 22nd January 2020, viewed 13th May 2020, http://english.scio.gov.cn/ pressroom/2020-01/22/content_75639229.htm>

⁴ Foreign Investment Law of the People's Republic of China, State Council, 15th March 2019, viewed 24th April 2020, http://www.gov.cn/xinwen/2019-03/20/content_5375360.htm

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the cohesion among the FIL, its implementing measures and other amendments to Chinese legislation, and will actively monitor developments in the new regulatory framework.

Negative Lists

At the State Council executive meeting of 10th March 2020, the Chinese leadership announced that it would shorten the negative list on foreign investment and encourage financial institutions to increase foreign trade loans by deferring principal and interest payments.⁵ At the same time, to cushion the economic impact caused by Coronavirus Disease 2019 (COVID-19), the National Development and Reform Commission (NDRC) published a policy designed to stabilise and boost foreign investment, underscoring the efforts by the Chinese authorities to widen market access for foreign capital and to expand the catalogue of industries in which foreign investment is encouraged.⁶

On 24th June 2020, the State Council released an updated version of China's *Negative List for Foreign Investment*, which reduced the number of items on the national negative list from 40 to 33, and the number on the free trade zone (FTZ) negative entry list from 37 to 30.⁷ The revision also included a new mechanism that allows the State Council to selectively override the Negative List for Foreign Investment and permit specific foreign investors into the market upon approval.

The working group views the updated Negative List for Foreign Investment as another small step forward in China's reform and opening up agenda. While a welcome development, the removal of equity cap restrictions in banking and financial services remains incomplete and has come at a late stage in China's economic development. For this opening to be meaningful, other deeper, systemic reforms are needed that can bring new opportunities for European companies to enter the Chinese market or expand their footprint.

Furthermore, the working group sees the addition of a

mechanism for the State Council to override the *Negative List for Foreign Investment* through two different lenses. If the mechanism could be employed so as to enable ad hoc approvals for foreign investment into certain areas, it also risks heightening the increasingly politicised nature of doing business in China, which may result in companies suddenly finding themselves out of favour depending on the actions of their home-country governments.

European Union (EU) Foreign Direct Investment (FDI) Screening Mechanism

On 25th March 2020, the European Commission issued guidelines to protect critical European assets and technologies amidst growing concerns over foreign takeovers in the wake of COVID-19.8 Adopted in March 2019, the existing EU FDI Screening Regulation (Regulation) empowers Member States to review investments from non-EU countries on the grounds of security or public order, and to take measures to address specific risks.9 In light of the economic downturn caused by the pandemic, the Commission has stepped up efforts to strengthen the protection of critical European industries, calling on Member States to make full use of national defences against opportunistic takeovers and to prevent the current health crisis from resulting in a sell-off of Europe's business and assets, notably in the areas of health infrastructure, medical research and biotechnology.¹⁰

Key Recommendations

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

Concern

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

⁵ Li Keqiang Chairs Executive Meeting of State Council to Determine New Measures to Deal with Impact of the Epidemic and Stabilize Foreign Trade and Foreign Investment, State Council, 11th March 2020, viewed 26th April 2020, http://www.gov.cn/premier/2020-03/11/content_5489970.htm

⁶ Notice on Further Deepening Reforms and Foreign Investment Projects, NDRC, 11th March 2020, viewed 24th April 2020, https://www.ndrc.gov.cn/xxgk/zcfb/tz/202003/t20200311_1222902.html

⁷ Special Management Measures for Foreign Investment Access (Negative List), 2020 Edition NDRC and MOFCOM, 24th June 2020, viewed 6th July 2020, <http:// images.mofcom.gov.cn/www/202006/20200624145659916.pdf>

⁸ Guidance to the Member States Concerning Foreign Direct Investment and Free Movement of Capital from Third Countries, and the Protection of Europe's Strategic Assets, ahead of the Application of Regulation (EU) 2019/452 (FDI Screening Regulation), European Commission, 25th March 2020, viewed 8th May 2020, <https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf>

⁹ Coronavirus: Commission Issues Guidelines to Protect Critical European Assets and Technology in Current Crisis, European Commission, 25th March 2020, viewed 8th May 2020, <https://ec.europa.eu/commission/presscorner/detail/en/ IP_20_528>

¹⁰ Guidance to the Member States Concerning Foreign Direct Investment and Free Movement of Capital from Third Countries, and the Protection of Europe's Strategic Assets, Ahead of the Application of Regulation (EU) 2019/452 (FDI Screening Regulation), European Commission, 25th March 2020, viewed 8th May 2020, <https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf>



Assessment

Bilateral negotiations between the EU and China for a CAI started at the end of 2013,¹¹ with the 29th round of negotiations having taken place in late May 2020.¹² On 22nd June 2020, the 22nd EU-China Summit was held via video conference. Yet, unlike the 21st EU-China Summit of 9th April 2019, which culminated with the release of a joint statement pledging to conclude CAI negotiations by 2020 and to make significant progress regarding industrial subsidies as part of the EU-China 2025 vision,¹³ the 2020 Summit failed to produce a joint communique, and the overall tone of the event was not particularly encouraging to European companies in China. The working group notes several positive outcomes from the 2020 EU-China Summit, including the joint commitment to finally sign the Agreement on Geographical Indications to protect exports; pledges to continue CAI negotiations, with the goal of concluding it in a timely manner; and continued discussions on World Trade Organization (WTO) reform and upgrading. Despite these positives, the notable decrease in the number and depth of commitments made between the 2019 and 2020 summits cannot be ignored. While the continuation of constructive dialogue is critical to maintaining good EU-China relations, actual results are urgently needed to buoy business sentiment, which has deteriorated rapidly due to COVID-19-induced economic uncertainty.14

The working group hopes that CAI negotiations will continue with the aim of securing a robust agreement that creates an open market with a level playing field, especially between European and Chinese private companies on the one hand, and China's state-owned enterprises (SOEs) on the other. Particular focus should be placed on reciprocity by the Chinese side to open its domestic market to European investment, as it is still significantly closed, especially in comparison to the EU's. As well as providing for a high level of protection for European investors in China, CAI negotiations

- 12 Report of the 29th Round of Negotiations on the EU-China Comprehensive Agreement on Investment, European Commission, 29th May 2020, viewed 7th July 2020, <https://trade.ec.europa.eu/doclib/docs/2020/may/tradoc_158765.pdf>
- 13 Joint Statement of the 21st EU-China Summit, European Council, 9th April 2019, viewed 29th April 2020, https://www.consilium.europa.eu/en/press/ pressreleases/2019/04/09/joint-statement-of-the-21st-eu-china-summit/>
- 14 European Chamber Stance on the 2020 EU-China Summit, European Union Chamber of Commerce in China, 24th June 2020, viewed 24th June 2020, https://www.europeanchamber.com.cn/en/press-releases/3248/european_ chamber_stance_on_the_2020_eu_china_summit



should also focus on issues relating to transparency, licensing, certification, and authorisation procedures. For example, the current process in China to legalise documents (e.g., power of attorney) is both burdensome and time-consuming. Not only does this make foreign investment in China more difficult, it further weakens the position of Chinese companies in controlled auction processes of sale, which are more and more frequent in Europe.

Furthermore—even though government procurement is outside of the scope of the CAI negotiations—the EU should look to address the often-privileged position held by Chinese SOEs. The EU's International Procurement Instrument (IPI) could be a useful mechanism in achieving this end.¹⁵

Recommendations

- Enshrine the notion of reciprocity in the EU-China CAI, guaranteeing European businesses that have invested in China the same rights as Chinese businesses that have invested in the EU.
- Address issues related to transparency, licensing and authorisation procedures, and provide a high level of protection for European investors in China, along with their investments.
- 2. Deliver Consistent and Proper Implementation of the New Foreign Investment Regime and Adhere to the Principle of National Treatment Across Government Levels

Concern

The new FIL entered into effect on 1st January 2020, yet uncertainties remain over vague wording and enforcement in practice, while there still are restrictions imposed on foreign-invested enterprises (FIEs) under special laws that need to be removed.

Assessment

China's new FIL took effect on 1st January 2020, together with several related regulations and notices

¹¹ EU and China Agree on Scope of the Future Investment Deal, European Commission, 15th January 2016, viewed 29th April 2020, <http://trade.ec.europa. eu/doclib/press/index.cfm?id=1435>

¹⁵ IPI Legislative Train Schedule, European Parliament, 2019, viewed 29th April 2020, <https://www.europarl.europa.eu/legislative-train/theme-a-balanced-andprogressive-trade-policy-to-harness-globalisation/file-international-procurementinstrument-(ipi)>

that were issued at the end of 2019.¹⁶ Superseding a foreign investment regime in place for nearly 40 years, this new regulatory framework holds the promise of ushering in a new era of foreign investment in China.

Despite this encouraging development, China continues to differentiate foreign companies from Chinese ones in the field of investment. In fact, 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 would be guaranteed in the country. The Investment Working Group maintains that there exist no compelling reasons to regulate companies differently based on their ownership structure or nationality of the investors. By contrast, EU market economies do not have a special law treating foreign capital differently.

Furthermore, China continues to adopt a negative list system, which either prohibits or restricts foreign investment in certain industry sectors. Although the Chinese Government has once again demonstrated its resolve to ease market access by shortening the negative list as recently as June 2020, investors are concerned about how these changes will indirectly affect existing investments and other policies in force. Therefore, the Investment Working Group would welcome more clarity regarding the interpretation and implementation of such administration systems by individual ministries, and what avenue of recourse foreign companies may have if subject to unfair treatment.

The Investment Working Group considers it a welcome step that the FIL and its *Implementing Regulations* adopt the principle of granting national treatment in all major investment areas. In practice, however, FIEs are still encountering unequal treatment compared to their domestic competitors, particularly in government funding, land supply, and public procurement areas. The Investment 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 open questions raised by European investors during public consultation on the FIL over the past year, 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, as well as (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 the new foreign investment regime allows investors to use or increase the registered capital in their existing FIEs to have such FIEs 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 widespread 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 so far on projects pending review.¹⁷ To date, the working group is not aware of a single case of foreign inbound investment blocked by the Chinese authorities on NSR grounds.

In 2019, the NDRC took over from MOFCOM as the leading government agency to oversee NSR filings.¹⁸ As future M&As take place under the new FIL regime, the number of potential FDI transactions that could become

¹⁶ Among others: Regulation on the Implementation of the FIL of the PRC ('FIL Implementing Regulation'), State Council, 12th December 2019; Foreign Investor Information Reporting Measures, MOFCOM, SAMR, 30th December 2019; Notice Regarding Foreign Investor Information Reporting-related Matters, MOFCOM, 31st December 2019; Notice on Effective Work on Registration of FIEs for the Implementation of the FIL, SAMR, 31st December 2019; and Interpretation on Certain Issues Regarding the Application of the FIL, SPC, 26th December 2019.

¹⁷ Simple Guide to Deal with the National Security Review Procedure in China, Dentons, February 2020, viewed 4th June 2020, <https://www.dentons.com/en/ insights/articles/2020/february/14/simple-guide-to-deal-with-the-national-securityreview-procedure-in-china>

¹⁸ Ibid.



subject to NSR looks likely to increase going forward. This has European investors concerned that China may reintroduce new market entry restrictions through the back door.

The working group notes that the scope of the NSR is currently very broad and that the Chinese authorities have yet to issue an exhaustive list of sensitive sectors that fall under the NSR category. For example, the new FIL stipulates that a NSR should be undertaken for any foreign investment that affects or may affect national security. This leaves great discretion to the NDRC and creates considerable uncertainty for foreign investors, who face self-assessment and self-reporting obligations under the NSR regime. 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 there exists no public record of NSRs that were undertaken in the past.

Although the FIL prescribes that a NSR shall be initiated either (i) through self-reporting of the investor or (ii) by a complaint to the NDRC from a third party, the working group remarks that cases have been reported in which the NDRC itself requested investors to initiate a NSR.

Recommendations

- Continue to decrease 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, such as the adoption of the debtto-equity ratio when procuring debt financing from overseas.
- Permit FIEs to freely use or increase their registered capital to make domestic investments.
- 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 NSR cases being undertaken.

3. Enhance Market Competitiveness and Encourage a Level Playing Field, Including Overseas 34

Concern

China's SOEs continue to enjoy preferential treatment, both at home and overseas, to the detriment of the private sector.

Assessment

There are growing concerns that the role of private enterprises in China, along with the importance attributed to them by the Chinese Government, is decreasing. Chinese policymakers have always supported SOEs. However, over the past decade and with the latest COVID-19 stimulus package, SOEs have increasingly benefitted from local and central plans, including national Five-year Plans and strategic plans such as the Belt and Road Initiative (BRI). European businesses, along with Chinese private firms, are increasingly concerned over the resurgence of the state-owned economy.

It is estimated, for example, that in 2019 alone central and local SOEs accounted for about 40 per cent of the total number of enterprises in the country.¹⁹ Findings from the European Chamber Business Confidence Survey 2020 (BCS 2020)²⁰ are consistent with this figure; in fact, almost half of respondents believe that SOEs will gain opportunities at the expense of private companies in 2020, which is up seven percentage points since 2019. The COVID-19 pandemic is likely to exacerbate this problem further, with the government turning to SOEs as a source of stability in uncertain times, which will drain yet more resources from the private sector.²¹ The Investment Working Group notes that these competition-blunting effects are now also being exported overseas with the BRI, whose bidding processes are opaque and far too often reward SOEs. With Chinese SOEs dominating BRI-related projects in third countries and holding significant advantages in such areas as public procurement and access to financing and licences, international companies are effectively barred from competing.

¹⁹ China's SOE Reforms: What the Latest Round of Reforms Mean for the Market, China Briefing, 29th May 2019, viewed 14th May 2020, <https://www.chinabriefing.com/news/chinas-soe-reform-process/>

²⁰ Business Confidence Survey 2020, European Chamber, 10th June 2020, https://www.europeanchamber.com.cn/en/publications-business-confidence-survey

SOE Reform and Competitive Neutrality

The path toward COVID-19 recovery and China's successful transition from a labour-intensive export model to one that relies on advanced technologies and high value-added industries necessitate robust market competition to unlock the new drivers of growth. Yet rather than broad reforms encouraging private competition across China's entire market, European companies have so far seen the emergence of a 'one economy, two systems' model. Whereas some sectors have been opened up to foreign investors over time, China's key industries remain accessible only to stateowned players that control the majority of the market.²² Ushering in a true market economy, making the most of China's entrepreneurial potential, and ensuring a level playing field between all company types will prove crucial for China to drive growth post-pandemic.

The Investment Working Group believes that 'competitive neutrality'—the principle by which the government should provide equal treatment to all enterprises, regardless of ownership—would put an end to the preferential treatment granted to SOEs across the country, boosting confidence in China's market and, in turn, foreign investment.

BRI

China's BRI has been described as everything from the Chinese Marshall Plan to a tool for debt-trap diplomacy. Extensive commentary has analysed the BRI from political, economic, and strategic perspectives, and to understand the role of European business in BRI projects, the European Chamber produced a report assessing the initiative from a business perspective.²³ The Investment Working Group endorses the report's key finding, namely that only a small portion of European companies have been able to participate in BRI-related projects, while a slightly broader number have enjoyed positive effects as a result of the initiative, such as access to new logistics options and increasing trade flows with recipient countries.

The Investment Working Group regrets that the BRI has so far failed to become the open, transparent and international initiative that it often claims to be, as China's SOEs take the lead, and the bulk of the value, from BRI-related projects. This drives the need for alternatives to the BRI to emerge, such as the EU Connectivity Plan, which was announced in September 2018.²⁴

Recommendations

- Acknowledge the decisive role that markets and private enterprises play in resource allocation.
- Draft and enforce rules that do not distinguish between state-owned and private entities.
- Ensure that SOEs act in accordance with commercial considerations such as price, quality and resource availability and that do not discriminate on the basis of nationality, except when SOEs make a public service available pursuant to government mandates and in a non-discriminatory manner.
- Realise competitive neutrality across the country to break a system that favours state-owned enterprises over private enterprises.
- Ensure that the BRI becomes an open, transparent, and international initiative.

4. Streamline the Mergers and Acquisitions Process for Inbound and Outbound Deals

Concern

Too many administrative filings and complex steps are required in inbound and outbound M&A deals, creating unnecessary uncertainties during transaction processes.

Assessment

The regulatory regime governing acquisitions in China remains complicated and restrictive, and its application unpredictable. Foreign investors have to overcome a number of constraints under the *Provisions on M&A of Domestic Enterprises by Foreign Investors* ('M&A rules') only to be confronted with additional challenges, such as merger control filing and national security review. Likewise, Chinese outbound deals must also undergo the aforementioned filing procedures and, for a limited category of investments, approval by various regulatory authorities. Relaxing the process in whole would both reduce the level of risk during execution and level the playing field for investors.

²² Business Confidence Survey 2020, European Chamber, 10th June 2020, https://www.europeanchamber.com.cn/en/publications-business-confidence-survey

²³ The Road Less Travelled: European Involvement in China's Belt and Road Initiative, European Chamber, 16th January 2020, <https://www. europeanchamber.com.cn/en/publications-belt-and-road-initiative>

²⁴ Connecting Europe and Asia – Building Blocks for an EU Strategy 2018-19, European Parliament, 19th September 2018, viewed 3rd June 2020, https://www.europarl.europa.eu/legislative-train/api/stages/report/current/theme/europe-as-astronger-global-actor/file/connecting-europe-and-asia



The M&A Process

The working group acknowledges the steps taken to streamline M&A rules for foreign investors in recent years: administrative approvals have been reduced and filings have become more common as a result. Nevertheless, obtaining such regulatory approvals, as well as the timeline thereof, remain the core hurdles in the M&A process. These approvals are usually the last step in a transaction process and create unnecessary uncertainty for the parties involved.

Moreover, foreign M&As are not only regulated by a dedicated set of rules issued by MOFCOM, but also by the rules applicable to general FDI in China, such as the negative list and the new FIL.²⁵ The working group maintains that foreign investors established in China should not be subject to dedicated rules, but rather be treated at par with their domestic counterparts.

Recommendations

- Reduce red tape throughout the M&A process.
- Grant FIEs national treatment to create a fair and level playing field for their investments in China.

5. Further Open China's Capital Market to Foreign-invested Enterprises (1)7

Concern

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

Assessment

FIEs still face many access restrictions to China's capital markets – a situation that is detrimental to both them and the Chinese economy, 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.²⁶

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 the company's global business being required to become a domestic public entity. In the renovation 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 domestic entities as well as international businesses, and the replacement of many filing requirements in the field of FDI. It would also encourage foreign private equity investment in domestic companies, by facilitating 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 while leading to greater diversification from new, high-quality issuers. This would also be conducive to establishing the much-anticipated international board

²⁵ M&A Structures and Regulation in China, Davis Polk & Wardwell LLP, 29th October 2019, viewed 14th May 2020, https://www.lexology.com/library/detail.aspx?g=bec4ec08-6e79-4e8d-9413-51ab735d8ef5

²⁶ Establishing a Business in China: Overview, 2020 Thomson Reuters, 1st July 2019, viewed 14th May 2020, <https://uk.practicallaw.thomsonreuters.com/1-623-4945?__IrTS=20180527090715068&transitionType=Default&contextData=(sc. Default)&firstPage=true&bhcp=1#co_anchor_a635168>

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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, socalled '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,27 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 need to 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',²⁸ allowing enterprises reporting under other accounting standards-such as the International Financial Reporting Standards (IFRS)-to access the panda bond market without converting their financial statements to Chinese Generally Accepted Accounting Principles. This had previously been a requirement for foreign companies incorporated in other jurisdictions that report their balance sheets globally according to IFRS.

More recently in 2019, the PBOC took a further step in opening China's financial sector and improving 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 both strengthen compliance awareness by domestic rating companies and boost industry credibility.29&30

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 SAFE as far as account openings

and foreign remittances are concerned.³¹ 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

There have recently been some significant efforts made to internationalise China's debt capital markets, particularly with regard to the inclusion of Chinese bonds into global indices. The Investment Working Group approves of this trend. On 31st January 2019, Bloomberg confirmed that Chinese RMB-denominated government and policy bank securities would be added to the Bloomberg Barclays Global Aggregate Index starting from April 2019, and phased in over a 20-month period.32&33

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 assetbacked 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.

²⁷ 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 28th April 2020, <http://www pbc.gov.cn/goutongjiaoliu/113456/113469/3634126/index.html> 28 Ibid.

²⁹ NAFMII Issues Guidelines on Debt Financing Instruments of Overseas Non-Financial Enterprises (for Trial Implementation), NAFMII, 17th January 2019, viewed 28th April 2020, <http://www.nafmii.org.cn/english/lawsandregulations/ selfregulatory_e/201902/t20190201_75773.html>

³⁰ China Opens to Foreign Credit Raters to Boost Bond Credibility, Bloomberg, 27th February 2019, viewed 28th April 2020, <https://www.bloomberg.com/ news/articles/2019-02-27/china-opens-to-foreign-credit-raters-to-boost-bondcredibilitv>

³¹ 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 28th April 2020, <http://www. pbc.gov.cn/goutongijaoliu/113456/113469/3634126/index.html>

³² Bloomberg Confirms China Inclusion in the Bloomberg Barclays Global Aggregate Indices, Bloomberg, 31st January 2019, viewed 28th April 2020, https:// www.bloomberg.com/company/announcements/bloomberg-confirms-chinainclusionbloomberg-barclays-global-aggregate-indices/>

³³ Please note: neither the European Chamber nor its Investment Working Group have a position on the index providers mentioned or any other index providers. The mention in this paper is only meant for informational purposes



Abbreviations

| BCS | Business Confidence Survey |
|----------|--|
| BRI | Belt and Road Initiative |
| CAI | Comprehensive Agreement on Investment |
| COVID-19 | Coronavirus Disease |
| CSRC | China Securities Regulatory Commission |
| ECIPE | European Centre for International |
| | Political Economy |
| EU | European Union |
| EUR | Euro |
| FDI | Foreign Direct Investment |
| FICLS | Foreign-invested Company Limited |
| | by Shares |
| FIE | Foreign-invested Enterprise |
| FIL | Foreign Investment Law |
| IFRS | International Financial Reporting |
| | Standards |
| IP | Intellectual Property |
| IPI | International Procurement Instrument |
| IPR | Intellectual Property Rights |
| MOFCOM | Ministry of Commerce |
| MOF | Ministry of Finance |
| NSR | National Security Review |
| PBOC | People's Bank of China |
| RMB | Renminbi |
| UNCTAD | United Nations Conference on Trade |
| | and Development |
| WFOE | Wholly Foreign-owned Enterprise |



Legal and Competition Working Group

Key Recommendations

1. Continue to Strengthen the Rule of Law 1.

- Continue to focus on advancing the rule of law.
- · Continue to remove all unnecessary opening clauses from relevant legal documents.
- Ensure equitable, transparent, predictable and impartial implementation and enforcement of laws and regulations nationwide.
- Define further the scope of state secrets.
- · Permit foreign nationals to attend civil and commercial hearings in the People's Courts.
- Ensure prompt, comprehensive and correct enforcement of judicial decisions and arbitral awards, by providing enforcers and right owners with relevant information.
- Enhance compliance with terms and deadlines in court and administrative procedures, even with the provision of pecuniary sanctions and/or limitation and prescription periods.
- Standardise the public consultation process by publishing plans with sufficient lead time, providing
 public alerts on upcoming public consultations to facilitate input from chambers of commerce and
 other relevant organisations, allowing at least 60 days for comments to be provided on draft laws
 and regulations, publishing stakeholders' comments and regulators' feedback, and providing English
 translations of important regulations and rules.
- Promote initiatives to accelerate the process of codifying People's Republic of China (PRC) laws into a single document.
- Engage with the public, and take into account their feedback, on the revision of the Law on the Protection of Wild Animals before its promulgation.

2. Ensure Smooth Implementation of the Foreign Investment Law (FIL) and Its Implementing Regulations, and Minimise any Potential Negative Impacts on Foreign Business (3)2

- Formulate in a timely manner necessary implementation rules to clarify the uncertainties and ambiguities caused by the launch of the new FIL, particularly the gaps created by abolishing old laws.
- Adjust and consolidate all other pertinent laws and regulations to maintain alignment of the whole legal framework in the field of foreign investment, including green field investment and mergers and acquisitions (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 approach so that there is no further differentiation between Chinese and foreign investment, so as to ensure a level playing field and non-discriminatory access to the market.
- Clarify the requirements and terms of the investment review that requires approval, and remove conditional approvals.



3. Eliminate Restrictions on Foreign Legal Services (1)

- Allow foreign law firms to fully practice PRC law in non-contentious areas through the employment of individuals who are qualified and licensed to practice 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.

4. Adopt Regulations that Encourage Fair Enforcement of the Anti-monopoly Law (AML) (13)

- 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 (SAMR) and local Administrations for Market Regulation (AMRs).
- · Further clarify and refine the conditions in AML enforcement and judicial practice.

Introduction to the Working Group

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

Recent Developments

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

The Foreign Investment Law and its Implementing Regulations

On 15th March 2019, the National People's Congress

(NPC) adopted the Foreign Investment Law (FIL), followed by the roll out of the *FIL Implementing Regulations* on 26th December 2019, with both coming into effect on 1st January 2020.¹ The new FIL regime aims to streamline existing legislation by unifying the foreign investment framework in China. The FIL, the *FIL Implementing Regulations*² and other related rules play an important role in formalising the legal foundation for the shift from the old foreign investment catalogue to the new market access system based on a negative list. It also addresses some of the biggest challenges faced by foreign businesses, such as intellectual property rights (IPR) protection, participation in standards-setting activities and receiving equal treatment in government procurement activities.

¹ Foreign Investment Law, NPC, 15th March 2019, viewed 30th April 2020, http://www.npc.gov.cn/npc/c30834/201903/121916e4943f416b8b0ea12e0714d683.shtml

² FIL Implementation Regulations, State Council, 31st December 2019, viewed 31st July 2020, <www.gov.cn/zhengce/content/2019-12/31/content_5465449. htm?trs=1>

The State Council (SC) also released the *Regulations on Optimising the Business Environment* on 22nd October 2019. Taking effect on 1st January 2020, they are aimed at further optimising China's business environment.³

However, full implementation of the legislation, including various implementing regulations, will require both extensive follow-through from the administrative authorities at all levels of government, and full support of the legal system in cases where protections found within the FIL are not respected.

The Special Administrative Measures (Negative List) for the Access of Foreign Investment in Pilot Free Trade Zones (2020 Version) and the Special Administrative Measures (Negative List) for the Access of Foreign Investment (2020 Version)

On 23rd June 2020, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) jointly announced the latest negative lists for foreign investment for the free trade zones and nationwide.⁴ The 2020 version of both negative lists continued to expressly prohibit the provision of consultancy services for Chinese lawrelated matters (except for providing assistance in connection with delivering information on the impact that China's legal environment is having). Also, an investor of foreign identity is still not allowed to become a partner of a domestic law firm. The working group notes the absence of any improvements in this aspect for more than two decades.

Key Recommendations

1. Continue to Strengthen the Rule of Law

Concern

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

Assessment

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

Vagueness of laws and regulations: opening clauses

A lack of precision is an undesirable element in lawmaking. One of the vaguest parts of Chinese law, at all levels, is the 'opening clause' that appears in the articles of almost all normative documents.

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

³ Regulations on Optimising the Business Environment, SC, 22nd October 2019, viewed 30th April 2020, http://www.gov.cn/zhengce/content/2019-10/23/content_5443963.htm

⁴ NDRC and MOFCOM Release the 2020 Version of National Negative List and the Free Trade Zones Negative List for Foreign Investment, MOFCOM, 23rd June 2020, viewed 1st July 2020, http://www.mofcom.gov.cn/article/ae/ai/202006/20200602977244.shtml>



welcomes this new style of law-making and expects the relevant legislators and regulators to reform the entire legal system, adapting it so it complies with the rule of law.

Implementation of Laws and Regulations

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

State and Commercial Secrets

The foreign business community continues to be concerned about several PRC laws regarding state and commercial secrets. On one hand, foreign companies doing business in China want to fully comply with PRC laws in all of their activities. In this respect, the 2014 version of the Implementing Regulations to the PRC Law on the Protection of State Secrets has been disconcerting to foreign investors.⁵ Foreign investors and their advisors still lack sufficient legal certainty to fully understand the original and excessive scope of state secrets, in order to determine with confidence if they are in breach of such regulations. On the other hand, China saw significant developments in laws that address trade secrets. Introduced in 2017, China's Antiunfair Competition Law (AUCL) strengthened trade secret protection in civil and administrative proceedings. On 23rd April 2019, the Standing Committee of the NPC passed a bill amending the AUCL, with the newly introduced punitive damages rules and the shifting of the burden of proof in trade secret theft cases onto the infringer further enhancing protection for trade secret right holders.

Enforcement of Judgments and Awards

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

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

Terms and Deadlines

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

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

Court Judgments

European businesses welcome the increase in transparency and publicity of Chinese court judgments. They also appreciate the efforts that have been put into improving and expanding the websites of the Supreme People's Court (SPC) and local courts,^{6&7} through which a growing selection of court judgments has now been made available. However, the search capabilities and user-friendliness of these tools need to be further invested in and improved. Doing so would be beneficial to the entire business and civil community.

⁵ Implementing Regulations on the PRC Law on the Protection of State Secrets, Ministry Of Justice, 17th January 2014, viewed 30th April 2020, <http://www.moj.gov.cn/government_public/content/2014-02/07/593_202886. html>

⁶ Website of the SPC, Chinacourt.org, viewed 21st May 2020, <http://www. chinacourt.org/>

⁷ For example, Beijing local court's website, bjgy.chinacourt.org, viewed 21st May 2020, <http://bjgy.chinacourt.org/>

The publication of *Guiding Cases*⁸ by the SPC was also a very welcome step towards a developing a comprehensive approach to jurisprudence, and should contribute to more consistent interpretation and implementation of laws and regulations throughout the country's courts.

The amendment to Article 156 of the Civil Procedure Law is a positive development to the extent that it expressly guarantees the public the right to check and review effective civil judgments and rulings,⁹ except those involving state and commercial secrets and personal privacy. However, 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.

Official Publication of Laws and Regulations

Upon its accession to the WTO, China made a commitment to establish an official journal dedicated to the publication of all laws, regulations and other measures concerning or affecting trade in goods and services, or the Agreement on Trade-related Aspects of Intellectual Property Rights. This has been achieved to some extent through a website maintained by the Ministry of Justice (MOJ).¹⁰ However, this tool remains basic and is not user-friendly. The working group encourages the government to further invest in this tool by including professional search and hyperlinking features, and ensuring same-day publication of all laws and regulations. This would enhance the rule of law by providing greater accessibility to laws and regulations for both foreign and domestic enterprises, instead of them having to rely on costly commercial alternatives.

Public Consultation Process

Public consultation is a crucial element in the lawmaking process, as it facilitates the resolution of potential problems in the practical implementation of laws before their official promulgation, and therefore facilitates better legislation. Despite efforts to improve transparency and maintain the public consultation website by the MOJ, many ministries and commissions, especially at the provincial level and below, still do not allow for a period of at least 30 days for public consultation on draft regulations, despite it being committed to by China in the Interim Regulation on Major Administrative Decision-Making Procedures.¹¹ In addition, this public consultation process should be made more transparent by sharing with the public a working plan with sufficient lead time, providing alerts of forthcoming public consultation exercises. This could be accomplished, for example, by publishing an annual plan to be disclosed to the public 90 days before the start of a new year. This would allow the public, including chambers of commerce or similar associations, to provide input more effectively.

The working group would also like to encourage legislators to publish major contributions received from stakeholders on draft laws and regulations, together with feedback from regulators on the stakeholders' comments, in a manner similar to the European Commission website.¹² The current lack of transparency in China renders the current consultation process little more than a 'black box'. Even though China allows non-Chinese nationals to participate in public consultations on draft laws, foreign stakeholders may be discouraged from providing comments because no comprehensive assessment is provided when regulations are published in their final form.

Civil Code

China experienced a turning point in 2017 in its path towards creating a comprehensive Civil Code. On 15th March 2017, the NPC passed the *General Provisions of the Civil Code (General Provisions)*, which came into effect on 1st October 2017.¹³ The *General Provisions* constitute the first chapter of a broader project to regulate all aspects of civil law, namely property, contracts, right of personality, marriage, torts, family and inheritance. The other six chapters that compose the Civil Code have been adopted and promulgated by

⁸ SPC website, viewed 9th July 2020, <http://www.court.gov.cn/shenpangengduo-77.html>

⁹ Civil Procedure Law of the People's Republic of China (2012 Amendment), NPCSC, 31st August 2012, viewed 30th April 2020, http://www.npc.gov.cn/wxzl/gongbao/2012-11/12/content_1745518.htm

¹⁰ The MOJ public consultationwebsite (公开征求意见系统), viewed 21^{et} May 2020, <http://zqyj.chinalaw.gov.cn/index>

¹¹ Interim Regulation on Major Administrative Decision-Making Procedures, State Council, 8th May 2019, viewed 30th April 2020, http://www.gov.cn/ zhengce/content/2019-05/08/content_5389670.htm>

¹² The European Commission Consultations website, viewed 21st May 2020, ">https://ec.europa.eu/info/consultations_en?page=6>

¹³ General Provisions of the Civil Code, NPC, 15th March 2017, viewed 21st May 2020, <http://www.npc.gov.cn/zgrdw/npc/xinwen/2017-03/15/content_2018907. htm>



the 13th NPC in June 2020.¹⁴ The *General Provisions* regulate the basic principles of civil activities, i.e. natural persons' capacity, status and civil rights; legal persons and associations; civil legal acts; and agencies. The Legal and Competition Working Group welcomes the promulgation of the *General Provisions* and deems it a good sign regarding the modernisation of China's legal system. The promulgation and implementation of the entire Civil Code will help to provide European enterprises with more legal certainty when conducting business in China.

Pieces of Legislation Specially Supported by the Working Group

The working group is encouraged to see that the Legislative Affairs Commission of the NPCSC has listed the revision of the Law on the Protection of Wild Animals in its 2020 legislative work plan. The working group also strongly supports the NPCSC's decision on Thoroughly Banning the Illegal Trading of Wild Animals and Abolishing the Irrational Practice of Consuming Wild Animals to Effectively Safequard People's Life and *Health*.¹⁵ Both the legislative work plan and the decision demonstrate China's intent and its understanding of the need to protect both food safety and people's health, especially where such provisions prohibit hunting, transportation or trading of animals living in the wild, for edible purposes. The working group wants to engage in an open dialogue with the relevant authorities, and share its experiences on such matters.

Recommendations

- · Continue to focus on advancing the rule of law.
- Continue to remove all unnecessary opening clauses from relevant legal documents.
- Ensure equitable, transparent, predictable and impartial implementation and enforcement of laws and regulations nationwide.
- Define further the scope of state secrets.
- Permit foreign nationals to attend civil and commercial hearings in the People's Courts.
- Ensure prompt, comprehensive and correct enforcement of judicial decisions and arbitral awards, by providing enforcers and right owners with relevant

information.

- Enhance compliance with terms and deadlines in court and administrative procedures, even with the provision of pecuniary sanctions and/or limitation and prescription periods.
- Standardise the public consultation process by publishing plans with sufficient lead time, providing public alerts on upcoming public consultations to facilitate input from chambers of commerce and other relevant organisations, allowing at least 60 days for comments to be provided on draft laws and regulations, publishing stakeholders' comments and regulators' feedback, and providing English translations of important regulations and rules.
- Promote initiatives to accelerate the process of codifying PRC laws into a single document.
- Engage with the public, and take into account their feedback, on the revision of the Law on the Protection of Wild Animals before its promulgation.
- Ensure Smooth Implementation of the Foreign Investment Law (FIL) and Its Implementing Regulations, and Minimise any Potential Negative Impacts on Foreign Business (2)

Concern

Although the FIL and its implementing regulations have been effective since 1st January 2020, there is still a lot of room for improvements to 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, creating a level playing field, and expanding market access and opening-up. At the same time, the willingness of Chinese authorities to enhance foreign investment promotion, protection and management is welcomed. It has been a constant position of the European Chamber to support the needs of foreign-invested companies in order to avoid any discrimination between domestic and foreign players. This is the best way to provide a level playing field and non-discriminatory access to the market.

The FIL embodies China's positive intent to further promote reform and opening up, and protect foreign

¹⁴ Civil Code, NPC, 1st June 2020, viewed 8th June 2020, <http://www.gov.cn/ xinwen/2020-06/01/content_5516649.htm>

¹⁵ Thoroughly Banning the Illegal Trading of Wild Animals and Abolishing Irrational Practice of Consuming Wild Animals to Effectively Safeguard People's Life and Health, NPCSC, 24th February 2020, viewed 30th April 2020, <http://www.npc.gov.cn/npc/c30834/202002/ c56b129850aa42acb584cf01ebb68ea4.shtml>

investment, but it does not fundamentally abolish the distinction between foreign and domestic investment, making European businesses feel that genuine national treatment and a level playing field are far from guaranteed.¹⁶ The European Chamber believes there are no compelling reasons to regulate companies differently due to their ownership structure or by the nationality of the investors. By contrast, European Union (EU) Member States have adopted a market economy that does not have a special law specifically treating foreign capital differently. Considering China is now the world's second largest economy, and is increasingly sharing international responsibilities in more and more areas, real consideration should be given to fundamentally changing the existing foreign investment management approach in favour of a more confident and open attitude. In particular, this should entail ceasing to differentiate between Chinese and foreign investment.

The new FIL, while eliminating the three foreign direct investment (FDI)-related laws, is creating substantial uncertainties for all those that have established constructive and functioning governance models. Although the new FIL allows for a five-year transition period for those that need to adjust their governance models, via its implementing regulations, it imposes practical pressures on existing FIE projects to adapt to the new FIL by freezing their company registration procedures.

The new FIL addresses many key concerns of foreign investors, highlighting IPR protection, equal support policies, equal participation in government procurement, and pre-establishment national treatment and negative list management. However, many regulations under the new FIL—and to some extent substantiated by its implementing regulations—still require more detailed rules to ensure operability, as well as to link up with relevant laws and regulations to truly reflect the intention of the law. In this respect, the working group notes the positive move of the State Council on 2nd March 2019, when it deleted some restrictive technologytransfer-related provisions under the *Technology Import and Export Administrative Regulations* and the Implementation Regulations of the Chinese-Foreign Equity Joint Ventures 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 an un-discriminatory way, irrespective 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 FIL.

Interference with Other Existing Foreign Investment Laws and Regulations and Special Policies

Despite abolishing the previous three FDI laws, the FIL is silent regarding the validity of other foreign investment regulations, rules and policies that impose restrictions on only foreign investors (e.g. in the area of foreign exchange and financing). Such other regulations focus on areas such as re-investment of foreign-invested enterprises (FIEs) inside China; foreign-invested holding/investment companies; the administration of total investment, registered capital and foreign debt of FIEs; and mergers and acquisitions (M&A) by foreign investors in domestic enterprises.

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

Recommendations

- Formulate in a timely manner necessary implementation rules to clarify the uncertainties and ambiguities caused by the launch of the new FIL, particularly the gaps created by abolishing old laws.
- Adjust and consolidate all other pertinent laws and regulations to maintain alignment of the whole legal framework in the field of foreign investment, including green field 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.

¹⁶ According to the WTO, national treatment means treating foreigners and locals equally, i.e. imported and locally-produced goods should be treated equally – at least after the foreign goods have entered the market. (*Principles* of the Trading System, WTO, viewed 30th April 2020, <https://www.wto.org/ english/thewto_e/whatis_e/tif_e/fact2_e.htm>



- Consider fundamentally changing the existing foreign investment management approach so that there is no further differentiation between Chinese and foreign investment, so as to ensure a level playing field and non-discriminatory access to the market.
- Clarify the requirements and terms of the investment review that requires approval, and remove conditional approvals.

3. Eliminate Restrictions on Legal Services of Foreign Law Firms (199)

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 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. The working group is concerned that in the Negative List (2020),¹⁷ the provision of legal services remains in the 'prohibited' category. This does not reflect the strengthened market positioning of Chinese law firms in the global arena, as can be seen in their fast growth and expansion in European markets, as well as in other important jurisdictions outside Europe.

Further opening up the legal services sector—especially cooperation between foreign and Chinese law firms and the practice of non-contentious areas—in crossborder investments, would permit the clients of Chinese companies to have better access to the guidance of international laws and practices. It would also provide Chinese legal advice for foreign investors to operate in China. The working group would welcome progress in the following five areas:

1) Employment of Chinese-licensed Lawyers by Foreign Law Firms

Currently, when foreign law firms hire licensed PRC lawyers, those individuals' qualifications and licences to practise PRC law in non-contentious areas are suspended. Allowing Chinese-licensed lawyers to practice in foreign law firms operating in Mainland China will give those law firms' clients—both Chinese and foreign—faster, more cost-effective and efficient access to PRC law and international legal practice. It will also broaden the career prospects of PRC-licensed lawyers, allowing them to grow and gain expertise in an international environment, which will benefit Chinese investors abroad.

2) Participation of Lawyers from Foreign Law Firms in Meetings with the Chinese Government

Appearance, participation and representation by lawyers from foreign law firms (including PRC-licensed lawyers) before Chinese Government authorities and other public, non-judicial, authorities on behalf of their clients is permitted occasionally on a case-by-case basis. This lack of a transparent and consistentlyenforced 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 the Supervising Authorities

Foreign law firms in China would like to keep an open channel of exchange and discussion about not only foreign legal services, but also legal cooperation and exchanges between Chinese and EU lawyers through a direct dialogue with the MOJ at a central level.

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 registered firms in the EU, the working group values very much the guidance of, and dialogues with, EU supervision

¹⁷ NDRC and MOFCOM Release the 2020 Version of National Negative List and the Free Trade Zones Negative List for Foreign Investment, MOFCOM, 23rd June 2020, viewed 1st July 2020, <http://www.mofcom.gov.cn/article/ae/ ai/202006/20200602977244.shtml>

authorities at the central level, and would like to have such exchanges with the MOJ, and other competent Chinese departments at the central level. The working group deems such open channels vital to the legal profession, to enable valuable exchanges among professionals that are practicing the law in different areas, including private practitioners, in-house counsels, public administration and legislative bodies, either foreign or Chinese.

4) Access to Joint Venture (JV) Firms

The Closer Economic Partnership Arrangements signed between Mainland China and the Hong Kong and Macao special administrative regions in November 2015,^{18&19} indicate that China is committed to opening part of its legal market to Hong Kong law firms and Chinese permanent Hong Kong residents.

Further developments under the 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 (Pilot Work Plan) issued by the MOJ in 2014, and its implementing rules, have yet to be rolled out in other free trade zones.²⁰ While a few pilot JV firms have been established since 2015, such developments still appear quite limited, as existing rules only allow a 'one office, two teams' model and not a 'fully integrated JV model' that combines the strengths of the Chinese and foreign firms' partners.

In the 2020 Negative List,²¹ the provision of consultancy services on Chinese law-related matters remains prohibited. The Legal and Competition Working Group considers this to go against the publicly-stated intention to open up China's market. It puts foreign law firms at a competitive disadvantage compared to Chinese firms. Furthermore, the working group sees enforcement problems associated with the *2019 Negative List*, since some foreign lawyers (as foreign law firms and foreign investors) have decided not to register with the MOJ. They chose instead to practice Chinese law by either setting up foreign investment consulting companies or controlling smaller Chinese law firms that use a foreign brand.

5) Registration Procedures and Requirements

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

Recommendations

- Allow foreign law firms to fully practice PRC law in non-contentious areas through the employment of individuals who are qualified and licensed to practice 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.

Adopt Regulations that Encourage Fair Enforcement of the Anti-monopoly Law (AML) 13

Concern

Aspects of AML enforcement remain unclear, resulting in excessive levels of discretionary, and in some cases inconsistent, enforcement by the Chinese authorities.

¹⁸ Agreement on Trade in Services to the Mainland and Hong Kong Closer Economic Partnership Arrangement, Invest in China, 27th November 2015, viewed 30th April 2020, http://www.fdi.gov.cn/1800000121_23_72641_0_7. html>

¹⁹ Agreement on Trade in Services to the Mainland and Macao Closer Economic Partnership Arrangement, Invest in China, 2nd July 2007, viewed 30th April 2020, http://www.fdi.gov.cn/1800000121_23_59865_0_7.html

²⁰ Official Reply of the MOJ 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, China Shanghai Free Trade Zone, 27th January 2014, viewed 27th May 2020, <http://www.china-shftz.gov.cn/PublicInformation.aspx?GID=e86e7a98b9c0-4901-b874-d3eeee11b6d2&CID=953a259a-1544-4d72-be6a-264677089690&MenuType=>

²¹ NDRC and MOFCOM Release the 2020 Version of National Negative List and the Free Trade Zones Negative List for Foreign Investment, MOFCOM, 23rd June 2020, viewed 1st July 2020, <http://www.mofcom.gov.cn/article/ae/ ai/202006/20200602977244.shtml>



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 public consultation on the *Draft Amendments to the AML (Draft for Comments) (Draft)* on 2nd January 2020.²² The *Draft* does not envisage wholesale revision of the AML and, therefore, uncertainty remains among businesses regarding AML enforcement processes in 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 a mandatory option. However, in certain cases some companies had their illegal gains confiscated while others did not. The Draft introduces a new prohibition for organising or facilitating others to enter into anticompetitive 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 AML. The Draft suggests that anticompetitive conduct could be subject to criminal liability without specificity. In the area of merger control, the need for clear and transparent standards (e.g. definition of control), fairness and proportionality is more important than ever before, especially given the proposed increase of fine levels to up to 10 per cent of a business's turnover.

2) The '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 underlying concerns around the relative unpredictability of merger reviews, especially under the standard case procedure. The working group acknowledges the important progress that resulted from the creation of the 'simple case' procedure. This normally allows cases to proceed fairly quickly to acceptance, as the stakeholder process is done through the publication of a notice on the SAMR's website, which has also resulted in a higher level of transparency for businesses. The working group continues to encourage the SAMR to expand the benefits of this system to all kinds of merger cases. In particular, the SAMR should 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 issue of connecting administrative enforcement and AML enforcement through the courts. In particular, the *Draft* still leaves the divergence between administrative enforcement and judicial rulings on the treatment of resale price maintenance unsolved, which leaves businesses uncertain over which is the appropriate legal test to apply for.

4) The potential for discrimination between local and foreign firms. 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 (e.g. granting subsidies, or granting bank guarantees or loans on preferential terms to support overseas acquisitions or public procurement projects) meaning that foreign companies are not able to compete on an equal footing. In the area of merger control, the working group has observed that none of the interventions to date relate to domestic transactions; all interventions to date concern transactions between foreign companies, or where at least one of the parties is a foreign company.

5) The time allowed to notify different 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 Administrations for Market Regulation (AMRs) become more active in enforcing the AML, a centralised repository and timely

²² Notice on SAMR's Public Consultation on the Draft Amendmentsto AML (Draft for Comments), SAMR, 2nd January 2020, viewed 25th May 2020, http://www.samr.gov.cn/hd/zjdc/202001/t20200102_310120.html>

2020/2021

publication of local AMRs' measures or decisions are critical to ensure full compliance with the AML.

As a result, lawful business operators in China continue to face challenges and more companies are stepping up their demands for clarity and transparency. The absence of such 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 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 SAMR and local AMRs.
- Further clarify and refine the conditions for AML enforcement and judicial practice.

Abbreviations

| AML | Anti-monopoly Law |
|--------|--------------------------------------|
| AMR | Administration for Market Regulation |
| AUCL | Anti-unfair Competition Law |
| CPC | Communist Party of China |
| EU | European Union |
| FIE | Foreign-invested Enterprise |
| FIL | Foreign Investment Law |
| IPR | Intellectual Property Rights |
| JV | Joint Venture |
| M&A | Mergers and Acquisitions |
| MOFCOM | Ministry of Commerce |
| MOJ | Ministry of Justice |
| NDRC | National Development and Reform |
| | Commission |
| NPC | National People's Congress |
| PRC | People's Republic of China |
| SAMR | State Administration for Market |
| | Regulation |
| SOE | State-owned Enterprise |
| SPC | Supreme People's Court |
| WTO | World Trade Organization |



Research and Development Working Group

Key Recommendations

- 1. Encourage Foreign-invested Enterprises 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 <a>[Implication] 6
 - Establish a transparent, efficient and fair mechanism to facilitate Chinese-European R&D cooperation with participation by foreign companies in China.
 - Publish English-language versions of notices about R&D funds and grants applications and communicate them in a timely manner, with an appropriate response period allowed.
 - Remove restrictions that hinder multinational companies from applying for High and New Technology Enterprise (HNTE) status to ensure that all qualified enterprises can benefit from their participation in the Chinese innovation system.
- 2. Invest in Green and Sustainable Technology Development to Facilitate Relevant R&D Activities 15
 - Provide enterprises with additional incentives that focus on the long-term development of new breakthroughs on green technologies.
 - Pay continued attention and efforts towards green and sustainable development in the 14th Five-Year Plan and China-EU collaboration.
 - Facilitate the creation of pilot and demonstration areas for low-carbon and green technologies and their commercialisation.

3. Facilitate the Mobility of International Talent Between China and Foreign Countries 1

- Communicate policy advances actively via various channels such as industrial associations and organisations in a timely manner.
- Increase foreign enterprises' 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.

4. Facilitate Multinational Enterprises' Digital Innovation in China

- Publish a list of open databases that foreign enterprises could access, and clarify whether they can establish and manage independently their own public database.
- Issue policies to further elaborate on data protection rules.
- 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 plan for the local digital economy.

5. Strengthen Protection of R&D Including Intellectual Property-related Aspects to Foster a Business Environment that Enables World-Class Innovation in China 14

- Consult universities, foreign research institutions, and foreign and local companies' R&D departments while drafting new policies related to innovation and intellectual property 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 in order to avoid forced technology transfer or technology transfer difficulties.

I

Introduction to Working Group

Research and development (R&D) involves the innovation, promotion and improvement of products and processes, pushing the limits of technology and continuously improving technological products, services and solutions. Companies use their R&D to guickly respond to societal changes and market demands for the development of cutting-edge products, while also significantly improving the country's economic growth and ability to create jobs. R&D contributes to the development of emerging technologies, like artificial intelligence (AI) and the Internet of Things (IoT), which can be applied in various industries to improve people's lives, such as through increasing efficiency in manufacturing, improving diagnostic in healthcare and providing equal education for children living in remote areas. At present, innovation capability is regarded as key for China to avoid the middle-income trap and to enhance overall technological strength. The recommendations of the Research and Development Working Group in this position paper aim at improving the policy environment and thereby facilitating R&D activities of foreign-invested enterprises (FIEs) in China, eventually helping to boost the innovation capacity of China.

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, with the majority located in and around Beijing and Shanghai. Various industries are represented in the working group, including automotive, chemicals and petrochemicals, information and communications technology, aerospace, energy and pharmaceuticals. 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-focussed country. The 2019 Global Innovation Index, published by the World Intellectual Property Organization (WIPO), ranks China 14th out of 129 countries. China, among other middle-income economies, rose in importance both as targets for R&D-orientated foreign direct investment by multinational firms and as sources of new knowledge.²

In recent years, the Chinese Government at all levels has rolled out policy plans to stimulate R&D development in China. The importance of international stakeholders' participation is usually highlighted in the documents. The working group welcomes this development, but also regrets that, in many cases, implementation is rather slow and uneven across regions and industries.

MNCs play an important 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, collaborating with Chinese universities and academic laboratories. They are equipped with decades of experience and leadership in S&T that can help improve China's R&D ecosystem and domestic innovation capacity. While 40 per cent of respondents in the European Business in China Business Confidence Survey 2020 (BCS 2020) report that China's innovation and R&D environment is more or as favourable as the worldwide average,³ more can be done to improve the transparency of the process for granting incentives for innovation, to provide flexible access to global talent and to deliver greater legislative support.

Various innovation-specific policies and incentives have been implemented to stimulate innovation. For instance, the new Foreign Investment Law (FIL) took effect on 1st January 2020, of which Article 22 prohibits administrative bodies from forcing technology transfer

¹ Building a World Power in Science and Technology, Xinhua, 30th May 2018, viewed 18th April 2020, http://www.xinhuanet.com/politics/xxjxs/2018-05/30/ c 1122908666.htm>

² Global Innovation Index 2019, WIPO, 2019, viewed 23rd April 2020, <https:// www.wipo.int/publications/en/details.jsp?id=4434>

³ European Business in China Business Confidence Survey 2020, European Union Chamber of Commerce in China, 2020, p. 40, https://static.europeanchamber.com. cn/upload/documents/BCS_EN2020_final[774].pdf>



by administrative measures.⁴ However, this leaves the possibility for any non-administrative body to use other means to compel technology transfers. Instead, the FIL should simply prohibit forced technology transfer by any means. It is also notable that, in most cases, forced technology transfers do not take place through administrative means but are mostly disguised in a business context. On 26th December 2019, the State Council approved the *Regulation for Implementing the Foreign Investment Law* to further specify implementation of the law. The working group welcomes such progress and expects that the regulations will have a positive practical effect.

In the Guidelines on Promoting the Development of New Research and Development Institutions issued by the Ministry of Science and Technology (MOST) on 12th September 2019, new R&D institutions are encouraged to conduct projects with international companies and attract foreign talent.⁵ The working group praises the spirit of the guidance encouraging the R&D institutions to be actively engaged in international cooperation and expects to see a substantial realisation of this. Also In 2019, the State Council issued the notice of Promoting Innovation in State-level Economic and Technological Development Zones to Create a New Plateau for Reform and Opening-up, emphasising incentive policies provided to R&D centres based in China, including supporting financial services, talent policies and intellectual property rights (IPR) protection measures.⁶ The working group welcomes the attention that the Chinese government pays to the R&D sector in statelevel economic and technological development zones and recognises the importance of these supporting policies. The working group also hopes that these policies will be rolled out to other areas in China.

In April 2019, during the fourth European Union (EU)-China High Level Innovation Cooperation Dialogue, the European Commission and the MOST shared views on S&T collaboration and exchanged information about their latest plans and priorities. Both sides confirmed their intention to renew the EU-China S&T Cooperation Agreement.⁷ The EU side focused on the Horizon Europe proposal for 2021–2027, while the Chinese side promoted its Medium and Long Term S&T Development Plan for 2021–2035.⁸ 2020 marks the last year of the current EU-China Co-funding Mechanism on Research and Innovation for 2018–2020, intended to support joint research and innovation-related projects under the framework of Horizon 2020, but the working group believes that this project will be replaced by an even more efficient mechanism.

In late 2019 and early 2020, the outbreak of Coronavirus Disease 2019 (COVID-19) further stimulated the public's interest and industry's focus on R&D activities relating to vaccines and efficient treatment methods. The working group believes that the pandemic brings both risks and opportunities to the R&D sector: open databases and data-sharing platforms are expected to become a new standard to address common challenges. However, the catastrophic financial consequences of the pandemic may lead to a reduction in funding for the R&D sector.

Key Recommendations

1. Encourage Foreign-invested Enterprises to Contribute to China's R&D Operations by Optimising the Financial Incentives Framework as well as Improving International R&D Cooperation ()6

Concern

Compared with local Chinese enterprises, foreigninvested companies still face difficulties such as acquiring the status of High and New Technology Enterprise (HNTE), obtaining tax deductions, 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 superdeduction scheme for reducing costs) and 'tactical support' (focused grants for projects with a definite scope and target).

⁴ Summary of China's New Foreign Investment Law, NPCO bserver, 2019, viewed 29th March 2019, https://npcobserver.com/2019/03/15/summary-of-chinas-new-foreign-investment-law

⁵ Notice of Guidance on Promoting the Development of New Research and Development Institutions, MOST, 12th September 2019, viewed 22nd April 2020, http://www.most.gov.cn/mostinfo/xinxifenlei/fgzc/gfxwj/gfxwj2019/201909/t20190917 148802.htm>

⁶ 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 23rd April 2020,<http://www.gov.cn/zhengce/ content/2019-05/28/content_5395406.htm>

⁷ Joint Statement of the 21st EU-China Summit, European Council, 9th April 2019, viewed 13th April 2020, <https://www.consilium.europa.eu/media/39020/euchina-joint-statement-9april2019.pdf>

⁸ Fourth EU-China High Level Innovation Cooperation Dialogue – Joint Communique, European Commission, 9th April 2019, viewed 7th April 2020, https://ec.europa.eu/ research/iscp/pdf/policy/ec_rtd_joint_communique_icd4_2019.pdf>

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).⁹ Although certain requirements were somewhat relaxed, such as the minimum R&D expense ratio and academic qualifications of technical personnel, the requirements for intellectual property (IP) ownership were actually tightened. Under the revised rules, a global exclusive licence valid for at least five years is no longer required for obtaining the HNTE status; instead, the core IP needs to be owned by the applicant. FIEs run some of China's largest R&D operations. However, in many cases, although they are operating within China, their core technologies were originally developed outside of China, and 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 can jointly develop innovative technologies of common interest. However, the R&D working group found that there is 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 application materials into account, application and announcement periods are often extremely short, meaning there is very little time to translate documents and send to headquarters in Europe for input. At the same time, FIEs tend to have more limited access to grants due to language barrier and delays in communication this brings.

The working group welcomes the Chinese Government's commitment to allow international businesses 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*.¹⁰ For innovation, while funds are indeed 'catalysts' to development, talent and innovative culture or atmosphere matter as well.

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 applications and communicate them in a timely manner, with an appropriate response period allowed.
- Remove restrictions that hinder MNCs from applying for HNTE status, to ensure that all qualified enterprises can benefit from participation in the Chinese innovation system.
- 2. Invest in Green and Sustainable Technology Development to Facilitate Relevant R&D Activities (1)5

Concern

The government does not sufficiently support R&D activities relating 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.¹¹ In the 13th Five-year Plan, green development is highlighted as one of the fundamental principles under which China has set stringent goals for itself. According to the plan, China is set to revamp traditional manufacturing industries to adopt green technologies that can, for example, optimise waste heat recovery, recycle industrial water and reduce heavy metal pollution, as well as substitute harmful and toxic materials. Other goals include the adoption of green manufacturing systems, the promotion of eco-conscious products, and the establishment of green supply chains and logistics systems.

⁹ Regulation on the Determination and Administration of High and New-Technology Enterprise (2016 Revision), 2016, viewed 10th April 2020, http:// www.most.gov.cn/kjzc/gjkjzc/qyjsjb/201706/t20170629_133827.htm>

¹⁰ Notice of the State Council on Several Measures for Promoting Growth of Foreign Investment, Ministry of Commerce, 16th August 2017, viewed 30th April 2020, <http://www.mofcom.gov.cn/article/ae/ai/201708/20170802627851.shtml>

¹¹ China's National Plan on Implementation of the 2030 Agenda for Sustainable Development, Ministry of Foreign Affairs, September 2016, viewed 8th June 2020, https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/W020161014332600482185. pdf>



2020 marks the end of the 13th Five-Year Plan. Although China's emissions per unit of gross domestic product (GDP) in 2018 was already 45.8 per cent lower than in 2005,¹² and the share of non-fossil fuel energy in China had increased to 14.3 per cent by 2018,¹³ total coal consumption continued to increase in recent years, putting pressure on the realisation of the emission reduction target for 2020. To achieve its goal of seeing a peak in emissions by 2030, China has emphasised its commitment to developing clean energy, low-carbon technology, clean mobility and plastic recycling.¹⁴

The implementation and enforcement of new regulations that impose stricter environmental standards is a major instrument used by the Chinese Government to address environmental issues. Regulations include, for example, the revised Environmental Protection Law of 2015 and a green data centre evaluation system planned by the Ministry of Industry and Information Technology (MIIT) in 2019. The working group believes that these measures are beneficial but should be complemented by additional incentives that focus on the long-term development of new breakthroughs on green technologies.

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 successful rate 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. Given the determination and ambition of the EU to develop green technologies and reduce emissions within the next few years and the related advanced technology of European companies, the R&D working group expects to see more China-EU collaboration in this area.

Recommendations

• Provide enterprises with additional incentives that focus on the long-term development of new

breakthroughs on green technologies.

- Pay continued attention and efforts towards green and sustainable development in the 14th Five-Year Plan and China-EU collaboration.
- Facilitate the creation of pilot and demonstration areas for low-carbon and green technologies and their commercialisation.
- 3. Facilitate the Mobility of International Talent between China and Foreign Countries (6)

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 policy advances, such as visas for foreign interns and permanent residence for senior talent or longterm employees. The working group has taken note of China's efforts to alleviate administrative burdens and facilitate global talent mobility. In 2017 and 2018, a series of changes to the rules governing Chinese work permits and permanent residency status for foreigners were introduced and policies related to talent acquisition piloted in FTZs were rolled out nationwide in 2019. However, companies sometimes are not fully informed of the latest policy changes in a timely manner given the complexity of polices.

According to the BCS 2020, international talent acquisition was still one of the top three issues hampering China's R&D environment for respondents. Internal mobility programmes across borders are commonly developed by MNCs to provide professional opportunities for their employees. Yet FIEs operating in China have limited authority to hire international talent. A simple measure, such as allowing these companies to issue a list of personnel to be invited and accordingly simplify their visa application process in cooperation with relevant government departments, would be helpful.

Currently, the Chinese visa policy favours senior foreign talent 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 have difficulty obtaining a visa. However, joint R&D



¹² The 2019 Annual Report on China's Policies and Actions on Climate Change, Ministry of Environment and Ecology, November 2019, viewed 20th April 2020, http://www.mee.gov.cn/ywdt/hjnews/201911/W020191127531889208842.pdf>

¹³ China Energy Development Report, China Electric Power Planning and Engineering Institute, 28th April 2019, viewed 20th April 2020, <http://www.cinic. org.cn/hy/ny/513137.html>

¹⁴ For more information, please see the *Environment Working Group Position* Paper.



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. For example, defining what qualifies as a "well-known domestic enterprise" that is allowed to hire foreign interns, while rules such as "only Fortune 500 companies can hire qualified foreign interns"¹⁵ could be changed to giving this right to the top 100 companies in each sector. Offering a favourable and stimulating environment for R&D talent is essential for generating innovative ideas and making them commercial successes.

Recommendations

- Communicate policy advances actively via various channels such as industrial associations and organisations in a timely manner.
- Increase foreign enterprises' 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.

4. 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 information technology (IT) standards demotivate international companies from carrying out IT R&D in China.

Assessment

The Measures for Managing Scientific Data,¹⁶ the first national-level policy on data management issued by the State Council, includes a brief guideline for scientific data management and sharing, emphasising the establishment of data management systems, publications and open catalogues of scientific data and data-sharing services. But data privacy and other limitations to data access are defined too vaguely; for example, Article 25 states "scientific data involving national secrets, national security, societal public interests, commercial secrets and privacy are forbidden to be shared publicly."¹⁷ Meanwhile, though China has made certain progress in improving data protection based on the guideline,¹⁸ the working group believes that further elaboration of data protection regulations is necessary.

While effective regulations to protect data privacy are necessary, access to open data resources and the freedom to create and manage databases stimulate companies' innovation. So far, the Chinese authority has not issued regulations on this regarding FIEs, and the working group expects to see clearer guidelines.

Further harmonisation of Chinese and international IT standards is also expected. 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,¹⁹ most of China's standard-setting bodies currently only allow very limited participation by international businesses.²⁰ Aligning rules with the international community would help to raise the international profile of China's R&D capacity and improve the reputation of Chinese products in international markets.

Article 15 of the Notice to Promote Innovation in Statelevel Economic and Technological Development Zones to Create a New Plateau for Reform and Opening-up (Notice)²¹ encourages all kinds of capital to invest in IT infrastructure in state-level economic and technological development zones to promote the development of digital economy. The working group welcomes the Notice and hopes that these policies will be rolled-out nationwide.

Recommendations

· Publish a list of open databases that foreign enterprises

17 Ibid.

¹⁵ The National Immigration Administration Promotes the Replication of 12 Policies on Immigration and Immigration Facilitation in the Free Trade Zones Nationwide, Ministry of Public Security, 17th July 2019, viewed 20th April 2020, https://www.mps.gov.cn/n6557558/c6613913/content.html

¹⁶ Notice of the General Office of the State Council on the Measures for Managing the Printing and Distributing of Scientific Data, State Council, 17th March 2018, viewed 18th April 2020, <http://www.gov.cn/zhengce/content/2018-04/02/ content_5279272.htm>

¹⁸ The Latest Progress of Scientific Data Management and Opening in China, Cyberspace Administration of China, 21st July 2019, viewed 20th April 2020, http://www.cac.gov.cn/2019-07/21/c_1124779769.htm

¹⁹ Regulation for Implementing the FIL of the People's Republic of China, State Council, 26th December 2019, viewed 28th April 2020, http://www.gov.cn/ zhengce/content/2019-12/31/content 5465449.htm>

²⁰ For more information, please see the Standards and Conformity Assessment Working Group Position Paper.

²¹ 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 28th April 2020, http://www.gov.cn/zhengce/ content/2019-05/28/content_5395406.htm>



can access, and clarify whether they can establish and manage independently their own public database.

- Issue rules and regulations to further elaborate on data protection rules.
- 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 plan of local digital economy.

5. Strengthen Protection of R&D Including IP-Related Aspects to Foster a Business Environment that Enables World-Class Innovation in China

Concern

Despite continuous improvements to China's IP protection system, international businesses still encounter difficulties in protecting their IPR related to the innovation process, inventions and research, negatively influencing 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,²² growing innovation-driven enterprises, and promoting highquality economic growth, where international businesses developing new technologies are making significant contributions to China's economic transformation. Despite a significant improvement in European companies' perceptions of the innovation ecosystem in China in the past few years, 37 per cent of respondents in the BCS 2020 still see IP protection as unfavourable or very unfavourable.²³

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 academic, scientific and private sectors should be all consulted in order to pinpoint the most suitable solutions to protect and foster innovation.

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 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)*,²⁴ which is 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. 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 system²⁵ 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.²⁶ According to the *Science and Technology Progress Law*²⁷ 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

²² Opinions of the Supreme People's Court on Comprehensively Strengthening the Judicial Protection of Intellectual Property Rights, Invest in China, 15th April 2020, viewed 1st June 2020, <http://www.fdi.gov.cn/1800000121_23_75409_0_7. html>

²³ European Business in China Business Confidence Survey 2020, European Union Chamber of Commerce in China, 2020, pp. 41-42, <https://static.europeanchamber. com.cn/upload/documents/documents/BCS_EN2020_final[774].pdf>

²⁴ Administrative Decree No.709, State Council, 2nd March 2019, viewed 20th April 2020, <http://www.gov.cn/zhengce/content/2019-03/18/content_5374723.htm>

²⁵ For more information, please see the Intellectual Property Rights Working Group Position Paper.

²⁶ External Transfer of Intellectual Property Rights Measures (Trial Implementation), State Council, 18th March 2018, viewed 18th April 2020, http://www.gov.cn/ zhengce/content/2018-03/29/content_5278276.htm>

²⁷ Science and Technology Progress Law, Standing Committee of the National People's Congress, 29th December 2007, viewed 20th April 2020, http://www.gov.cn/ziliao/lffg/2007-12/29/content_847331.htm

projects that receive Chinese state funding require: 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 issued to a Chinabased entity.

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 in order to avoid forced technology transfer or technology transfer difficulties.

Abbreviations

| AI | Artificial Intelligence |
|------|--------------------------------------|
| BCS | Business Confidence Survey |
| CNY | Chinese Yuan |
| EU | European Union |
| EUR | Euro |
| FIE | Foreign-invested Enterprise |
| FIL | Foreign Investment Law |
| FTZ | Free Trade Zone |
| HNTE | High and New Technology Enterprise |
| IoT | Internet of Things |
| IP | Intellectual Property |
| IPR | Intellectual Property Rights |
| IT | Information Technology |
| MIIT | Ministry of Industry and Information |
| | Technology |
| MNC | Multinational Corporation |
| MOF | Ministry of Finance |
| MOST | Ministry of Science and Technology |
| NPC | National People's Congress |
| OECD | Organisation for Economic Co- |
| | operation and Development |
| 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

- 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 13
 - Ensure proper notification of all mandatory standards, technical regulations and conformity assessment procedures, including administrative licensing, that may impact market access.
 - Limit the scope of technical regulations and mandatory standards to issues related to the protection of environment, health and safety, in accordance with the WTO/TBT Agreement.
 - Provide English versions of the notified documents.
- 2. Review Mandatory Market Access Requirements, Including the Simplification of Testing and Certification Procedures 13
 - 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 (1)13

- 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.

4. Continue the Current Reform of the Chinese Standardisation System and Increase Harmonisation Efforts (1)5

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.

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 industry 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.

Enterprise standards

- · Clarify the definition of 'enterprise standards'.
- Clarify the disclosure or format requirements for enterprises, and limit the scope of the selfdeclaration mechanism to mandatory national standards adopted by enterprises.
- · Improve the enterprise standards online service platform.
- 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.

5. Ensure Fair and Transparent Market Surveillance 13

- Align market surveillance and market access requirements.
- Limit market surveillance to compliance with laws, regulations, mandatory standards and certification schemes.
- Allow commercial organisations that meet accreditation requirements to join market surveillance.

Quality and Safety Services Sub-working Group

- 1. Improve Market Access for Foreign-invested Testing, Inspection and Certification (TIC) Agencies
- 1.1 Accelerate the Revision of the Regulations on Certification and Accreditation (1)2
 - Accelerate the revision of the *Regulations on Certification and Accreditation*, taking into account feedback from enterprises on the updated draft before promulgation.

1.2 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.

1.3 Allow Foreign-invested TIC Agencies to Provide Container Inspection Services

 Open the container inspection market to ship inspection agencies from all member states to the International Convention for Safe Containers, and allow foreign-invested ship inspection agencies to carry out container surveys.

2. Furthering Reforms for a Market-orientated TIC Industry

- 2.1 Adopt Market-based Mechanisms to Reform Government-affiliated TIC Agencies and Avoid a Second Monopoly Through Administrative Support (1)7
 - Implement market mechanisms to avoid rent-seeking and monopolistic behaviour during the reform of government-affiliated TIC agencies.
 - Reduce excessive and unclear market entry barriers, and use international norms for assessment.
 - Provide equal treatment to international TIC agencies so that they enjoy the same market status as their domestic peers.





- 2.2 Allow Non-public Institutions to Qualify to Provide Special Equipment Testing and Inspection Services (3)2
 - Allow non-public institutions to apply for special equipment testing and inspection qualifications and participate in the periodic inspection of special equipment.
- 2.3 Remove the Inspection of Imported Bulk Commodities from the Catalogue of Entry-Exit Commodities Subject to Inspection and Quarantine by Exit-Entry Inspection and Quarantine Institutions (Catalogue)
 - Accelerate the process of cancelling statutory quality assessments for other imported bulk cargo and allow third-party testing and inspection agencies designated by international trade parties to provide quality assessment services.

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 (ICT) and machinery. It contains the Quality and Safety Services Sub-Working Group. The working group aims to support the development of China's SCA systems in order to facilitate China's integration into the world economy. As China opens its door wider to the world, standardisation and conformity assessment 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 aims to reform the overall standards systems and mechanisms for standardisation management. The reform timeline was divided into three stages, and it is currently in its last stage (the *Division of the Key Tasks for the Implementation of the Plan for Deepening the Reform of Standardisation Work (2019–2020)* was published on 19th April 2019).¹ Reforms have led to a number of developments:

• Building an effective and authoritative standardisation coordination mechanism

During the 2018 plenary sessions of the National People's Congress and the Chinese People's Political Consultative Conference (Two Sessions), 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.

• Streamlining mandatory standards, and optimising recommended and industry standards

The work of streamlining and consolidating mandatory standards has continued to move forward since 2017. On 17th October 2018, the SAMR launched a public consultation on its draft *Administrative Measures for Mandatory National Standards*,² which were published on 17th January 2020.³ The Standards and Conformity Assessment Working Group is pleased that a number of its comments were taken into account in the final version, and will continue to provide feedback on the implementation of the regulation.

Throughout 2019, the SAC released four batch

¹ 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 20th April 2020, <http://gkml.samr.gov.cn/nsjg/bzjss/201904/ t20190419_293018.html>

² Notice from the General Office of the State Administration for Market Regulation on Soliciting Opinions on the Administrative Measures for Mandatory National Standards (Draft for Comment), SAC, 17th October 2018, viewed 15th April 2020, http://www.sac.gov.cn/szhywb/sytz/201810/t20181018_343098.htm

³ Administrative Measures for Mandatory National Standards, SAMR, 13th January 2020, viewed 20th April 2020, <http://gkml.samr.gov.cn/nsjg/fgs/202001/ t20200113_310467.html>

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plans on recommended national standards, with a total of 1,270 formulated standards and 736 revised standards.⁴ On 31st March 2020, the First Batch Plan on Recommended National Standards introduced the revision of 121 standards and the formulation of 311. According to April 2020 data from the Seconded European Standardisation Expert in China (SESEC), the number of mandatory national standards had been reduced to 2,100, while at the time there were still 35,287 recommended national standards.⁵

The SAC's *Key Areas for Standardisation Work in China in 2020* is aimed at further improving the mandatory national standards management system by strengthening the implementation and enforcement of existing regulations. The document also mentions optimising the management of recommended standards. Regarding industry standards, the document promotes better integration between different standards, enhancement of the review process and substitution of industry standards in general products and services with social organisation standards.⁶

Cultivating and developing social organisation standards

According to *Guofa [2015] No. 13*, China encourages associations, federations, unions, industrial technology alliances and other social organisations to develop standards that meet market demands.⁷ Following this mandate, social organisation standards (also known as association standards) were granted legal status in the revised China Standardisation Law. On 15th December 2017, the former AQSIQ and the SAC jointly published the *Provisions on the Administration of Social*

Organisation Standards (For Trial Implementation).⁸ On 9th January 2019, the Ministry of Civil Affairs and the SAC issued the *Provisions on the Administration* of Social Organisation Standards, which set the basis for social organisation standards by stipulating, among other things, that the technical requirements should not be lower than those for mandatory standards, and that this category of standards should fill the gaps left by other standards and meet market needs for innovation.

A search through the national social organisation standard information platform in April 2020 showed that the number of registered groups was 3,213, a 69 per cent increase over the previous year,⁹ and the standards had doubled to 14,360.¹⁰

According to the *Key Areas for Standardisation Work in China in 2020*, associations should take the lead in drafting relevant standards for general products and services, and replace industry standards in these areas. Given the situation with COVID-19, the regulations also encourage associations to develop standards related to epidemic prevention and control. The document also promotes the participation of associations in international standardisation activities.

• Easing restrictions to, and allowing more room for, enterprise standards

In 2018, an enterprise standard 'top runner' system was established in order to encourage enterprises to proactively set and implement advanced standards.¹¹ This system materialised with the issuing of the *Opinions on Implementing the Enterprise Standards* 'Top Runner' System (Opinions) by the SAMR, the National Development and Reform Commission (NDRC), the Ministry of Industry and Information Technology (MIIT) and five other regulatory agencies. According to the *Opinions*, through the self-declaration scheme for enterprise standards, third party institutions will assess the quality of different enterprise standards

⁴ Notice of the National Standardisation Administration on the Issuance of the First Batch Plan on Recommended National Standards, SAC, 1st April 2019, viewed 15th April 2020, <http://www.sac.gov.cn/szhywb/sytz/201904/l20190401_343484. htm>; Notice of the National Standardisation Administration on the Issuance of the Second Batch Plan on Recommended National Standards, SAC, 8th July 2019, viewed 22nd April 2020, <http://www.sac.gov.cn/sbgs/sytz/201907/ P020190715517120413892.pdf>; Notice of the National Standardisation Administration on the Issuance of the Third Batch Plan on Recommended National Standards, SAC, 17th October 2019, viewed 22nd April 2020, <http://www.samr. gov.cn/bzjss/tzgg/201910/P020191030305654280112.pdf>; Notice of the National Standardisation Administration on the Issuance of the Fourth Batch Plan on Recommended National Standards, SAC, 31st December 2019, viewed 22nd April 2020, <http://www.samr.gov.cn/bzjss/tzgg/202001/P020200115340115198364. pdf>

⁵ Updates to China's Standards, SESEC, 20th April 2020, viewed 21st April 2020, https://www.sesec.eu/updates-of-chinas-standards/>

⁶ Key Areas for Standardisation Work in China in 2020, State Council, 24th March 2020, viewed 20th April 2020, <http://www.gov.cn/zhengce/zhengceku/2020-03/24/ content_5494968.htm>

⁷ Notice of the State Council on Printing and Distributing the Report Plan for Deepening the 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 2020, http://www.ttbz.org.cn/Home/Show/3332/>

⁹ Associations List, National Social Organisation Standards Information Online Platform, viewed 22nd April 2020, ">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page=122>">http://www.ttbz.org.cn/Home/ActGroupList/?serType=1&serKey=&sheng=&page

¹⁰ Standards List, National Social Organisation Standards Information Online Platform, viewed 22nd April 2020, http://www.ttbz.org.cn/Home/Standard?page=456>

¹¹ SAC Held the Enterprises Standards Management Reform Team Meeting, SAC, 1st August 2017, viewed 15th April 2020, <http://www.sac.gov.cn/xw/bzhxw/201708/ t20170802_251882.htm>



and 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 and 2019.^{14&15} Finally, on 11th June 2019, the SAMR published the *Guidelines for Random Inspection of Social Organisation Standards* and the *Guidelines for Random Inspection of Enterprise Standards*.¹⁶

• Boosting the internationalisation of Chinese standards Enhancing the international influence of Chinese standards is an important task for the Chinese Government. On 22nd December 2017, China unveiled the Action Plan for Harmonisation of Standards for Jointly Building the Belt and Road (2018–2020),¹⁷ to extend its standardisation strategy to countries involved in the initiative. After sparking interest in the international community, the English version of the Standardisation Law was officially published on 3rd January 2018.¹⁸ The Division of the Key Tasks for the Implementation of the Plan for Deepening the Reform of Standardisation work (2019–2020) mentioned standards internationalisation as one of the key goals for this period.

In addition, a multiplicity of regulations, including the Notice of the State Council on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment, the Guiding Opinions on Foreign-invested Enterprises Participating in the Standardisation Work of China and the Foreign

- 15 2019 Enterprise Standards Top Runner List Announced, SAC, 28th May 2019, viewed 25th June 2020, <http://www.sac.gov.cn/sbgs/sytz/201906/ P020190604503571128473.pdf>
- 16 Guidelines for Random Inspection of Group Standards and Guidelines for Random Inspection of Enterprise Standards, SAC, 11th June 2019, viewed 19th May 2020, http://www.sac.gov.cn/sbgs/sytz/201906/P020190611596885330106.pdf>
- 17 Action Plan for Harmonisation of Standards for Jointly Building the Belt and Road (2018–2020), SAC, 19th January 2018, viewed 15th April 2020, https://www.sac.gov.cn/ztlydyl/bzhyw/201801/t20180119_341413.htm
- 18 English Version of the Standardisation Law Launched, SAC, 3rd November 2018, viewed 15th April 2020, <http://www.sac.gov.cn/zt/bzhf/bzhfdt/201801/ t20180103_341234.htm>

Investment Law (FIL),^{19,20821} all stipulate that foreigninvested enterprises (FIEs) will enjoy the same treatment as Chinese-invested enterprises while doing standardisation work in China.

China Standardisation Law

The revised China Standardisation Law entered into force on 1st January 2018.²² During the law's revision, there were three calls for comments. In consultation with its members, the European Chamber submitted comments for each version and reinforced its core messages during face-to-face meetings with relevant stakeholders. The working group was pleased to note that many of the suggested amendments were implemented. One of the priorities of the SAC's *Key Areas for Standardisation Work in China in 2020* is to accelerate the development of a supporting system for the law, and to advance the revision of related implementing regulations.

China's Standardisation Strategy

On January 2018, the SAC and the former AQSIQ announced that, along with high-end think tanks like the Chinese Academy of Engineering, they would develop China's new standardisation strategy titled 'China Standards 2035',²³ with the inaugural meeting taking place in March 2018. The project aimed to tackle the following four topics: the strategic positioning of the standardisation system; methodology and evaluation; support for developing a high-quality standardisation system; and the establishment of a standardisation strategy for fostering civil-military cooperation. The concluding meeting took place in January 2020.

Moving forward, the SAC's *Key Areas for Standardisation Work in China in 2020* stated that the next focus in terms of standardisation strategy would be the incorporation of the findings of the China Standards 2035 project in

¹² Opinions on Implementing the Enterprise Standards 'Top Runner' System, SAC, 20th July 2018, viewed 15th April 2020, http://www.sac.gov.cn/sfwyb/sytz_2087/201807120_342707.htm

¹³ Notice on the Opinions on Implementing the Enterprise Standards 'Top Runner' (Trial), CNIS, 22nd February 2019, viewed 15th April 2020, <http://www.cnis.gov.cn/ wzgg2/201902/t20190222_24758.shtml>

¹⁴ Enterprise Standards Top Runner List Announced, Standards Information Platform, 7th November 2018, viewed 15th April 2020, <http://www.zjsis.com/ contents/4/464630.html>

¹⁹ 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 2020, <http://www.gov.cn/zhengce/content/2017-01/17/ content_5160624.htm>

²⁰ Guiding Opinions on Foreign-funded Enterprises Participating in the Standardisation Work of China, SAC, 6th November 2017, viewed 15th April 2020, <http://www.sac.gov. cn/szhywb/sytz/201711/P020171130363181265870.pdf>

²¹ Foreign Investment Law of the People's Republic of China (bilingual), China Daily, 22nd March 2019, viewed 15th April 2020, http://language.chinadaily.com.cn/a/201903/22/WS5c94798ca3104842260b205f.html>

²² Standardisation Law of the People's Republic of China, SAC, 4th November 2017, viewed 15th April 2020,<http://www.sac.gov.cn/zt/bzhf/bzhfdt/201711/ t20171106 317995.htm>

²³ 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>

to a 'National Standardisation Development Strategy Outline'. Another key focus will be the development of the standardisation strategy within the framework of the 14th Five-year Plan.

Update on the China Compulsory Certificate (CCC)

On 15th March 2018, the CNCA published the *Notice on Issues of the China Compulsory Certificate Product Marks Reform.*²⁴ The notice allowed for cancelling the review and fee for printing/moulding CCC marks. It also included the requirements for certification bodies to start issuing standard-size CCC marks, and 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 which, among other provisions, announced the adjustment of the implementation requirements of compulsory product certification through measures like eliminating the issuing of compulsory product certification certificates for products following self-declaration evaluation procedures. Still ongoing at time of writing, the transition will encompass a number of different stages in which companies would be able to shift from third-party certification to self-declaration evaluation methods. With the transition period concluding on 1st November 2020, the designated certification body would then cancel all compulsory product certification certificates applicable to products with self-declaration evaluation.

Key Recommendations

 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 (13)

Concern

China's practices do not fully comply with the WTO/ TBT Agreement principles, and create unnecessary obstacles for foreign enterprises trying to access the Chinese market.

Assessment

a) Proper notification of mandatory standards, technical regulations and conformity assessment procedures including administrative licensing—required for market access

According to the WTO/TBT Agreement, central government bodies in China are obliged to notify members of the WTO about proposed technical regulations and conformity assessment procedures—together with a brief indication of their objectives and rationale—at an early stage, which enables amendments and comments to be taken into account. While the working group recognises the positive progress made by China with regards to notification, noncompliance with the WTO/TBT notification rules has been observed in cases of recommended (and thus voluntary) standards involved in mandatory certification schemes, mandatory sectoral standards, and some regulations that require conformity assessment procedures for market access.

Although the number of recommended standards applied in the CCC scheme has been reduced dramatically, they still account for nearly half of the standards therein. These recommended standards cover different product areas, including machinery, automobiles and automobile components, low voltage devices, wires and cables, electrical accessories and telecommunications devices.²⁵ A considerable proportion of these recommended standards are domestic standards and may differ significantly from international ones. Meanwhile, sector-specific mandatory standards still exist in public security industries, and seven of them are currently being used in the CCC scheme.

Furthermore, some laws and regulations stipulating conformity assessment procedures for market access are not promptly notified to other WTO members. Such regulations include the Cryptography Law and the *Cloud Computing Services Security Assessment Measures*, among others.

b) Limiting the scope of technical regulations and mandatory standards to issues related to the protection of health, safety and the environment, according to the WTO/TBT Agreement

²⁴ Notice on Issues of the China Compulsory Certificate Product Marks Reform, CNCA, 13th March 2018, viewed 15th April 2020, <http://www.cnca.gov.cn/xxgk/ ggxx/2018/201803/t20180315 56469.shtml>

²⁵ For more information on the usage of voluntary standards to support mandatory certifications in the information and communication technology (ICT) sector, please see Key Recommendation (KR) 2 of the *Information and Communication Technology Working Group Position Paper*.



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 health, safety and environment. 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, especially in sectors-like healthcare equipmentwhere there is still room for improvement on actions such as reducing administrative requirements that do not necessarily impact standards.²⁶ Additionally, 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, technical regulations and conformity assessment procedures, including administrative licensing, that may impact market access.
- Limit the scope of technical regulations and mandatory standards to issues related to the protection of environment, health and safety, in accordance with the WTO/TBT Agreement.
- Provide English versions of the notified documents.
- 2. Review Mandatory Market Access Requirements, Including the Simplification of Testing and Certification Procedures (13)

Concern

Market access barriers are created when certain products have to fulfil multiple market access requirements published by different authorities that are not coordinated with one another, and certain testing and certification procedures that place unnecessary burdens on manufacturers, increase costs and hinder the import of technology and services without increasing product safety.

Assessment

 a) The concurrent existence of mandatory standards, compulsory certification and administrative licensing schemes According to the Standardisation Law, many products have to comply with mandatory standards. In addition, other regulations require certain products to comply with specific mandatory certification schemes (e.g. the CCC or the Mining Products Safety Approval and Certification) and individual administrative licensing schemes. Although the Standardisation Law, and subsequent regulations, provide for the streamlining of standards, some areas like environmental protection, engineering and medical devices are exempted.²⁷ The lack of coordination between these regulations results in manufacturers having to manage overlapping testing requirements, which leads to additional costs 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 in most cases, as happens in areas like cybersecurity.²⁸ Improved coordination among different stakeholders and authorities can help to eliminate any overlap/conflict between the various mandatory standards, compulsory certification schemes and administrative licensing systems.

Simplifying market access requirements would allow Chinese customers to access the latest technologies, increase manufacturing efficiency and revitalise the Chinese economy. In many instances, the government restructuring during the 2018 'Two Sessions' resulted in the consolidation of several separate entities into one. 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 a national level

There are still examples of test reports issued by CCCdesignated testing laboratories not being accepted by other testing laboratories for identical tests of the same product. In such a situation, manufacturers have to re-test their products as a pre-requisite for being approved. Such practices negatively affect both foreign manufacturers that are active in China, and Chinese businesses wishing to place their products on the domestic market. Duplicative testing neither increases product safety nor benefits the Chinese authorities and customers. Instead, it wastes company resources,

28 For further information on the lack of coordination in cybersecurity, please refer to KR 3 of the Cybersecurity Sub-Working Group Position Paper.

²⁶ Please see KR 2.1 of the Healthcare Equipment Working Group Position Paper.

²⁷ For further information on medical device mandatory standards, please refer to KRs 2.1 and 3 of the *Healthcare Equipment Working Group Position Paper*.

ultimately resulting 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 in all Chinese laboratories 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 allow the use of test reports documenting manufacturers' in-house testing or third-party type testing for medical device product registration, among others.²⁹

c) Recommended standards used as market access requirements

Recommended standards need to remain voluntary. Unfortunately, some have either become 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. Cases can be found in many industries such as telecoms, electronics, machinery, automotive and mining. The lack of transparency on these instances causes problems for enterprises that must comply with mandatory market access schemes, including CCC and industry-specific mandatory certification schemes.

Recommendations

- Optimise the synchronisation of mandatory standards, compulsory certification schemes and administrative licensing schemes.
- Support the recognition of test reports at the national level.
- Allow more manufacturers to use their own testing laboratories, provided they meet all necessary accreditation requirements.
- Ensure all mandatory-type approval schemes for market access are based only on national mandatory standards and 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 (1)

Concern

Even though it has been stipulated in numerous pieces of Chinese legislation that all relevant stakeholders shall be granted equal access and participation rights in standardisation work, there is still a substantial gap in implementation.

Assessment

Equal participation in standardisation work in China is a long-standing concern for FIEs in China. Although this principle has been enshrined in key pieces of legislation such as the FIL, more often than not it does not happen in practice. 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. Indeed, data from the European Chamber's *Business Confidence Survey 2020* (BCS 2020) shows that around half of the companies that reported participating in standards-setting activities indicated that they did not encounter barriers to participation.³⁰ However, the principle of granting equal access to TCs to all stakeholders—which has been strengthened in the China Standardisation Law and further detailed in the *Guidelines on FIEs' Participation in China's Standardisation Work*³¹—has not been fully

²⁹ For more information on industry concerns regarding to other aspects of testing (e.g. third-party testing reports), please see KR 2.1 of the *Healthcare Equipment Working Group Position Paper*.

³⁰ *European Business in China Business Confidence Survey 2020*, European Chamber, p. 64, 10th June 2020, viewed 10th June 2020, https://www.europeanchamber.com.cn/en/publications-business-confidence-survey

³¹ Guidelines on FIEs' Participation in China's Standardisation Work, 2018, SAC, 29th November 2017, viewed 22nd April 2020, <http://www.sac.gov.cn/szhywb/ sytz/201711/t20171129_324590.htm>



implemented. In fact, according to data from the BCS 2020 and internal surveys conducted within the working group, for those companies that did report access issues, the picture was slightly more nuanced. While straightforward barriers like directly being denied participation in TCs seem to have been reduced, major issues for European industry. These include instances of opaque access procedures and a general lack of information, the inability to become lead drafters for standards, and blockades by Chinese competitors that are already in the committee. Examples of TCs that have access restrictions include some under the National Healthcare Commission, such as the committee in charge of food contact materials. Other obstacles include companies being only granted observer status, and foreign businesses being charged different fees to Chinese ones.32

In addition to accessing TCs, FIEs wish to contribute to standardisation work in China by leveraging their strengths and resources. The working group hopes that the Chinese Government will step up its efforts to encourage FIEs' equal participation in various standardisation activities in China, such as holding the secretariat of a TC, taking lead in the drafting of Chinese standards, participating or even leading in China's international standardisation activities in certain technical fields, and enjoying incentive policies from governments at various levels.

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.

4. Continue the Current Reform of the Chinese Standardisation System and Increase Harmonisation Efforts (1)5

Concern

Although China has entered the final stage of standardisation reform, and the revised Standardisation Law has been in force for more than two years, 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

Both *Guofa [2015] No. 13* and the Standardisation Law aim to reform the overall standards systems and mechanisms for standardisation management, in order to transition to a fully functioning new standards system. Such comprehensive changes cannot be achieved overnight and require cooperation between all parties. The working group recommends that standardisation reform be expanded to include areas so far exempted, such as environmental protection, engineering and construction, and healthcare,³³ and proposes the following suggestions to ensure the success of the reform process:

a) Mandatory national standards

The working group has observed progress in streamlining and consolidating mandatory national standards over the past few years. The recently released *Administrative Measures for Mandatory National Standards* has the potential of facilitating an orderly mandatory national standard system revision provided the principle of openness and transparency is followed. The working group expects the following outcomes from the implementation of these regulations:

- Notification of all mandatory national standards should be 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 the industry authorities and the SAC in organising the drafting of mandatory national standards.

³² 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*.

³³ For more information on the implementation of the standards management system in the medical sector, please see KR 3 of the *Healthcare Equipment Working Group Position Paper*.

- 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. For example, for English standards, the transition period is generally two to four years.
- Explicit prohibition of the inclusion of mandatory clauses in any non-mandatory national standards.

b) Social organisation standards

Moving away from the model where the government is the only entity that can set standards, social organisation standards aim to satisfy the needs of the market and innovation, and stimulate market vitality. The social organisation standards system has been developed at an incredible speed.

One key point 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. Departments and local governments are also encouraged to apply social organisation standards in industrial policy formulation, administrative management, government procurement, and testing and certification, as well as bidding. The working group understands that this goes against the policy of independent development and free use, and that it will lead to unfair position of players in the market. Thus, the working group recommends that authorities stick to the policy of independent development and free use of social organisation standards and strictly avoid their inclusion in administrative measures.

When social organisation standards do get transformed into national or industry standards, they should follow relevant procedures to make sure all stakeholders can have equal opportunities to provide feedback. In addition, 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 should have equal access to all 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.

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 often contain confidential information protected through intellectual property rights (IPR), which companies/right holders have the right to withhold from public disclosure. 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.

Currently, there are no sufficient written guidelines and definitions under the system to direct enterprises from a compliance point of view. However, in the practice of 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 in the disclosed standards, despite meeting quality compliance requirements. This is a concerning development for the industry, 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 adopted by enterprises, and that the disclosure and format requirements of enterprise standards be clarified. The working group also recommends that any potential requirements that could lead to involuntary disclosure of IP to the public be avoided by all means, in order to boost the industry's acceptance of enterprise standards.

The Chinese Government is reducing control over enterprise standards. An enterprise standards online



service platform has been set up (the Information Public Service Platform of Enterprise Standards: http://www. qybz.org.cn/), and manufacturers are encouraged to make online disclosures and sign the self-declaration of conformity. However, the platform still needs improvement in certain areas, such as the categories of products. Although it is impossible to list all product categories, because it is a mandatory selection item, the industry will face challenges in post-market surveillance. For instance, there is an option for 'medical masks' but no specifications for different types (e.g. disposable masks).

New schemes such as the 'top runner' system have raised concerns among the business community, partly because of questions regarding the scientific nature of the assessment method, and partly because of the involvement of the government in a system thataccording to the spirit of standardisation reformshould be based on market competition and encourage market-led processes. Regarding the assessment and ranking method under the 'top runner' system, the implementation of standards varies from product to product, making it difficult to compare products based on the standards they implement. So far, few renowned brands have been listed as a 'top runner', which raises questions over the breadth of representation of the market: if this system is intended to serve as a guidance for consumers, an inaccurate or incomplete representation of the market would not suffice. The working group therefore recommends that the government take steps to ensure the system is fair, open and transparent, and that it follows a reliable scientific process.

d) Industry standards

The Standardisation Law has clarified that industry standards are voluntary standards; however, some industry standards remain mandatory – e.g. the YY series standards for medical devices. Furthermore, while the streamlining of national standards has reduced the number of mandatory national standards, the number of industry standards, as well as market-driven social organisation standards and enterprise standards, is sky-rocketing. This situation has created numerous overlaps among the different standards. One of the stated goals of the SAC's *Guiding Opinions on the Further Strengthening Management of Industry Standards*, published on 10th April 2020, is to optimise the industry standard supply structure and improve

coordination between industry standards and other standards.³⁴ The working group hopes that this can be implemented, and recommends that harmonisation efforts not be limited to industry standards, but expanded to the whole system.

Recommendations

Mandatory national standards

- Expand standardisation reform to include exempted areas.
- Introduce reasonable transition periods for mandatory standards and implement the European concept of transition periods in more industries.

Social organisation standards

- Stick to the policy of independent development and free use of social organisation standards and strictly avoid the inclusion of 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.

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.
- 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.

³⁴ Guiding Opinions on Further Strengthening Management of Industry Standards, SAC, 10th April 2020, viewed 25th April 2020, <http://www.sac.gov.cn/sbgs/ sytz/202004/P020200415371585800963.pdf>

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5. Ensure Fair and Transparent Market Surveillance 13

Concern

The current market surveillance process for many products has been intentionally extended to voluntary requirements, e.g. recommended national standards, industry standards, local standards, social organisation standards and enterprise standards, which are not related to mandatory market access requirements.

Assessment

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 intentionally extended to recommended and voluntary items, which has resulted in the punishment of manufacturers whose products do not meet the requirements of recommended standards. Such a situation leads to workload increases for both manufacturers and authorities, and prevents the latter from focusing on the original task of protecting the environment, improving health and safety, and preventing deceptive practices. Additionally, as described in KR4, European businesses encounter situations where, in market surveillance processes, they 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, which aim to ensure that products do not affect the ability to protect the environment, improve health and safety, and prevent deceptive practices.

Key Recommendations

- Align market surveillance and market access requirements.
- Limit market surveillance to compliance with laws, regulations, mandatory standards and certification schemes.
- 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 |
| EU | European Union |
| FIE | Foreign-Invested Enterprise |
| FIL | Foreign Investment Law |
| ICT | Information and Communication |
| | Technology |
| IP | Intellectual Property |
| IPR | Intellectual Property Rights |
| KR | Key Recommendation |
| MIIT | Ministry of Industry and Information |
| | Technology |
| NDRC | National Development and Reform |
| | Commission |
| SAC | Standardisation Administration of |
| | China |
| SAMR | State Administration for Market |
| | Regulation |
| SCA | Standards and Conformity Assessment |
| SESEC | Seconded European Standardization |
| | Expert in China |
| TC | Technical Committee |
| WTO/TBT | Technical Barriers to Trade of the |
| | World Trade Organization |



Quality and Safety Services Sub-working Group

Introduction to the Sub-working Group

Since the release of the 13th Five-year Plan (13FYP) and the China Manufacturing 2025 (CM2025) initiative, China has stepped up the pace of its marketbased reforms to improve the quality and safety of its products. The Quality and Safety Services (QSS) Sub-working Group wants to see a continuation of these reforms, particularly for the third-party testing, inspection and certification (TIC) industry. The subworking group's members 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 marketorientated reforms and the CM2025 initiative 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 would like China to further open its TIC market and provide opportunities for cooperation between China and Europe in the area of quality and safety management.

The Quality and Safety Services Sub-working Group was established in 2012 as a sub-working group of the Standards and Conformity Assessment (SCA) Working Group. The QSS sector is defined as independent, third-party agencies that provide manufacturers and end users with TIC services and other conformity assessment-related services in relation to their products and management systems, with the aim of improving the safety and quality of products on the market. The sub-working group identifies concerns and makes constructive recommendations in order to create a QSS system that is more transparent, better coordinated and that improves market access for all players.

Recent Developments

Compared to other major economies, China has a heavily regulated TIC system, which is operated by the SAMR and other government authorities. These authorities have a tremendous amount of influence on quality and safety—as well as standards development and enforcement-by having extensive control over mandatory TIC processes. This situation enables stateowned enterprises (SOEs) and government-affiliated enterprises to monopolise a huge market share of China's QSS sector, with international TIC agencies making up only a small portion. Occasional quality and safety scandals have highlighted 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. Despite this, government-affiliated and state-owned TIC agencies remain dominant in the creation and enforcement of national and industry standards, the receiving of science and research projects in their industries, and in being appointed or recommended as designated laboratories. This leaves international QSS firms at a competitive disadvantage in areas that are crucial to the government. However, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) released the Catalogue of Encouraged Industries for Foreign Investment (2019) (Catalogue) on 30th June 2019,¹ which included the TIC industry for the very first time.

Market Developments in the TIC Industry

The TIC industry continued to grow quickly throughout 2019. According to the SAMR, by the end of 2019, in total, 597 TIC agencies had been approved, representing year-on-year growth of 24.6 per cent. Over 2,227,000 valid certificates were issued in 2019 a 15 per cent increase over 2018—issued to 686,000 organisations, representing a 10 per cent increase over 2018. Furthermore, a total of 42,000 TIC agencies were accredited, with year-on-year growth of 6.6 per cent.²

Developments in the Regulatory Environment

On 25th October 2019, the SAMR issued the Opinions on Advancing the Reform of the Certification of Testing



¹ Catalogue of Encouraged Industries for Foreign Investment (2019), MOFCOM, 30th June 2019, viewed 6th April 2020, <http://www.mofcom.gov.cn/article/b/ f/201906/20190602877005.shtml>

² Speech at the National Certification, Accreditation, Testing & Inspection Conference, CNCA, 14th January 2020, viewed 8th April 2020, http://www.cnca.gov.cn/rdzt/2020/qgh/202001/120200114_57615.html



and Inspection Agencies.³ It calls for the acceleration of reforms to the certification of testing and inspection agencies and proposes reform measures, including: defining the scope of the certification pursuant to law; piloting a notification and commitment system; optimising the quality certification process; reducing review times; and integrating qualification certificates.

On 1st December 2019, the SAMR released the Opinions on the Implementation of Regulations to Improve the Business Environment (Opinions),⁴ which proposes the separation of permits from business licences to be piloted in all free trade zones (FTZs), before being gradually introduced nationwide after assessing progress of this pilot. The Opinions call for: the equal treatment of domestic and foreigninvested enterprises, the rigorous implementation of the Foreign Investment Law and the Regulations on the Implementation of the Foreign Investment Law, the establishment of a pre-market national treatment plus negative list system, the facilitation of foreign-invested enterprises' (FIEs') registration, the implementation of a foreign investment information reporting system, and the promotion of institutional reforms from the perspectives of regulations, management measures, and standards. The sub-working group welcomes these reform measures.

In December 2016, the former Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), the CNCA and 32 other ministerial-level Chinese Government departments jointly released the 13FYP for China's Testing, Inspection-Certification and Accreditation Development.⁵ The plan provided guidance for the development of China's TIC industry and accreditation system from 2016 to 2020. The plan recognises the importance of the TIC industry in safeguarding people's safety, and supporting the country's economic development. It calls for: crossministerial cooperation to facilitate industry growth; classifying state-owned TIC agencies as either public service or commercial service providers; separating business and commercial service providers from government administrative work so they can operate as

companies; encouraging and adopting TIC results from third parties; avoiding duplicative TIC work to reduce enterprises' burdens; promoting national treatment for foreign-invested TIC agencies; allowing the inflow of capital and advanced TIC technologies; and improving risk prevention mechanisms. As stated in the Notice on the 2019 Key Assignments of Certification, Accreditation, Testing and Inspection, issued by the CNCA in April 2019, the reforms of inspection and testing institutions would be driven further to promote both the transformation of public institutions and fair competition, and the pilot programme for the classification reform of quality inspection institutions would be supported under permissible conditions.⁶ The sub-working group looks forward to seeing the government's reform promises being translated into concrete action.

Key Recommendations

- 1. Improve Market Access for Foreigninvested TIC Agencies
- 1.1 Accelerate the Revision of the Regulations on Certification and Accreditation (3) 2

Concern

Although a series of documents on revising the *Regulations on Certification and Accreditation (2016 Amendment) (Regulations)* have been formulated by the SAMR and the CNCA, it appears that it may take a long time to complete the revisions, which will hinder market opening and fair competition.

Assessment

In April 2019, the CNCA issued the *Notice on the 2019 Key Assignments of Certification, Accreditation, Testing, and Inspection (Notice)*,⁷ which stipulates not only that the extra administrative measures placed on foreigninvested certification agencies will be abolished entirely, but also that national treatment will be granted to them. Some progress was made in the following month, when the CNCA called for comments on the amendments to the *Regulations*.

In November 2019, the State Council released the Work Plan for the Comprehensive Pilot Project of Opening-up of the Service Sector in Beijing (Work

³ Opinions on Advancing the Reform of the Certification of Testing and Inspection Agencies, SAMR, 25th October 2019, viewed 8th April 2020, <http://gkml.samr. gov.cn/nsjg/rzjcs/201910/t20191025 307884.html>

⁴ Opinions on the Implementation of Regulations to Improve the Business Environment, SAMR, 30th December 2019, viewed 8th April 2020, <http://www. gov.cn/zhengce/zhengceku/2020-01/14/content_5468806.htm>

^{5 13} FYP for China's Testing, Inspection-Certification and Accreditation Development, CNCA, 13th December 2016, viewed 8th April 2020, http://www.cnca.gov.cn/xxgk/gwxx/2016/20161213_53009.shtml

⁶ Notice on the 2019 Key Assignments of Certification, Accreditation, Testing and Inspection, CNCA, 2nd April 2019, viewed 6th April 2020, <http://www.cnca.gov.cn/ xxgk/gwxx/2019/201904/t20190402_57126.shtml>

⁷ Ibid.



Plan),⁸ which proposes a temporary adjustment to the implementation of certain provisions of the Regulations. This adjustment removed the requirement for foreigninvested agencies to be certified by an accredited agency in the country or region in which they are located, and that they must have over three years of business experience in certification before they can qualify to become a certification agency, as stipulated by Article 11 of the Regulations. The sub-working group welcomed both the Notice and the Work Plan, introduced by the government to further implement reforms to simplify administration and delegate power, combine decentralisation and management, and optimise public services. However, market access restrictions imposed on foreign-invested certification agencies have not yet been completely removed. These adjustments are so far only applicable to Beijing and China's FTZs. Certification services are not listed as either 'prohibited' or 'restricted' to foreign access in the Special Management Measures for Foreign Investment Access (2020 Edition).9 What's more, placing these special measures exclusively on FIEs is not in line with the pre-market national treatment plus negative list system referred to in Article 4 of the Foreign Investment Law,¹⁰ and hinders market opening and fair competition.

The revision of the *Regulations* was listed in the 2020 SAMR Legislative Work Plan published in March 2020.¹¹ However, no expected completion date was provided. The sub-working group recommends that the government accelerates the revision of the *Regulations*, and engages with industry enterprises to solicit their feedback, incorporating their comments on the proposed draft before final promulgation.

Recommendation

• Accelerate the revision of the Regulations on *Certification and Accreditation*, taking into account feedback from enterprises on the updated draft before promulgation.

1.2 Ensure Equal and Fair Treatment in Government Procurement Activities

Concern

Certain discriminatory and unreasonable conditions set in government procurement activities prevent foreign TIC agencies from receiving equal and fair treatment in this process.

Assessment

China has committed to establishing a government procurement system that provides equal and fair treatment for domestic enterprises and FIEs,¹² with its efforts having already achieved notable results. Along with the transformation of government functions, China has introduced reform initiatives in the procurement of public services and has been continuously expanding the scope of procurement activities. More thirdparty inspection agencies now have the opportunity to participate in government quality sampling and inspection activities. However, since the reform of government procurement involves multiple parties, overlapping responsibilities between different authorities have become more prominent. The imposition of unfair and unreasonable bidding requirements to exclude or restrict market competition is still a major issue encountered by FIEs in government bidding and procurement activities.

Furthermore, in the process of promoting a marketorientated approach to public resource allocation, many current practices have been found to conflict with current legislation. In particular, these practices are not in line with China's efforts to join the World Trade Organization's Agreement on Government Procurement.

In practice, the two most common statutory methods of public procurement adopted by the government are public bidding and competitive negotiation. Competitive negotiation receives comparatively fewer questions and complaints, as this approach relies solely on prices to determine winners. Furthermore, the tender price will eventually be publicly announced. Public bidding adopts a comprehensive scoring method where price only accounts for a portion of the score, with other factors such as product quality, sales and after-sales

⁸ Official Reply of the State Council on the Work Plan for the Comprehensive Pilot Project of Opening-up of the Service Sector in Beijing, State Council, 22nd February 2019, viewed 8th April 2020, <http://www.gov.cn/zhengce/content/2019-02/22/ content_5367708.htm>

⁹ NDRC and MOFCOM Release the 2020 Version of National Negative List and the Free Trade Zones Negative List for Foreign Investment, MOFCOM, 23rd June 2020, viewed 1st July 2020, http://www.mofcom.gov.cn/article/ae/ai/202006/20200602977244.shtml>

¹⁰ Foreign Investment Law, National People's Congress (NPC), 15th March 2019, viewed 8th April 2020, <http://www.npc.gov.cn/npc/xinwen/2019-03/15/ content 2083532.htm>

¹¹ Notice on the Printing and Distribution of the 2020 SAMR Legislative Work Plan, SAMR, 26th March 2020, viewed 8th April 2020, <http://gkml.samr.gov.cn/nsjg/ fgs/202003/t20200326_313464.html>

¹² State Council Policies Briefing Meeting on 29th October 2019, State Council Information Office, 29th October 2019, viewed on 6th July 2020, < http://www.gov. cn/xinwen/2019zccfh/69/index.htm>

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services also taken into consideration. All these factors together determine who wins the bid, which can leave the system open to manipulation. To be specific, bidding requirements may be established to impede bidders that are otherwise qualified but unable to meet the unreasonable procurement rules set in the bidding document. *Consequently, they cannot be shortlisted*.

In the interests of furthering the implementation of the Plan for Deepening the Reform of the Government Procurement Mechanism and the Notice on Focusing on Enterprises' Concerns and Further Promoting the Implementation of Policies to Optimise the Business *Environment*^{13&14} —to create a unified, open, competitive and orderly government procurement market system, promote fair competition in government procurement and optimise the business environment-the Ministry of Finance (MOF) issued a notice on eliminating any practices and regulations that hinder fair competition in the field of government procurement.¹⁵ The notice calls for the strict implementation of a fair competition review system. After review, regulations considered not to exclude or restrict competition can be published and implemented, while those considered to exclude or restrict competition should not be published or must be revised to meet requirements prior to their release. 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, factors deciding 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) any recommendations or awards they have received; and 3) their year-end performance review. However, sampling and inspection services—the testing and inspection services procured by the government—just started in recent years. Previously, such services had only been led by government agencies or carried out by public institutions. Therefore, foreign-invested TIC agencies clearly lack the necessary experience in this field. Additionally, awards, commendations and performance reviews are mostly exclusive to public institutions, which acts as an invisible barrier to non-public institutions. Consequently, many of the above-mentioned factors have resulted in foreign invested TIC agencies receiving low scores in bidding activities, which leaves them disadvantaged and practically excluded from competition. This would account for the low proportion of foreign-invested TIC agencies engaged in public bids to provide sampling 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.
- 1.3 Allow Foreign-invested TIC Agencies to Provide Container Inspection Services

Concern

According to the *Regulations on 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 TIC agencies are restricted from providing container inspection services.

Assessment

Currently, in China, containers are still subject to statutory surveys, managed by the MOT and the China Maritime Safety Administration (MSA). The MSA has only granted the qualification of statutory surveys of containers to a secondary public interest institution, the China Classification Society, which then subcontracts the work to its subsidiary company, the China Classification Society Certification Company, authorising it to carry out surveys of containers owned by both domestic and foreign enterprises. Foreigninvested ship inspection agencies are restricted to inspecting only containers owned by foreign businesses, i.e. foreign export containers, through the

¹³ Plan for Deepening the Reform of the Government Procurement Mechanism and the Notice on Focusing on Enterprises' Concerns and Further Promoting the Implementation of Policies to Optimise the Business Environment, CGP News, 14th November 2018, viewed 20th April 2020, http://www.cgpnews.cn/articles/46544>

¹⁴ Notice on Focusing on Enterprises' Concerns and Further Promoting the Implementation of Policies to Optimise the Business Environment, State Council, 8th November 2018, viewed 20th April 2020, <http://www.gov.cn/zhengce/ content/2018-11/08/content_5338451.htm>

¹⁵ Notice on Promoting Fair Competition in Public Procurement and Optimizing Business Environment, MOFCOM, 4th December 2019, viewed on 6th July 2020, http://www.mofcom.gov.cn/article/b/fwzl/201912/20191202919267.shtml



Regulations,¹⁶ the Notice on Improving the Supervision and Management of Inspections Carried Out by Foreign Ship Survey Agencies in China,¹⁷ and the Vessel Inspection Administration Regulation.¹⁸

Such dissimilar treatment clearly contradicts the Foreign Investment Law, which provides that both domestic and foreign-invested businesses must be treated equally. Moreover, there are no other countries with similar statutory container inspection regulations. According to the International Convention for Safe Containers (Convention) and the majority of international practices, once an inspection agency has obtained the necessary qualification of statutory surveys of containers from the member states-i.e. TIC carried out pursuant to the Convention-provided that the container manufacturer or owner applies to the agency, it will be qualified to carry out statutory surveys of any containers, regardless of who owns them.¹⁹ The inspection results and certificates issued by the agency must be accepted and recognised by all contracting states.

Recommendation

- Open the container inspection market to ship inspection agencies from all member states to the *International Convention for Safe Containers*, and allow foreigninvested ship inspection agencies to provide container inspection services.
- 2. Furthering Reforms for a Market-orientated TIC Industry
- 2.1 Adopt Market-based Mechanisms to Reform Government-affiliated TIC Agencies and Avoid a Second Monopoly Through Administrative Support (1)7

Concern

The current reforms being carried out in the TIC sector, coupled with excessive administrative interference, are likely to result in market fragmentation and potential industry monopolies.

Assessment

By introducing and developing world-leading TIC services, the quality, safety and performance of China's products may be more clearly demonstrated to end users or consumers. TIC services also provide support for industrial upgrading and transformation, as well as an effective and objective basis for evaluation of government and industry management personnel, and ultimately protect the rights and interests of consumers and users. The Chinese Government-in line with President Xi Jinping's vision for the Belt and Road Initiative (BRI)— has continued to enhance international cooperation and increase production capacity. The TIC industry plays an indispensable role in this process. Through their global influence, knowledge and resource base, international third-party TIC agencies can support the quality and service capabilities of products manufactured under the CM2025 initiative, helping such products to meet the legal standards of their destination countries and ease users' concerns regarding quality and safety.

According to the CNCA's Research Report on the Share of the Contribution Made by the Certification and Accreditation Industry to the National Economic and Social Development, the certification and accreditation industry contributed over one per cent of China's total gross domestic product in 2015 and 2016. This demonstrates the importance of the TIC services industry to the overall development of China's economic growth. Ensuring that the domestic TIC industry shifts to a market-orientated approach to development will therefore have a significant impact on the Chinese economy. This process is also in line with the main aims of the CM2025 initiative – the overall upgrading of China's economic and industrial capacity.

On 21st February 2014, the State Council published the Notice on the State Commission Office for Public Sector Reform and the AQSIQ Opinions on Implementing the Integration of TIC Agencies (Notice).²⁰ Based on the Notice, the former AQSIQ officially issued the Guiding Opinions on the Integration of TIC Agencies Under the Nationwide Administration System of Quality Supervision, Inspection, and Quarantine

¹G Regulations on Governing Survey of Ships and Offshore Installations, State Council, 2nd March 2019, viewed 20th April 2020, http://www.gov.cn/gongbao/content/2019/content-5468917.htm>

¹⁷ Notice on Improving the Supervision and Management of Inspections Carried Out by Foreign Ship Survey Agencies in China, PKU Law, 2nd March 2009, viewed 20th April 2020, <http://pkulaw.cn/fulltext_form.aspx?Db=chl&Gid=8492e 9f098114d90bdfb>

¹⁸ Vessel Inspection Administration Regulation, MOT, 4th February 2016, viewed 20th April 2020, <http://xxgk.mot.gov.cn/jigou/fgs/201602/t20160204_2973409. html>

¹⁹ International Convention for Safe Containers, International Maritime Organization, 6th September 1977, viewed 20th April 2020, http://www.imo.org/en/About/Conventions/ListOfConventions/Pages/International-Convention-for-Safe-Containers-%28CSC%29.aspx>

²⁰ Notice on the Opinions on Implementing the Integration of TIC Agencies, State Council, 11th March 2014, viewed 20th April 2020, <http://www.gov.cn/zhengce/ content/2014-03/11/content_8707.htm>

(Guiding Opinions)²¹ on 6th March 2015. The Guiding Opinions explicitly state that over 3,500 TIC agencies under the former AQSIQ system will be classified into two categories – commercial and public welfare organisations. They also stipulate that administrative and supervisory functions are to be separated from service functions. The system's overall restructuring should essentially be completed by the end of 2020, and that branded, comprehensive TIC corporations should take shape by then.

Released by the Central Committee of the Communist Party of China and the State Council in September 2015, the Guiding Opinions on Deepening the Reform of SOEs (Guiding Opinions) state that SOEs will be categorised as either commercial or public interest organisations. This categorisation is based on the strategic positioning and development objectives of state-owned capital, and the roles, status and need for economic and social development of different types of SOEs. Furthermore, the Guiding Opinions state that SOEs would be reformed, developed, regulated, assigned responsibilities and evaluated based on their category so as to promote their in-depth integration into the market economy, and integration between enterprises' economic and social profits. The subworking group feels justified in its worries that the government-based on the current situation where administrative and public institutions and governmentaffiliated SOEs account for a quarter of all TIC agencies in China-will decide to categorise SOEs in this sector as public welfare enterprises.²² Based on its previous experience, the Quality and Safety Services Subworking Group believes the current market-orientated reforms in the TIC sector are just the beginning. When implementing regulations, in order to ensure the success of institutional and market-orientated reform, it is essential to prevent government-affiliated agencies from abusing their power.

The sub-working group is greatly concerned about the risk of an administratively-supported monopoly driven by state-owned TIC service agencies absorbing the 'reform vacuum' during ongoing administrative reforms, which would constitute a breach of the Antimonopoly Law and further hinder the development of a competitive market environment. A concentration of SOEs in the TIC industry or market fragmentation, both of which deviate from the mandate of market-orientated reform, could jeopardise the reform process and hinder any efforts at resolving China's pressing quality and safety issues. European enterprises have advanced management concepts and market experience, as well as positive experiences that assisted the European Union (EU) and its member states to reform their own TIC sectors in the past. The sub-working group would therefore like to offer industry recommendations on administrative reform, in order to improve the quality and safety environment in China, to increase the competitiveness of 'Made in China', to enhance the international influence of the 'China brand' and to achieve mutually beneficial outcomes for EU-China trade and investment. This experience-sharing would be relevant to the ongoing negotiations on the EU-China Comprehensive Agreement on Investment, and help to reduce EU-China trade conflicts while also upgrading the level of quality and safety of Chinese products and services.

Recommendations

- Implement market mechanisms to avoid rent-seeking and monopolistic behaviour during the reform of government-affiliated TIC agencies.
- Reduce excessive and unclear market entry barriers, and use international norms for assessment.
- Provide equal treatment to international TIC agencies so that they enjoy the same market status as their domestic peers.
- 2.2 Allow Non-public Institutions to Qualify to Provide Special Equipment Testing and Inspection Services (1) 2)

Concern

Only public institutions can currently qualify to provide special equipment testing and inspection services, which is a market access barrier for independent thirdparty TIC agencies.

Assessment

Special equipment consists of items such as boilers, pressure vessels, pressure pipes, elevators, lifting machinery, passenger ropeways, large-scale amusement facilities, and special purpose motor vehicles which constitute key infrastructure and are

²¹ Guiding Opinions on the Integration of TIC Agencies Under the Nationwide Administrative System of Quality Supervision, Inspection and Quarantine, former AQSIQ, 16th March 2015, viewed 20th April 2020, http://www.aqsiq.gov.cn/ xxgk_13386/jgfl/tzsbaqicj/tzdt/201503/t20150316_434296.htm>

²² SAMR Releases Data on TIC Industry of China in 2019, SAMR, 28th June 2020, http://www.samr.gov.cn/rkjcs/sjdt/gzdt/202006/t20200628_317425.html



vital to the economy and society as a whole. China has gradually established a safety monitoring mechanism for special equipment, which is a dual-track model of safety monitoring and technical inspection agencies. These agencies have been a significant force in ensuring safety and quality, promoting industrial development, protecting consumers' rights and public security, and accelerating energy conservation, emission reductions and environmental protection. With the joint efforts of the government and various stakeholders, the rate of accidents related to special equipment has steadily decreased, although certain safety concerns remain.

By the end of 2019, there were around 15,254,700 units of special equipment across the country. This included 383,000 boilers, 4,191,200 pressure vessels, 7,097,500 elevators, 2,440,100 units of heavy lifting machinery, 1,089 passenger ropeways, 24,900 large-scale entertainment facilities and 1,116,900 special purpose motor vehicles.²³ If such a large number of special equipment was not subject to adequate inspection, the potential risk would be immeasurable. As the economy develops, the use of more complex special equipment increases, bringing higher risks and creating greater requirements for safety management. While this results in increasing demands for the testing and inspection services of such equipment and significant changes in demand, the growth rate of inspection personnel is significantly lower than that of special equipment. It is therefore clear that current special equipment inspection capacity is insufficient and that the overall capabilities of inspection personnel need to be further improved. For example, the growth of inspection personnel for elevator inspections is far behind the increase in numbers of elevators. Some personnel have to complete up to 1,000 elevator inspections per year, whereas experts suggest that the ideal workload is approximately 400 units per year. This raises considerable concern about the quality of inspections and potential safety issues that may arise due to such heavy workload.

Deep-seated conflicts and prominent problems in the safety supervision of special equipment are becoming increasingly acute. As well as the lack of qualified inspection personnel, this is reflected in the mismatch between the safety status and supervision level of special equipment and the general public's everincreasing demand for quality and safety. Specifically, such discrepancies are reflected in the following aspects:

1. constantly increasing demand for quality and safety is unmet

Due to the restriction on qualifications, only the China Special Equipment Inspection and Research Institute (CSEI) and a very small number of companies are qualified to provide testing and inspection services for special equipment. As of the end of 2019 there were only 454 comprehensive testing agencies for special equipment in China, of which 270 were in the administrative system and the remaining 184 either industry or in-house testing agencies.²⁴ The limited number of inspection agencies and personnel falls well short of the target of having comprehensive coverage for testing and assessment services.

2. Insufficient market competition

Many qualified third-party TIC agencies have been unable to enter the market due to access barriers. The resulting lack of competition means that qualified agencies with access are not motivated to drive technological innovation and further invest in personnel training. In addition, their capabilities and equipment are often inadequate, particularly with respect to any special equipment involving new technology or materials. This inability to perform comprehensive, systematic and scientific testing and inspections services means that some hazards may not be identified accurately or in a timely manner. As the currently installed special equipment ages, the potential for serious incidents will inevitably pose greater challenges for the government's risk prevention and control work.

3. Lack of specifications, standards and risk assessment

The standards related to technical safety requirements in China are inconsistent with international practices, restricting the competitiveness of Chinese special equipment. Certain technical measures and regulations face implementation difficulties due to a lack of quantitative indicators. Additionally, a considerable portion of service equipment currently in use has quality and safety issues and there is an urgent need for technologies to carry out safety risk assessment, lifespan estimation and malfunction warnings. However, there is a lack of unified technical requirements, measures and standards for such calculations.

²³ Notice on the Status of Special Equipment in 2019, Sohu, 20th April 2020, viewed 10th July, https://www.sohu.com/a/389444978_9938651>



The participation of third-party TIC agencies can relieve pressure on the government's safety and quality monitoring responsibilities, and improve the supply of testing and inspection services for special equipment. Their advanced testing and inspection technologies, as well as their comprehensive assessment systems, operating mechanisms, management models, methodologies and qualified personnel, would effectively serve the needs of the current mandatory testing system. Participation of third-party TIC agencies would also help mandatory testing agencies to enhance their innovation capabilities and improve internationalisation, thereby boosting the industry overall.

Recommendation

- Allow non-public institutions to apply for special equipment testing and inspection qualifications and participate in the periodic inspection of special equipment.
- 2.3 Remove the Inspection of Imported Bulk Commodities from the Catalogue of Entry-Exit Commodities Subject to Inspection and Quarantine by Exit-Entry Inspection and Quarantine Institutions (Catalogue)

Concern

Although the General Administration of Customs (GAC) adjusted the weight appraisal of imported bulk commodities in 2019 to further optimise the business environment at ports and facilitate cross-border trade, continued reform of the supervision mode of imported bulk commodities is still needed.

Assessment

Weight and quality are important bases for the settlement of bulk cargo. The assessment of weight and quality of import and export commodities has long been a statutory process in China. When state-owned import and export companies dominated, the GAC imposed the assessment process on enterprises, playing a vital role in protecting the interests of enterprises and helping them recover economic losses. However, with the increasing number of private import and export companies, as well as more and more MNCs participating in international trade, the rules for inspecting and assessing imported and exported bulk cargo should be updated accordingly. Per the assessment of weight and guality, as a general international practice, contract parties agree on a designated third-party to issue a corresponding testing and inspection report.

The sub-working group is glad to see that the GAC adapted to the situations and made significant changes regarding the weight appraisal of imported bulk cargo. For bulk cargo imported at the port, the GAC was once the 'athlete' who performed the weight assessment. After the introduction of the new policy, import ports have granted consignees more autonomy. Businesses may now independently decide whether to have a thirdparty assessment agency issue a weight and quality certificate or to request a free weight assessment performed by the GAC. Therefore, the role of the GAC has shifted to that of a 'referee'. However, quality assessment is still required for the majority of imported bulk cargo. Consequently, despite being spared from the GAC's compulsory weight assessment process, import businesses are still required to go through a quality assessment carried out by the GAC as part of the customs clearance process. This hinders the development of the customs clearance to an extent and does not meet import businesses' needs to speed up the clearance process.

According to Order No. 159 (2019),²⁵ from 1st November 2019, the batch weight assessment performed by the GAC for bulk cargo could be optional, depending on the requirements of enterprises. That is, any imported bulk cargo consignee or agent who wants a customs-issued weight certificate can submit an application to the GAC-which will then carry out a weight assessment and issue the weight certificate-whereas those not in need of such a weight certificate would not be assessed by the GAC. This major change helps to optimise the allocation of the GAC's supervision resources, shorten customs clearance time, and achieve scientific and efficient commodities inspection. The GAC also issued the Notice on Adjusting the Supervision of Imported Cotton, effective from 5th April 2020, which removes the requirement for sampling quality inspections for cotton imports, but such inspections will continue to be provided at the request of importers.²⁶

Based on current customs policies, apart from a few types of imported bulk cargo, the vast majority of cargo is still legally required to undergo a quality assessment carried out by the GAC. Ships cannot leave port until the GAC has completed all the necessary inspection

²⁵ Order No. 159 (2019), GAC, 17th October 2019, viewed 20th April 2020, <http:// www.customs.gov.cn/customs/302249/302266/302267/2687445/index.html>

²⁶ Notice on Adjusting the Supervision of Imported Cotton, GAC, 26th March 2020, viewed 20th April 2020, <http://www.customs.gov.cn/customs/302249/302266/302267/2939252/ index.html>



and assessment procedures. If a ship misses the tide as a result of this, and is unable to leave, it will likely incur additional berthing costs of hundreds of thousands Chinese yuan for every extra 12 hours. The delay will also affect the subsequent berthing schedule, resulting in the decrease of overall port efficiency. Third-party testing and inspection agencies are able to provide fair and impartial quality assessment services for imported bulk cargo and can greatly reduce the time needed for customs clearance, due to their sufficient personnel reserve and high-quality services.

Recommendation

 Accelerate the process of cancelling statutory quality assessments for other imported bulk cargo and allow third-party testing and inspection agencies designated by international trade parties to provide quality assessment services.

Abbreviations

| 13FYP | 13 th Five-year Plan |
|--------|--|
| AQSIQ | Administration of Quality Supervision, |
| | Inspection, and Quarantine |
| BRI | Belt and Road Initiative |
| CM2025 | China Manufacturing 2025 |
| CNCA | Certification and Accreditation |
| | Administration of China |
| EU | European Union |
| FIE | Foreign-invested Enterprise |
| FTZ | Free Trade Zone |
| GAC | General Administration of Customs |
| MOFCOM | Ministry of Commerce |
| MOT | Ministry of Transport |
| MSA | Maritime Safety Administration |
| 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 |



Section Three Goods



Goods

The Goods section of the *Position Paper* encompasses 10 European Chamber working groups and 3 sub-working groups:

- · Agriculture, Food and Beverage
 - Cheese
 - Paediatric Nutrition and Food for Special Medical Purpose
- Automotive
- Automotive Components
- Cosmetics
- Energy
 - Carbon Market

- Fashion and Leather
- Healthcare Equipment
- Petrochemicals, Chemicals and Refining
- · Pharmaceutical
- Shipbuilding

The global trading system experienced immense instability in 2019 and 2020, due to a combination of factors, which has had a considerable impact on European Chamber members both producing goods in, and importing goods into, China.

Many companies caught in the crossfire of the United States (US)-China trade war had been cautiously optimistic about the 'Phase One' trade deal that had been under intense negotiations for more than 18 months. While not approving of Washington's tariff approach, the European business community had been in agreement that the issues that seemed to be the root cause of the conflict—such as the need for improved intellectual property protection and a ban on unfair technology transfers in China—must be dealt with. It was therefore disappointed when the deal, finally signed on 15th January 2020, appeared largely transactional in nature. Its focus on managed trade, by artificially increasing imports of American products to China, goes against the principles of globalisation and raises concerns that European imports will suffer as a result. It was also notable that substantial tariffs remained in place.¹ The status of the deal remains in flux at the time of writing.

The COVID-19 outbreak amplified the level of unpredictability experienced by European companies, damaging different businesses in a variety of ways. Once the full impact took hold in China, supply chains were severely disrupted and production ground to a halt across multiple industries. This—combined with plummeting international oil prices—hit the petrochemicals, chemicals and refining industry particularly hard. The Petrochemicals, Chemicals and Refining Working Group is now advocating for an extension of preferential economic and tax policies to aid industry recovery and enable manufacturers to maintain their focus on energy saving and reducing carbon emissions.

It is extremely important that the need to effectively combat COVID-19 does not distract from China's overall sustainable development goals. Although the pandemic saw China's emissions reduce by about 25 per cent, coal consumption at power plants and for oil refinery use returned to a normal range by the

¹ Disis, Jill and Riley, Charles, A World Trade War is Brewing. The US-China Deal Won't Stop it, CNN Business, 16th January 2020, viewed 30th June 2020, https://edition.cnn.com/2020/01/15/business/trade-risks-2020/index.html

end of March 2020. The virus has also stoked fears that the Chinese Government will use coal to prop up economic growth.²

China's renewable energy (RE) policy is also a source of great uncertainty at this time, as the National Energy Administration's recent draft Energy Law lacks a clear roadmap for increasing RE utilisation, pushing instead for the "rational development of fossil energy sources".³ As subsidies decline,⁴ RE generators, especially solar photovoltaic (PV) projects, are struggling to compete with cheaper coal-fired electricity producers. This issue is especially salient in light of depressed fossil fuel prices due to the COVID-19 pandemic. The dramatic drop in oil and natural gas prices at the beginning of 2020 jeopardised the PV and wind grid parity that had been achieved in 2019, and raises concerns that RE growth will continue to slow.

The Shipbuilding Working Group expects COVID-19 to have a particularly negative impact on the market for complex ship types, such as cruise vessels, platforms and equipment needed for the exploitation of resources at sea. Furthermore, the current drop in oil prices will have a further deleterious effect on the construction of offshore oil and gas platforms and related ships.

The European shipbuilding industry is facing off against Chinese competitors that are strongly motivated to achieve independence from non-Chinese technology. This poses both an opportunity and a threat. The working group believes that in order to preserve the technological sovereignty of the sector, the European Union should consider designating shipbuilding and its supply chain as a strategic sector subject to the foreign investment screening mechanism by member states.

The COVID-19 outbreak saw consumer demand for automobiles diminish in China at the beginning of 2020. The knock-on effects emerged in the automotive industry in February,⁵ before rippling along the entire supply chain.⁶ It could take a very long time for the situation to improve, necessitating essential policy support to allow the industry to recovery. The Automotive Working Group recommends that the Chinese authorities adopt such measures as adjusting new-energy vehicle (NEV) quota requirements for 2020, and permitting corporate average fuel consumption and deficits generated in 2020 to be banked for the next three years, among others.

The Chinese healthcare market was heavily affected by the pandemic. While demand for protective equipment, ventilators and a few other types of medical devices surged, the suspension of non-essential surgeries, to make room for COVID-19 treatment, resulted in a dramatic drop in revenue for many medical companies.

Medical equipment manufacturers in China were also impacted by export controls announced jointly by the Ministry of Commerce (MOFCOM), the National Medical Products Administration (NMPA) and

² Hausfather, Zeke, Analysis: Global Fossil-fuel Emissions up 0.6% in 2019 Due to China, Carbon Brief, 4th December 2019, viewed 9th April 2020, https://www.carbonbrief.org/analysis-global-fossil-fuel-emissions-up-zero-point-six-per-cent-in-2019-due-to-china

³ Announcement of the National Energy Administration on the Public Solicitation of the "Energy Law of the People's Republic of China", NEA, 10th April 2020, viewed 24th April 2020, https://www.nea.gov.cn/2020-04/10/c_138963212.htm

⁴ Chen, Xuewan and Lu, Yutong, China to Slash Subsidies for Renewable Energy Amid Drive to Cut State Support, Caixin, 11th March 2020, viewed 24th April 2020, https://www.caixinglobal.com/2020-03-11/china-to-slash-subsidies-for-renewable-energy-amid-drive-to-cut-state-support-101527138.html>

⁵ China Automobile Industry Association and Auto House Jointly Released '2020 New Crown Outbreak China Automobile Consumption Insight Report', China Automobile Industry Association, 10th March 2020, viewed 26th March 2020, https://www.caam.org.cn/chn/1/cate_3/con_5229082.html



the General Administration of Customs (GAC) on 31st March 2020.⁷ This policy delayed the delivery of critical medical equipment to Europe and other regions, by requiring products to have NMPA registration certification to qualify for export. This issue was addressed on 26th April, through a joint announcement from MOFCOM, the GAC and the State Administration for Market Regulation,⁸ and seemed to resolve the situation. However, a further policy, adding the requirement for blanket quality inspections of medical equipment before export, was issued by the GAC on 10th April,⁹ which is also likely to delay the arrival of medical goods at hospitals around the world.¹⁰

The COVID-19 outbreak has had diverse impacts on the agriculture, food and beverage (AFB) industry in China. At the same time that overall food demand and imports increased,¹¹ consumption of non-dailyessentials decreased, and although traditional retail outlets suffered badly due to lockdown measures, e-commerce platforms providing daily essentials boomed. Shrinking demand in sectors such as wine and catering services, along with the change in consumer purchasing behaviour, means that companies in the AFB industry will need to become more innovative, adjusting their strategies in order to survive the impacts of the pandemic.

The Cosmetics Working Group also believes that innovation is one of the best ways to help boost development and industry recovery in the wake of the COVID-19 crisis. To allow this to take place, the working group is advocating continued regulatory reform in the sector. Specifically, as the basis for all cosmetics-related policies, it is important that the Cosmetics Supervision and Administration Regulation (CSAR), and the implementing guidelines that accompany it, minimise the administrative burden placed on enterprises, while maximising product quality and safety. This will allow cosmetics companies to devote more resources to upgrading their research and development.



This icon represents the number of years the working group has been making this recommendation.

7 Heads of Related Departments of the Ministry of Commerce, the General Administration of Customs and the National Medical Products Administration Addressing Media Questions on the Orderly Export of Medical Supplies, MOFCOM, 3rd April 2020, viewed 1st July 2020, http://english.mofcom.gov.cn/article/newsrelease/ policyreleasing/202004/20200402953218.shtml>

8 Announcement No.12 (2020) of the Ministry of Commerce, the General Administration of Customs, and the State Administration for Market Regulation on Further Enhancing Quality Oversight for Exported Epidemic Prevention and Control Supplies, Ministry of Commerce, 27th April 2020, viewed 1st July 2020, http://english.mofcom.gov.cn/article/newsrelease/significantnews/202004/20200402959471.shtml>

11 Head of the Consumption Promotion Department of the Ministry of Commerce Discusses the Performance of China's Consumer Market from January to April 2020, MOFCOM, 19th May 2020, viewed 8th June 2020, https://www.mofcom.gov.cn/article/ae/sijd/202005/20200502966364.shtml

⁹ Announcement No.53 (2020) of the General Administration of Customs on Strengthening the Supervision of the Export Quality of Medical Supplies, GAC, 27th April 2020, viewed 1st July 2020, https://www.customs.gov.cn/customs/302249/302266/302267/2961602/index.html

¹⁰ Bradsher, Keith, China Delays Mask and Ventilator Exports After Quality Complaints, The New York Times, 11th April 2020, viewed 1st July 2020, https://www.nytimes.com/2020/04/11/business/china-mask-exports-coronavirus.html

Agriculture, Food and Beverage Working Group

Key Recommendations

- Reinforce the Coordination Between Different Government Authorities in Legislation and Establish a Unified System for Compliance Evaluation to Ensure the Consistent Enforcement of Rules and Regulations at All Levels in China 17
 - Reinforce the coordination between different government authorities in legislation.
 - Establish a unified system for compliance evaluation to ensure the consistent enforcement of rules and regulations at all levels in China by improving law enforcement officers' ability to enforce the rule of law through systematic training and promotion of case studies, and regulating their practices.
- 2. Adopt a Reasonable Monitoring and Regulatory Framework for Manufacturers of Imported Food With Clear Targets
 - Limit the definition of high-risk categories to the currently targeted categories of products and keep to a minimum the requirements for categories that are not on the high-risk list for overseas food manufacturers and government bodies.
 - Recognise food safety management systems established in other countries, increase the trust in industry associations and leading companies worldwide, and recognise existing globally established voluntary certification systems.
 - Engage in dialogue with enterprises to work out practical risk classification management and engage with overseas authorities to prepare the implementation if they are affected.
- 3. Distribute Responsibilities Proportionately Across the Supply Chain while Implementing 'Punishment Exemption' where Appropriate, Design a Reasonable Major Punishment System and Establish a Unified National Traceability System 17
- 3.1 Distinguish between the Responsibilities of Food Producers and Operators, and Design a Rational Major Punishment System and Specific Principles
 - Distinguish and enforce the responsibilities of food producers and operators separately.
 - Take full account of the subjectivity of senior management of enterprises when 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 Implement the 'Punishment Exemption' Principle where Appropriate and Apply it to the Entire Agricultural Product Value Chain
 - 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.



- 3.3 Establish a Unified National Traceability Platform, Legal Framework and Basic Standards to Promote Effective Tracing
 - Unify the national platform, regulations and standards for the food safety traceability system.
 - Ensure the tracing entities, products and information are bonded, technologies used are compatible and information is reliable.
- 4. Confirm the Approval Procedures and Timetable for the Use of Novel Food Ingredients and Food Additives Derived from Genetically Modified Microorganism (GMM) Technology and Simplify the Application Procedure (1)5
 - Call for comments on and publish a transparent, predictable, efficient, science- and riskbased *Guidance on Safety Evaluation of GMMs (and Products) for Food Use.*
 - Differentiate the safety evaluation data requirements for domestic and imported products and avoid requesting irrelevant information.
 - Reduce the number of ministries involved and clarify the duties and authority of relevant ministries.
 - Refer to the GMM enzyme approval procedure to start the GMM-sourced food and food additive approval.
- 5. Ensure a Transparent, Scientific and Efficient Procedure for Biotechnology Products Evaluation and Approval and Strengthen the Protection of New Plant Varieties
- 5.1 Accelerate the Approval Procedure for Genetically Modified (GM) Feed Additives and GM Agricultural Products
 - Accelerate the approval procedure for GM feed additives and GM agricultural products and ensure a public and effective procedure of approval.
 - Adopt more flexible data localisation requirements and consider the intended use of the product in China.
- 5.2 Relax Restrictions on GM Varieties Breeding and GM Seed Production
 - Relieve the restriction on GM varieties breeding and GM seed production in the Special Administrative Measures for Foreign Investment Admittance (Negative List) from 'prohibit' to no more than 'restricted'.
- 5.3 Create a Favourable Environment for Innovation in the Seed Sector and Safeguard the Rights and Interests of Seed Breeders by Strengthening the Protection of Intellectual Property of 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 Intellectual Property Rights (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
 - Strengthen communication with the OECD and its members to support the advancement of China's accession to the OECD Framework Agreement in the pesticide field to facilitate compatibility between Chinese and international pesticide registration test systems.
 - · Continue to accept and approve foreign Good Laboratory Practice (GLP) data to support

pesticide registration application and approval in China before the Article 16 of the *Measures for Pesticide Registration Administration* is reinterpreted and implemented.

- 7. Optimise the Implementation of the National Nutrition Plan 2017–2030 Based on Strong Scientific Evidence and under the Guidance of Healthy China 2030 Plan to Better Educate Consumers
 - 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 packaging labelling.
- 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
 - Include commonly used additives for FCMs in the positive list in an efficient manner.
 - Speed up the registration and approval process for new food-related products.
- 8.2 Establish Risk Assessment Framework for and Legalise the Use of Recycled Polyethylene Terephthalate (rPET) in FCMs
 - Establish risk assessment framework for and legalise the use of rPET in FCMs.
- 8.3 Update the Technical Requirements for FCMs Stipulating 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.

Cheese Industry Sub-working Group

1. Optimise the Regulation of Cultures Applied in Cheese Production 15

- Revise the labelling requirement in the relevant national food safety standard 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 cheese 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 cheese, and classify them as permitted ingredients in the production of cheese 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 <a>[1]
 - Improve regulations related to the change in registration of food for special medical purpose (FSMP) and infant formula recipes as soon as possible, and provide relevant detailed guidelines.



- Improve the onsite inspection system and clarify both the requirement of "actual needs" and the timeline for overseas inspections.
- Publish the annual overseas inspection plan in advance, while clarifying specific onsite inspection procedures and time limits, to allow manufacturers to better prepare for the inspection.
- 2. Guarantee a Sufficient Grace Period for Industry to Comply with the Newlyrevised Series of Infant Formula Standards, and Ensure a Smooth Transition Between the Implementation of the New Standards and Recipe Registration
 - Publish the new standards as soon as possible and establish a five-year transition period.
 - Accept registration applications that are based on, and reviewed according to, old standards, and review applications that are based on new standards in the meantime.
- 3. Encourage FSMP Market Access Expansion, Standardise Post-market Supervision and Improve Public FSMP Education
 - Simplify the general nutrient-complete FSMP registration mechanism and adopt a management model that includes national food safety standards and product filing.
 - 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. Continue to Revise National Food Safety Standards 15

- Revise national food safety standards so they are more aligned with the latest international standards.
- Add additional product categories in the national food safety standards for FSMP to promote industry development and fulfil people's increasing product needs, while putting in place technical indicators for relevant products.
- Verify differences among existing testing methods, clarifying what the scope is for each, and develop food safety national testing methods for FSMP.
- Establish industry standards for domestic infant and young children formula and FSMP products containing amino acids and gradually improve the applicable amino acid national standards.

5. Optimise Legislation by Basing it on Scientific Evidence

- Establish regulations to make up for the shortcomings of the current regulatory system by considering industry compliance enforcement and maintaining consistency with other mandatory requirements.
- Legislate only after thorough investigation of industry practices and market conditions, to ensure the legislation is scientific, rational and fair.
- 6. Enhance the Transparency and Consistency of Law Enforcement, and Facilitate Communication with the Industry
 - Improve the openness and transparency of legislation concerning major decisions that may affect industry development and seriously impact enterprise interests, and actively communicate with the industry, giving enterprises opportunities to voice their opinions.

• Publicise specific technical review and administrative approval requirements for registration to improve the overall transparency and fairness of the review and approval process.

7. Publish New Administrative Measures on the Sale of Breast Milk Substitutes 15

- Develop new Administrative Measures on the Sale of Breast Milk Substitutes and clarify the definition and scope of breast milk substitutes as soon as possible.
- Allow FSMP manufacturers to communicate with healthcare professionals regarding scientific feeding, under the prerequisite that the companies do not interfere with 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.

8. Optimise the Requirements for Clinical Trials of FSMP 13

8.1 Rationalise the Requirements Placed on Trial Participants

- Establish a method for businesses to be exempted from conducting clinical trials, or allow a
 reduction in the use of clinical trial cases for populations under the age of 10, and 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 FSMPs that apply to single group studies.

8.2 Adopt Hierarchical Management to Verify FSMP Clinical Effectiveness

- Request reasonable supporting materials, such as hierarchical management for clinical verification, and confirm the clinical effectiveness of disease-specific FSMPs based on the specific disease characteristics.
- Consider the fact that FSMPs are only clinical nutritional support products, and design reasonable clinical observation indicators.

Introduction to the Working Group

Agriculture, food and beverage (AFB) industries have a significant impact on people's daily lives. At the global level, they are continuously innovating, with more attention being paid to food safety and the sustainable sourcing of food, pushing them to achieve new breakthroughs and employ new technology. In China, in addition to furthering agricultural development and modernising food production processes, improving the safety and security of food is essential to ensure the continuous and sustainable development of the economy and people's livelihood.

The Agriculture, Food and Beverage Working Group helps connect members with the Chinese authorities, in order for the government to better understand what needs to be done to promote food safety, improve market access for European food and beverage companies and promote the importance of a healthy diet in China. This working group represents a wide range of companies that include importers and exporters, manufacturers, distributors, retailers, catering service providers, specialised testing laboratories, and consultancies. Currently, this working group has over 150 member companies.

The Agriculture, Food and Beverage Working Group is composed of three sub-working groups – the Cheese Industry Desk, the Food for Special Medical Purpose Advisory Committee and the Paediatric Nutrition Desk. The Cheese Industry Desk was established in 2014 and has nine prominent European cheese 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 10 international companies as members and four domestic manufacturers as local partners. All three desks represent member interests and promote dialogue and communication among relevant stakeholders.

Recent Developments

The working group welcomes the legislative progress providing benchmarks and guidelines for the AFB sectors, published following the institutional restructuring fully implemented by the beginning of 2019. Major legislative changes that drew the attention of the working group include the State Administration for Market Regulation's (SAMR's) draft Measures for the Supervision and Administration of Food and the revised draft General Standard for the Labelling of Prepackaged Foods from the National Health Commission (NHC). The working group is concerned about the laws targeting similar issues without a clear hierarchy defined and with some contradictory articles in the two texts. New laws have also raised questions for the industry as well. In November 2019, the General Administration of Customs (GAC) called for comments on the Regulations on the Administration of Registration of Overseas Food Manufacturing Enterprises and later on the Measures for the Administration of the Safety of Import and Export Food (Draft for Comments); rules which may cause extra financial burden and administrative requirements for food importers in China. In 2020, the SAMR is expected to publish seven new laws and revise 48 regulations,¹ among which several will have a significant impact on the AFB sector. The working group expects clear rules for businesses to comply with, but also hopes that those rules will not impose extra burden on enterprises.

International incidents influence the AFB sector in China as well. The US-China 'Phase One' trade deal included several agricultural issues, from import and export of agricultural products to agricultural biotechnology. The European Union (EU) and China concluded the eightyears-long negotiations on a bilateral agreement to protect 100 European Geographical Indications (GI) in China and 100 Chinese GI in the EU against imitations and usurpation, the first comprehensive and high-level GI protection bilateral agreement China has signed with one of its international partners. The working group expects the substantial implementation of these agreements and hopes to see conclusion of other bilateral agreements between the EU and China.

Entering 2020, the outbreak of COVID-19 has had nuanced impacts on the AFB industry in China: while food demand and food importation increased in general,² the consumption of non-essentials decreased. The retail sector has been heavily impacted by the lockdown measures during the pandemic, e-commerce platforms developed rapidly with customers increasingly turning to online means to purchase daily essentials, which requires companies to adapt to the trend. With market demand shrinking amid the pandemic in sectors such as wine and catering services, and consumers' buying patterns changing, businesses must adjust their operation mode and strategy in order to survive.

Key Recommendations

1. Reinforce Coordination Between Different Government Authorities in Legislation and Establish a Unified System for Compliance Evaluation to Ensure the Consistent Enforcement of Rules and Regulations at All Levels in China <a>7

Concern

Laws targeting similar issues from different government authorities could cause inconsistent interpretation of rules and regulations and extra burden for businesses.

Assessment

China's legal framework on food supervision has improved in recent years with the accelerated establishment of a unified and authoritative system. However, the working group expects the coordination of different departments to be considered in legislation. For example, the NHC's draft *GB* 7718 - *General Standard for the Labelling of Pre-packaged Foods* and the SAMR's *Measures for the Supervision and Administration of Food Labelling* have some overlapping features, yet it is not clear which takes

^{1 2020} Legislative Plan, SAMR, 17th March 2020, viewed 19th April 2020, <http:// www.gov.cn/zhengce/zhengceku/2020-03/26/content_5495857.htm>

² Head of the Consumption Promotion Department of the Ministry of Commerce Discusses China's Consumer Market Openness from January to April 2020, Ministry of Commerce (MOFCOM) 19th May 2020, viewed 8th June 2020, http://www.mofcom.gov.cn/article/ae/sijd/202005/20200502966364.shtml)



precedent. A transparent legislative process with full public consultation would lead to a more mature law text and ultimately facilitate implementation. Before the final publication of the aforementioned laws, the working group would like more opportunities to comment and have their suggestions taken into account into account by the authority.

A lack of appropriate coordination across relevant regulatory authorities at central and local levels creates challenges for companies: undue delay of approvals, increased operational complexity and greater noncompliance risks for companies, among others. The legitimate rights and interests of a company can be protected only if law enforcement officers exercise their power in a legal and rational manner by following proper procedures and accepting any responsibility for attendant consequences that may arise.

Recommendations

- Reinforce the coordination between different government authorities in legislation.
- Establish a unified system for compliance evaluation to ensure the consistent enforcement of rules and regulations at all levels in China by improving law enforcement officers' ability to enforce the rule of law through systematic training and promotion of case studies, and regulating their practices.

2. Adopt a Reasonable Monitoring and Regulatory Framework for Manufacturers of Imported Food With Clear Targets

Concern

The draft *Regulations on the Administration of Registration of Overseas Food Manufacturing Enterprises* leaves uncertainties about the future risk assessment management system and corresponding additional requirements for overseas food manufacturers and government bodies.

Assessment

The current management method for certain categories (meat, aquatic and dairy products, bird's nest) imposes heavy administrative burdens on food manufacturers and authorities in the exporting countries.³ In November 2019, the GAC called for comments on the *Regulations*

on the Administration of Registration of Overseas Food Manufacturing Enterprises (Consultation Draft).⁴ The draft was unclear about the connotation of overseas food production enterprises and the vagueness surrounding risk assessment of food categories. Moreover, some foreign authorities may not possess the necessary legal framework to provide certificates for production facilities or to confirm compliance with Chinese standards.

While the working group is fully aligned with government efforts to guarantee food safety and protect Chinese consumers, it is concerned that the introduction of additional bureaucratic hurdles and financial costs for overseas food producers that export different categories of food may have unintended results, such as reducing the availability of imported food for Chinese consumers and disrupting international trade. The vagueness of risk assessment of food sectors could bring unpredictability to market access for business, thus the risk rating by country and category must be transparent and simple and any additions to the high-risk list must be profoundly considered and prepared.

Recommendations

- Limit the definition of high-risk categories to the currently targeted categories of products (meat, aquatic and dairy products, bird's nest) and keep to a minimum the requirements for categories that are not on the high-risk list for overseas food manufacturers and government bodies.
- Recognise food safety management systems established in other countries, increase trust in industry associations and leading companies worldwide, and recognise existing globally established voluntary certification systems.
- Engage in dialogue with enterprises to work out practical risk classification management and engage with overseas authorities to prepare the implementation if they are affected.

³ Catalogue for the Implementation of the Registration of Overseas Producers of Imported Food, GAC, 31st December 2019, viewed 30th July 2020, <http://jckspj. customs.gov.cn/spj/zcfg18/gfxwj65/2847986/index.html>

⁴ Call for comments on the Regulations on the Administration of Registration of Overseas Food Manufacturing Enterprises (Consultation Draft), GAC, 26th November 2019, viewed 6th July 2020, <http://www.customs.gov.cn/ customs/302452/302329/zjz/2712639/index.html>



- 3. Distribute Responsibilities Proportionately Across the Supply Chain while Implementing 'Punishment Exemption' where Appropriate, Design a Reasonable Major Punishment System and Establish a Unified National Traceability System (1)7
- 3.1 Distinguish Between the Responsibilities of Food Producers and Operators, and Design a Rational Major Punishment System and Principles

Concern

Relevant laws and regulations do not clearly define the distinct responsibilities of food producers and operators, while implementation of policies and standards is inconsistent in different regions.

Assessment

Food producers (including farming, manufacturing and processing) and operators bear different responsibilities in the value chain. However, in many cases, the Food Safety Law and its supporting regulations often impose the responsibilities and obligations of food producers on food operators, resulting in operators often been handed down penalties that should be borne by the producers. With the implementation of policies and punishment standards varying in different regions, these challenges become even more severe.

In addition, the senior management of chain retailers are normally not involved in the daily operation of each store. The existing systems of punishment and broad principles such as 'punishment for responsible individuals' and 'joint punishments in cases of serious credit irregularity' will undoubtedly increase the potential compliance, reputation and financial risks for chain retailers and their senior management.

Recommendations

- Distinguish and enforce the responsibilities of food producers and 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 Implement the 'Punishment Exemption' Principle where Appropriate and Apply it to the Entire Agricultural Product Value Chain

Concern

Local departments do not always enforce the practice of 'punishment exemption' for retailers, and government departments are not consistent in applying it throughout the agricultural product value chain.

Assessment

Article 136 of the Food Safety Law lays out the 'punishment exemption' principle⁵ (a person who has achieved his/her due diligence could be exempted from punishments). The working group hopes to see the SAMR refine the guidelines and local authorities implement 'punishment exemption'. Several court cases over the responsibilities of food producers and operators followed the 'punishment exemption' principle. Realising fair and reasonable policy implementation and enforcement safeguards the rights and interests of enterprises. The safety of edible agricultural products falls under the responsibilities of the Ministry of Agriculture and Rural Affairs (MARA) and the SAMR. The MARA is revising Agricultural Products Quality and Safety Law, which needs to align with the Food Safety Law in keeping the principle of 'punishment exemption' in order to avoid operators being punished for producers' issues, such as excess of pesticide residue.

Recommendations

- 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.

3.3 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.

⁵ Food Safety Law, SAMR, 6th May 2019, viewed 20th May 2020, <http://gkml.samr. gov.cn/nsjg/tssps/201905/t20190506_293407.html>

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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 operators shall establish a food safety traceability system. 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 with each other, 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 the food safety traceability system.
- Ensure the tracing entities, products and information are bonded, technologies used are compatible and information is reliable.
- Confirm the Approval Procedures and Timetable for the Use of Novel Food Ingredients and Additives Derived from Genetically Modified Micro-organism (GMM) Technology and Simplify the Application Procedure (5)

Concern

The temporary joint-approval process for new food ingredients and additives derived from GMM technology by the NHC and the MARA has not yet been officially clarified, which results in relatively low regulatory efficiency, while the lack of an official document regarding requirements for applications creates uncertainty for new submissions.

Assessment

No official regulatory document has been released on the requirements for the joint approval procedure and application dossiers requirements, thus, the unpredictability and uncertainty remain of great concern to the industry. The *Guidance on Safety Evaluation of the GM Micro-organisms (and Products) for Food Use* has been expected by the industry for a long time. The government has drafted the *Guidance*, but its content and potential publication date have as yet not been disclosed. A transparent, predictable, efficient, scienceand risk-based guidance is of utmost importance for government monitoring and enterprise implementation.

Moreover, the working group hopes that relevant ministries establish an assessment procedure for approving food ingredients derived from GMM in a timely manner, in accordance with the trade agreement between China and the United States (US).⁶ Though the agreement was signed between China and the US, this procedure should also apply to relevant products of European enterprises. Meanwhile, safety evaluation data requirements of domestic and imported products should be nuanced, and requirements irrelevant for the safety evaluation avoided. In mid-June 2018, the NHC started accepting dossiers on food additives derived from GM technology, but only those submitted for MARA review. By the end of 2018, MARA had passed 14 enzyme products derived from GM technology. The NHC started its food additive review procedure for the same products in February 2019 and published the approval for the first new food additive in December 2019. The rest of the 13 GMM enzymes were finally approval in June 2020. Based on this, the working group thinks that the joint approval procedure is rather long, and believes it would be best for one ministry to complete the whole approval process, to avoid repetitive or confusing procedures and reduce enterprises' burden.

Recommendations

- Call for comments on and publish a transparent, predictable, efficient, science- and risk-based Guidance on Safety Evaluation of the GM Micro-organisms (and Products) for Food Use.
- Differentiate between the safety evaluation data requirements for domestic and imported products and avoid requesting irrelevant information.
- Reduce the number of ministries involved and clarify the duties and authority of relevant ministries.
- Refer to the GMM enzyme approval procedure to start the GMM-sourced food and food additive approval.

⁶ Economic and Trade Agreement Between the Government of the People's Republic of China and the Government of the United States of America, MOFCOM, 16th January 2020, viewed 3rd July, http://images.mofcom.gov.cn/ english/202001/20200116155105187.pdf>



- 5. Ensure a Transparent, Scientific and Efficient Procedure for Biotechnology Products Evaluation and Approval and Strengthen Protection of Intellectual Property Rights of New Plant Varieties
- 5.1 Accelerate the Approval Procedure for GM Feed Additives and GM Agricultural Products

Concern

The approval procedure for GM feed additives and GM agricultural products is currently inefficient.

Assessment

According to Agriculture GM Biosafety Management Office data, the Agricultural Genetically Modified Organisms Safety Certificate (Imports) Approved List contained 31 items⁷ in 2018, but in 2019 and 2020. the same list contained respectively only 12 and 8 approved items.8&9.849 In addition, the approval time of GM products is relatively long on average, involving multiple and repeated submission of different materials, which creates hurdles for enterprises when declaring products. Continued delays and uncertainties in approving biotech products have severely hampered global agricultural innovation and new products from entering China. Moreover, imposing strict 'one-sizefits-all' data requirements when implementing the Regulations on the Safety Management of Agricultural Genetically Modified Organisms¹⁰ does not help with running the approval process more efficiently and openly.

Recommendations

- Accelerate the approval procedure for GM feed additives and GM agricultural products and ensure the procedure is conducted publically and effectively.
- Adopt more flexible data localisation requirements and consider the intended use of the product in China.

5.2 Relax the Restrictions on GM Varieties Breeding and GM Seed Production

Concern

The Special Administrative Measures for Foreign Investment Admittance [Negative List (2020 version)]¹¹ published in 2020 still prohibit foreign investment in GM varieties breeding and GM seed production.

Assessment

Prohibiting foreign investment in areas of GM varieties breeding and GM seed production will not only limit market competition and efficiency, but it is also detrimental to China's goals for innovation and modernization in the agricultural sector. The working group hopes that the Chinese Government will scale back this provision from 'prohibited' to 'restricted' to allow joint ventures to engage more widely in seed technology innovation and crop production. This will help to bring in technology, talents and seed resources to China, develop domestic research and development (R&D) and management talent as well as promote the quality standard and management level of the industry in order to improve the benign competition and market development in China.

Recommendation

- Relax restrictions on GM varieties breeding and GM seed production in the Special Administrative Measures for Foreign Investment Admittance (Negative List) from 'prohibit' to no more than 'restricted'.
- 5.3 Create a Favourable Environment for Innovation in the Seed Sector and Safeguard the Rights and Interests of Seed Breeders by Strengthening the Protection of Intellectual Property 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 vague definitions for infringement and damage compensation are impeding intellectual property rights (IPR) protection for new plant varieties in China.

⁷ The Agricultural GM Organisms Safety Certificate (Imports) Approved List 2018, MARA, 8th January 2019, viewed 16th April 2020, http://www.moa.gov.cn/ztzl/zjyqwgz/spxx/201901/t20190108_6166293.htm

⁸ The Agricultural GM Organisms Safety Certificate (Imports) Approved List 2019, MARA, 21st January 2020, viewed 16th April 2020, http://www.moa.gov.cn/ztzl/ziyqwqz/spxx/201912/l20191230 6334015.htm>

⁹ The Agricultural GM Organisms Safety Certificate (Imports) Approved List 2020, MARA, 15th July 2020, viewed 20th July 2020, http://www.moa.gov.cn/ztzl/zjyqwgz/spxx/202006/P020200623381861104140.pdf>

¹⁰ Regulations on the Safety Management of Agricultural Genetically Modified Organisms, MARA, 22rd December 2017,viewed 20th May 2020, http://www.moa.gov.cn/ztzl/zjyqwgz/zcfg/201007/t20100717_1601306.htm

¹¹ Special Administrative Measures for Foreign Investment Admittance [Negative List (2020 version)], National Development and Reform Commission (NDRC) and MOFCOM, 23rd June 2020 viewed 30th June 2020, https://www.ndrc.gov.cn/ xxgk/zcfb/fzggwl/202006/P020200624549035288187.pdf>



Assessment

China became the 39th member of the International Union for the Protection of New Varieties of Plants in 1999,¹² yet the text adopted by China does not contain the concept of substantially derived varieties, which cannot effectively protect the rights of original breeders. The lack of this concept intensifies homogeneity of varieties, which is not conducive to variety innovation. The working group recommends the introduction of additional IP tools to provide comprehensive innovation protection and the establishment of an IP credit system for seed companies to better manage IPR related to seed development and enhance plant variety protection (PVP) enforcement. It also suggests incorporating essentially derived varieties (EDV) into the final version of the Regulations on the Protection of New Varieties of Plants;¹³ establishing technical specifications for the 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 Cooperation and Development (OECD) to Support the Advancement of China's Accession to the OECD Framework Agreement on the Pesticide Field

Concern

As of 1st November 2017, the MARA has stopped accepting OECD Good Laboratory Practice (GLP) reports issued by overseas laboratories for the pesticide registration procedure, increasing costs for foreign enterprises.

Assessment

On 1st June 2017, China's newly revised Pesticide Management Regulations were officially implemented. 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, up to now, China has not signed a mutual recognition agreement with any country or international organisation, such as the OECD framework agreement (or the OECD pesticides programme). China is in discussions but has yet to join the Mutual Acceptance of Data (MAD) system¹⁴ of the OECD in the pesticide field. 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 registration procedure that can stretch out for an additional 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 requires all registration tests to be conducted within its territory.

Therefore, before the Article 16 of the Measures for Pesticide Registration Administration is reinterpreted and the provisions of "signing mutual recognition agreement with relevant departments of the Chinese government" be implemented, transitional measures need to be taken from the MARA side.

Recommendations

- Strengthen communication with the OECD and its members to support the advancement of China's Accession to the OECD Framework Agreement on pesticide.
- Continue to accept and approve foreign GLP data to support pesticide registration application and approval in China before the Article 16 of the *Measures for Pesticide Registration Administration* is reinterpreted and implemented.

¹² China Accedes to UPOV, Grain, 7th April 1999, viewed 20th May 2020, <https:// www.grain.org/en/article/1900-china-accedes-to-upov>

¹³ 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 May 2020, https://www.forestry.gov.cn/xpzbh/4704/20190515/172838025835329.html>

¹⁴ Mutual Acceptance of Data (MAD), OECD, 2020, viewed 21st May 2020, <https:// www.oecd.org/env/ehs/mutualacceptanceofdatamad.htm>



 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 Educate Consumers

Concern

The National Nutrition Plan 2017–2030 (*Guoban Fa* [2017] *No.60* 2017)¹⁵ did not provide the food and beverage industries with clear guidance on the execution of the plan.

Assessment

Food and beverage industry players in China are expecting clearer guidance from authorities on the implementation of the National Nutrition Plan 2017-2030. 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 Association (CAN) released jointly the Guidelines for Salt Reduction in Chinese Food Industry,¹⁶ echoing the requirements in the National Nutrition Plan 2017-2030. However, whether it is necessary to publish similar guidelines for sugar and oil reduction in the food industry should be further considered by authorities 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, yet a dietary pattern characterised by the consumption of foods rich in protective compounds is likely to be of more benefit, and limiting portion sizes to reduce overall energy intake would also reduce the risk of unhealthy weight gain.¹⁷ Realising a national healthy diet requires more sophisticated education targeting different groups of people.

The China National Food Industry Association (CNFIA) and the CAN have their own system of group logos indicating certain ingredients and their portion to consumers, though both lean towards reducing salt, oil and sugar use in food. This could lead to confusion for consumers while also causing difficulties for supervision departments. Many countries have their own front of package labelling (FOP) systems, yet 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 Accelerate 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

GB 9685-2016 entered into effect on 19th October 2017. The standard introduced a clear management model for raw and auxiliary materials through positive lists. For each category of FCM—including plastic, coating, rubber and silica gel—a permitted additives list is provided. It is illegal to use unlisted additives in China. The NHC has since approved new additives and food contact materials to satisfy the demands of the FCM industry.¹⁸ 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 a substantially long time, which may lead to a significant reduction in inbound trade in terms of both volume and value. Even

¹⁵ Notice from the General Office of the State Council onIssuing the National Nutrition Plan 2017–2030, State Council, 2017, viewed 21st May 2020, http://www.gov.cn/zhengce/content/2017-07/13/content 5210134.htm>

¹⁶ China Proposes the First Salt Reduction Strategy for Food Industry, Xinhua, 19th April 2018, viewed 21st May 2020, <http://www.xinhuanet.com/food/2018-04/19/ c_1122705738.htm>

¹⁷ Limiting Portion Sizes to Reduce the Risk of Childhood Overweight and Obesity, World Health Organization, 14th September 2014, viewed 20th April 2020, https://www.who.int/elena/bbc/portion_childhood_obesity/en/>

¹⁸ Crisis Evaluation, NHC, viewed 20th April 2020, <http://www.nhc.gov.cn/sps/ s2909/new list.shtml>

though *GB* 9685-2016 took reference from standards and laws of the EU (EU 10/2011), the US (*Code of Federal Regulations Title 21*)¹⁹ and Germany (BfR Recommendations on Food Contact Materials)²⁰, 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 and Legalise the Use of Recycled Polyethylene Terephthalate (rPET) in Food Contact Materials

Concern

The use of rRET in FCM remains uncertain for the industry since it is not on the FCM White List and there is no official notice on the legal use of the substance in this manner.

Assessment

Many European countries and the US all permit the use of rPET in FCM, given the high demand for food packages. The FDA 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 food-contact applications. As early as 2012, the European Food Safety Authority (EFSA) authorised six PET recycling processes for up to 100 per cent use in FCM.²¹ Taking these into account, it is important for China to be geared towards international standards and practices. Using rPET in FCM could help clear any confusion over policy when importing food packed in rPET materials, and thereby facilitating the international food trade. On the other hand, 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 FCMs, Stipulating 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 conditions of use, FCM traders cannot accurately assess their 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 proprietary information 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.

Recommendation

 Update the technical requirements for FCM, stipulating limitations for used ingredients and additives in food-related products.

¹⁹ Code of Federal Regulations Title 21 database, US Food and Drug Administration (FDA), FDA, annual updating

²⁰ Bundesinstitut für Risikobewertung, BfR Recommendations on Food Contact Materials, German Federal Institute for Risk Assessment, 2020, viewed 21st May 2020, https://www.bfr.bund.de/en/bfr_recommendations_on_food_contact_materials-1711.html>

²¹ EFSA Authorizes Six PET Recycling Processes for up to 100% Use in Food Contact Materials, Food Packaging Forum, 6th December 2012, viewed 17th April 2020, https://www.foodpackagingforum.org/news/efsa-authorizes-six-petrecycling-processes-for-up-to-100-use-in-food-contact-materials>



Abbreviations

| AFB | Agriculture, Food and Beverage |
|--------|--------------------------------------|
| CAN | Chinese Nutrition Association |
| CNCA | Certification and Accreditation |
| | Administration of China |
| CNFIA | China National Food Industry |
| | Association |
| EDV | Essentially Derived Varieties |
| EFSA | European Food Safety Authority |
| EU | European Union |
| FCM | Food Contact Materials |
| FDA | Food and Drug Administration |
| FOP | Front of Package Labelling |
| GAC | General Administration of Customs |
| GB | Guobiao or Chinese national standard |
| GI | Geographical Indications |
| GLP | Good Laboratory Practice |
| GM | Genetically Modified |
| GMM | Genetically Modified Micro-organism |
| MARA | Ministry of Agriculture and Rural |
| | Affairs |
| MAD | Mutual Acceptance of Data |
| MOA | Ministry of Agriculture |
| MOFCOM | Ministry of Commerce |
| MNC | Multinational Corporations |
| NHC | National Health Commission |
| NPC | National People's Congress |
| OECD | Organisation for Economic Co- |
| | operation and Development |
| PVP | Plant Variety Protection |
| R&D | Research and Development |
| rPET | Recycled Polyethylene Terephthalate |
| SAMR | State Administration of Market |
| | Regulation |
| US | United States |



Cheese Industry Sub-working Group

Introduction to the Sub-working Group

Cheese making dates back several thousand years. The use of different microbes, amounts of salt and lengths of storage have over the years given rise to a huge variety of different cheeses all over the world, and it is widely considered a nutritional food in European diets. Chinese consumers are also now beginning to recognise cheese as a valuable source of nutrition.

The European Chamber's Cheese Industry Subworking Group was established in 2014, and has nine prominent European cheese producers and industry associations that are committed to bringing the best cheese products to China's market to meet Chinese consumers' demands.

The Cheese Industry Sub-working Group represents members' interests and promotes constructive dialogue and communication between relevant stakeholders, including industry associations and regulators, to ensure a level playing field for all.

Recent Developments

The past five years has seen double-digit growth of the sales value of China's cheese market,¹ which has benefitted both domestic producers and importers of cheese products. The import volume has grown from 28,600 metric tonnes in 2011² to 115,000 metric tonnes in 2019.³ It is predicted that the total value of retail sales of cheese in China will reach Chinese yuan (CNY) 11.2 billion by 2024, which would be more than 1.5 times that of 2019 levels.⁴

In 2016, the former National Health and Family Planning Committee (NHFPC) announced the revision of the *GB 5420-2010 National Food Safety Standard for*

Cheese,⁵ and the *GB 25192-2010 National Food Safety Standard for Process(ed) Cheese*.⁶ The China National Centre for Food Safety Risk Assessment (CFSA) coordinated with relevant institutes on the revision of these two standards. On 23rd May 2019, the National Health Committee (NHC) published on its homepage an invitation for public consultation on both drafts. Following public consultation, the draft *GB 25192-2010* was reviewed by the Expert Commission of the NHC in November 2019 and the draft *GB 5420-2010* has been approved by the Technical Director-Generals Meeting of the NHC in June 2020.

In the latest draft, the limits on yeast and mould were removed, which was very much welcomed by the European cheese industry. However, it is still too early to tell when these new standards will become effective. The Cheese Industry Sub-working Group provided comments during the public consultation, and expects both standards to be revised based on existing scientific evidence. The sub-working group further anticipates that barriers currently and potentially preventing both the importation of certain European cheese products and the development of the domestic cheese industry in China will be removed.

In September 2017, the importation of certain types of European cheeses that use particular types of cultures (e.g. geotrichum candidum, penicillium candidum and penicillium camemberti) was impacted by strengthened regulatory measures enacted by China to ensure food safety. The use of cultures in cheese production is an ongoing, longstanding issue that has been raised many times by the Cheese Industry Sub-working Group and has been discussed, in detail, in its past five 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 used by China in 2017 as a frame of reference to address the regulations of the use of cultures in cheese production. This action was welcomed by the cheese industry.

¹ Cheese Industry Sales Growing Rapidly to Reach CNY 8.289 Billion by 2020, qianzhan.com, 8th May 2018, viewed 17th May 2020, <https://d.qianzhan.com/ xnews/detail/541/180508-d65ccf56.html>

² First China Cheese Development Seminar held in Beijing, China Dairy Industry Association, 21st March June 2020, viewed 17th May 2020, http://www.cdia.org, cn/newsn.php?id=1529>

³ Volume of Cheese Imported to China in 2019, by Leading Exporting Country, www.statista.com, 2nd June, viewed 6th July 2020, <https://www.statista.com/ statistics/1048686/china-cheese-imports-by-leading-exporter/>

⁴ Analysis of the Current Situation of the Cheese Industry in China and Japan in 2019, chyxx.com, 2nd June 2020,, viewed 6th July 2020, http://www.chyxx.com/industry/202006/869768.html>

⁵ Notice on Plan for 2016 National Food Safety Standards (First Batch), NHFPC, 15th July 2016, viewed 17th May 2020, <http://www.nhc.gov.cn/sps/s3593/201609/ef18e4 0959cd4f2ab9b351e32db3eecd.shtml>

⁶ Notice on Plan for 2016 National Food Safety Standards (Second Batch), NHFPC, 12th December 2016, viewed 16th May 2020, <http://www.nhc.gov.cn/ sps/s3593/201612/42617c2ee7814f548a7de5638b271840.shtml>



In 2016, the former NHFPC started work on the development of the National Food Safety Standard for Microbial Food Cultures. In 2019, the 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 the 'fermentation strains' can be listed on the label instead of individual culture names. The cheese industry is encouraged by the 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 cheese industry to be promoted, in line with the Chinese Government's position on promoting trade liberalisation and economic globalisation. As cheese is well-recognised as a nutritional food, 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 2030,⁷ and the National Nutrition Plan 2017–2030.⁸ In addition, the development of the cheese industry is one of the key drivers that will facilitate the upgrading of China's dairy industry.

The Chinese Government intends to enhance its technical competence with respect to cheese industry regulation in order to ensure the safety of cheese products in China. The Cheese Industry Sub-working Group expects that the formulation and revision of the national food safety standards for cheese and processed cheese will be compatible with related international standards and manufacturing conditions, while maintaining a high level of food safety. As market demand for cheese continues to increase in China, sub-working group members continually seek opportunities to enhance communication with the regulatory authorities and present Chinese customers with a greater variety of nutritional products.

Key Recommendations

1. Optimise the Regulation of Cultures Applied in Cheese Production (1)5

Concern

Many cultures traditionally used in European cheesemaking processes are not included in the positive list that China uses to regulate the application of cultures in food production, which acts as a barrier to the Chinese market.

Assessment

China's regulation of food cultures allows a very limited number of microbial cultures to be used. In 2010, the then Ministry of Health (MOH) issued the *List of Cultures Applied in Food.*⁹ The notice included a positive list that only recognised a few microorganism types, mainly used for yoghurt manufacturing, with regulated cultures applied in food for infants and young children featuring in another list. This regulation exempts a number of cultures that are traditionally used for food manufacturing and processing. Although exempted cultures listed in the notice are not specified as those used in traditional Chinese cooking, the official interpretation and actual implementation does in fact apply only to cultures used in 'traditional Chinese food'; this includes vinegar, soy sauce and Chinese liquor, among others.

After the introduction of seven additional notices, a total of 38 cultures are now listed, expanded from the original 21. This means that only 17 cultures have been added in nine years. Cultures other than the 38 listed and those used in Chinese traditional foods must not be used in production until they are approved in a safety review conducted by the NHC. The review process is made impossible for producers of cultures used in cheese, as it requires information that is very difficult to obtain-such as the toxicological assessment of a certain culture, which is very time- and resourceconsuming-and so is hindering the development of the Chinese cheese industry. 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 cheeses.

Authoritative lists of microorganisms used by international



⁷ Outline of Healthy China 2030, State Council, 25th October 2016, viewed 16th May 2020, http://www.gov.cn/xinwen/2016-10/25/content_5124174.htm

⁸ National Nutrition Programme (2017-2030), State Council, 30th June 2017, viewed 16th May 2020, <http://www.gov.cn/zhengce/content/2017-07/13/ content_5210134.htm>

⁹ Notice of MOH Office on Issuing the List of Cultures Applied in Food, NHC, 28th April 2010, viewed 16th May 2020, <http://www.nhc.gov.cn/sps/s3593/201004/65 839d2d57554dd29ae40a52dca92c74.shtml>

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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.¹⁰ The Chinese Government and a number of research institutes are cooperating with the IDF to include the cultures used in manufacturing traditional Chinese food.

The Danish Veterinary and Food Administration (DVFA) has a list of notified microbial cultures used in food. The list is a record of all microbial cultures the DVFA has been notified of, and can be expanded if given more information by culture manufacturers. Safety documentation is not precluded in the notification process: the DVFA does not approve microbial cultures before they are used. In European countries, cultures are considered ingredients and must satisfy legal safety requirements, with the responsibility for their safety lying with manufacturers. Related regulations state that manufacturers shall only use cultures that have a history of safe use.

The contribution of certain microbes to cheese has been widely recognised, and pure microbial cultures are commonly used by cheesemakers. In addition to lactic acid bacterial starter cultures, various species of bacteria and fungi can be added to give cheese very specific characteristics. For instance, bluemould cheeses have always been fermented with Penicillium roqueforti. Spores of the filamentous fungus Penicillium camemberti are inoculated into milk during the production of bloomy, rind cheeses such as Brie and Camembert. The actinomycete bacterium Brevibacterium linens (B. linens) contribute to the reddish-orange colour found in the traditional cheese Epoisses. Over centuries, cheesemakers have learned how to consistently cultivate specific microbial colonies by manipulating the conditions a cheese is subjected to during the ageing process. Recognising the historical safe use of cultures applied in cheese will help promote the industry in China and allow Chinese customers to enjoy a wider variety of cheeses.

Recommendations

- Revise the labelling requirement in the relevant national food safety standard so that 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 cheese 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 cheese, and classify them as permitted ingredients in the production of cheese as soon as possible.

Abbreviations

| CFSA | China National Centre for Food |
|-------|-------------------------------------|
| | Safety Risk Assessment |
| DVFA | Danish Veterinary and Food |
| | Administration |
| IDF | International Dairy Federation |
| МОН | Ministry of Health |
| NHC | National Health Commission |
| NHFPC | National Health and Family Planning |
| | Commission |

¹⁰ 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 May 2020.



Food for Special Medical Purpose Sub-working Group and Paediatric Nutrition Sub-working Group

Introduction to the Sub-working Group

Food for special medical purpose (FSMP) can provide the best and most economical nutritional support for the treatment and recovery of people with special medical needs. It enhances people's quality of life by catering to their individual needs, cutting treatment costs and supporting healthier ways of living.

The European Chamber's FSMP Sub-working Group was established in 2016, and counts four leading international manufacturers as members that specialise in special nutrition. Members of this sub-working group have charted outstanding performance in the domestic FSMP market and are committed to FSMP industry growth in China.

The European Chamber's Paediatric Nutrition Subworking Group was established in 2009, and currently has ten international companies as members and four domestic manufacturers as local partners. Members and partners of the sub-working group include major manufacturers of infant and young children milk-based powder formula (infant formula) that are active in China, and their expertise in the infant formula sector is widely recognised by Chinese consumers. They are known for providing high-quality paediatric nutrition products that meet consumer needs. Members have also significantly contributed to the development of the paediatric nutrition industry in China. The sub-working group believes that breast milk is the best food for infants and wants to offer its support in educating both health workers and the general public on the benefits of breast milk.

The Food for Special Medical Purposes Sub-working Group and the Paediatric Nutrition Sub-working Group 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 June 2020, 51 FSMP products and 1,302 infant formulas had been approved for registration Over the past three years, registrations for infant formula has dropped from 952 in 2017 to 36 in 2018 and 55 in 2019. FSMP products face a similar predicament and sluggish registration rates have been a long-lasting problem. Only three products were approved in 2017, 18 in 2018 and 24 in 2019.

The two most significant related policies announced in 2019 are the following:

- The State Council issued the Regulation on the Implementation of the Food Safety Law of the People's Republic of China on 11th October 2019.¹
- The State Administration for Market Regulation (SAMR) issued the Interim Measures for the Administration of Censorship of Advertisements on Drugs, Medical Devices, Dietary Supplements and Formula Food for Special Medical Purposes on 27th December 2019.²

Key Recommendations

1. Optimise the Registration System for Special Food <

Concern

The requirements for infant formula and FSMP registration, registration procedure and subsequent supervision are uncoordinated and administratively demanding.

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¹ Regulation on the Implementation of the Food Safety Law of the People's Republic of China, State Council, 31st October 2019, viewed 20th April 2020, <http://www.gov. cn/zhengce/content/2019-10/31/content_5447142.htm>

² Interim Measures for the Administration ofAdvertisements on Drugs, Medical Devices, Dietary Supplements and Formula FSMP, SAMR, 27th December 2019, viewed 20th April 2020,<http://gkml.samr.gov.cn/nsjg/fgs/201912/ t20191227_309564.html>





Assessment

Product or Recipe Modification

Infant formula and FSMP manufacturers may need to make changes to recipes that have already been registered. The sub-working groups recommend that regulators promulgate regulations or guidelines for recipe changes of infant formula and FSMP with clear evaluation principles and data requirements for recipe upgrades, so that enterprises can develop new formulas accordingly.

However, the Administrative Measures for the Registration of Food for Special Medical Purposes and relevant regulations are ambiguous and unclear with respect to registration updates. The Items and Requirements on Application Materials for FSMP Registration (Trial) (Revised Version 2017) specifies that "for changes to items that may impact product safety, nutritional sufficiency and special medical purpose clinical effectiveness, and 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".³ This overly simple wording does not serve as practical guidance and requires further clarification.

Onsite Verification of Clinical Trials

According to existing regulations, there are 13 kinds of diseases for which nutritionally complete FSMP must undergo clinical trials based on actual needs and will be verified when finished. However, it remains unclear at this stage which agency will conduct the verification. As some enterprises have already conducted clinical trials, specifying the relevant agency and the standards for on-site verification is urgently needed to provide guidance on the process and improve trial quality.

Onsite Inspection of Factories

It is stated in Article 13 of the Management Measures on the Registration of Infant and Young Children Milkbased Powder Formula that the Centre for Food and Drug Inspection shall conduct on-site inspections based on "actual needs".⁴ 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".⁵ Yet it remains unclear what "actual needs" means in both cases. At present, the regulatory authorities have neither made nor published plans for onsite inspections of overseas factories, so manufacturers cannot plan ahead. As a result, the process, from the submission of registration to the final launch of a new product, will be unpredictable.

Similarly, the frequency of onsite inspections and personnel arrangements in overseas factories are affected and restricted by multiple factors, and the uncertainty of the time required makes the process from submission of registration to final launch difficult to predict. Particularly when influenced by major events, such as the COVID-19 pandemic, the suspension of onsite verification will delay the overall registration process.

Recommendations

- Improve regulations related to the change in registration of FSMP and infant formula recipes as soon as possible, and provide relevant detailed guidelines.
- Improve the onsite inspection system and clarify both the requirement of "actual needs" and the timeline for overseas inspections.
- Publish the annual overseas inspection plan in advance, while clarifying specific onsite inspection procedures and time limits, to allow manufacturers to better prepare for the inspection.
- 2. Guarantee a Sufficient Grace Period for Industry to Comply with the Newly-revised Series of Infant Formula Standards, and Ensure a Smooth Transition Between the Implementation of the New Standards and Recipe Registration

Concern

The newly revised series of national standards for infant formula, which will be implemented soon, will introduce multiple changes that will oblige companies to do research and development (R&D), sample trial production and re-registration preparation, and product marketing all over again, raising industry concerns that a sufficient transition period may not be provided.

³ Application Materials and Requirements for FSMP Registration (Trial) (Revised in 2017), SAMR, 11th March 2019, viewed 20th April 2020, http://www.samr.gov.cn/tssps/tzgg/zjwh/201903/t20190311_291856.html)

⁴ Management Measures on the Registration of Infant and Young Children Milkbased Powder Formula, State Council, 15th March 2016, viewed 20th April 2020,<http://www.gov.cn/gongbao/content/2016/content_5145569.htm>

⁵ Administrative Measures for the Registration of FSMP, State Administration for Market Regulation (SAMR), 8th December 2015, viewed 20th April 2020, <http://gkml.samr.gov.cn/nsjg/tssps/201903/20190329_292465.html>



Assessment

The National Health Commission (NHC) began seeking public opinion on national infant formula standards in September 2018 in an effort to keep up with international standards and meet domestic regulatory needs. The revision entered its final stages in 2019, and standards have been largely revised compared with the previous version. 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 accordingly prior to the standards being formally implemented. This means that manufacturers will have to spend a considerable amount of time carrying out formula R&D, trial production, and stability test research and inspection, before preparing formula registration data in compliance with the new national standards and completing the registration of the amended formulas.

The R&D of new recipes and preparation of formula registration data will take at least 29 months for each recipe. Based on the current Administrative Measures for the Registration of Infant Formula Milk Powder and its supporting documents-and working group members' experiences since the implementation of the registration system over the past year-conservative estimates indicate that domestic manufacturers require at least 18 to 24 months from the submission of registration materials to the final approval, while foreign manufacturers need at least 20 to 32 months. It then takes a further six months after obtaining the approval document for the products to enter the market, because domestic enterprises need to complete a production licence change, and overseas enterprises need to complete label replacement and customs clearance procedures.

Recommendations

- Publish the new standards as soon as possible and establish a five-year transition period.
- Accept registration applications that are based on, and reviewed according to, old standards, and review applications that are based on new standards in the meantime.

3. Encourage FSMP Market Access Expansion, Standardise Post-market Supervision, and Improve Public FSMP Education

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, onsite inspections, advertising and promotion.

Assessment

Distribution Channels and Patient Accessibility

FSMP products must only be used under the guidance of doctors or clinical nutritionists according to Article 38 of the Administrative Measures for the Registration of FSMP (CFDA Order No.24, 2016).⁶ Specifically, the main FSMP product sales channels are medical institutions and pharmacies. However, as an important tool for professional nutrition therapy, FSMP products face significant challenges in terms of circulation and application in medical institutions and clinical use. In terms of clinical application, approved enteral nutrition ('tube feeding') formulas have been used for years and are eligible for partial reimbursement. Despite FSMP products being professionally developed as enteral nutrition formulas, 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 such 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, specify that the marketing and advertising of general nutrientcomplete FSMP products must be carried out based on the methods used for over-the-counter (OTC) products,



⁶ Administrative Measures for the Registration of FSMP, State Council, 7th March 2016, viewed 20th April 2020, <http://www.gov.cn/gongbao/content/2016/ content_5076983.htm>



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 two, often classifying FSMP products as medicines or even regarding them as health foods.

Recommendations

- Simplify the general nutrient-complete FSMP registration mechanism.
- 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. Continue to Revise National Food Safety Standards (1)5

Concern

China's current National Food Safety Standards have been revised relatively slowly, resulting in the standards failing to meet the needs of companies for product innovation and preventing consumers from enjoying the latest technological research results.

Assessment

FSMP

The National Food Safety Standard—General Principles for Infant Formula Food for Special Medical Purpose was released in 2010,⁷ and the National Food Safety Standard—General Principles for Food for Special Medical Purpose were released in 2013, both of which are currently under revision. Disease-specific FSMP encompasses 13 product categories, and nutrientincomplete FSMP consists of five product categories, for which standards need to be issued as soon as possible. This is in order to meet urgent clinical needs, as well as the industry's development requirements. For example, nutrient-incomplete FSMP used in both the short-term treatment of diseases and in nutritional therapy is in great demand and should be included in the revision of the standards.

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).⁸⁶⁹ These standards were issued in 2010, and revisions to both started in March 2018. In the revised version of GB 10769-2010, it states that products that contain nutrients, such as iron and vitamin A, should take into consideration international standards and production. Iron is the most needed nutrient for weaning infants, and, according to international standards, the required iron intake is generally higher than what is currently advised by national standards. The working group therefore recommends that the upper limit for iron be increased accordingly. At present, many mature foreign complementary foods for infants and young children-such as canned instant cereal-based food supplements, baby melts, fruit and vegetable crisps and potato products, as well as ultra-high-pressure sterilised fruit and vegetable paste-have not been included in the existing national standards, which is not conducive to industry development.

Testing Method Standards for Special Foods

Since 2015, the former NHFPC (now the National Health Commission (NHC)) reviewed and consolidated hundreds of testing method standards. In developing and verifying the GB 5009 series of standards, no testing or research was conducted on products with FSMP substrates, hence the incompatibility of the testing methods with many existing products. Consequently, if a product is tested using methods that are specified in relevant national standards yet are inappropriate for that product, the amount of nutrients in the test result can be quite different to the actual amount, which results in erroneous judgements. The problems with the applicability of FSMP testing must therefore be urgently solved.

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



⁷ The National Food Safety Standard General Principles for Food for Special Medical Purposes (GB 25596-2010), former NHFPC, 21st December 2010, viewed 20th April 2020, <http://www.nhc.gov.cn/sps/s7891/201012/539e2314f74b402696c44e0906a a9ef1.shtml>

⁸ National Food Safety Standard of Cereal-based Complementary Foods for Infant and Young Children (GB 10769-2010), National Health Commission (NHC), 26th March 2010, viewed 20th April 2020, <http://www.nhc.gov.cn/wjw/ psp/201005/47405.shtml>

⁹ National Food Safety Standard of Canned Complementary Foods for Infant and Young Children (GB 10770-2010), NHC, 26th March 2010, viewed 20th April 2020, http://www.nhc.gov.cn/wjw/psp/201005/47405.shtml>



formula and FSMP products have no separate national standards. This lack of standards has hindered Chinese amino acid production plants from obtaining food production licences, meaning that downstream companies 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 and milk protein isolate. Moreover, the national standards established for certain raw materials are incomplete, causing industrywide problems. Lactoferrin, for example, faces such problems. The working group thus recommends reviewing the lactoferrin standard and re-evaluating it from a broader perspective.

Recommendations

- Revise national food safety standards so they are more aligned with the latest international standards.
- Add additional product categories in the national food safety standards for FSMP to promote industry development and fulfil people's increasing product needs, while putting in place technical indicators for relevant products.
- Verify differences among existing testing methods, clarifying what the scope is for each, and develop food safety national testing methods for FSMP.
- Establish industry standards for domestic infant and young children formula and FSMP products containing amino acids and gradually improve the applicable amino acid national standards.

5. Optimise Legislation by Basing it on Scientific Evidence

Concern

The lack of coordination between existing legislation and the regulatory framework disrupts enterprises' implementation and causes deviations in regulatory enforcement, which negatively impacts the industry.

Assessment

Food Labelling Laws and Regulations

Article 67 of the Food Safety Law specifies that the national food safety standards on labelling will prevail in the event of any conflicts. As a mandatory standard for the food industry, the *National Food Safety Standards-General Standard for the Labelling of Pre-packaged*

Foods includes comprehensive regulations, is closely related to other national labelling standards, and is widely accepted and well-practised by the industry.

The SAMR began seeking public opinions on the *Supervision and Management Measures on Food Labelling (Draft for Comments)* on 21st November 2019,¹⁰ fulfilling its role as the governmental authority responsible for regulating food labelling. As a departmental regulation, the *Supervision and Management Measures on Food Labelling* are either copies of or inconsistent with existing measures specified in the national food safety standard system. The inconsistencies will cause confusion in industry implementation and enforcement, and will negatively impact industrial development and consumer awareness.

Base Powder Usage and Labelling

From working group member's observations, regulatory agencies currently are leaning toward restricting the use of outsourced base powder. Base powder is commonly used in industrial production methods and has been widely used both domestically and internationally for many years. It is the unavoidable outcome of modernised mass production. The quality of infant formula produced using base powder is constantly improving. Moreover, it costs less and reduces waste, making its use crucial to industry development. Base powder is used by a number of Chinese manufacturers, and hasty restrictions on the use of outsourced base powder will have a significant impact on the industry.

Furthermore, current milk powder labelling is carried out in full consideration of consumers' right to know, and fulfils the strict requirements imposed by current national food safety standards and registration. The requirement to label base powder lacks legal basis, and does not consider manufacturers' actual needs in production. The requirement is neither consistent with enterprises' assumption of primary responsibility for food safety, nor is it conducive to the implementation of industrial policies.

Recommendations

• Establish regulations to make up for the shortcomings of the current regulatory system by considering industry compliance enforcement and maintaining



¹⁰ Supervision and Management Measures on Food Labelling (Draft for Comments), Ministry of Justice, 21st November 2019, viewed 20th April 2020, <http://www.moj. gov.cn/news/content/2019-11/21/zlk_3236132.html>



consistency with other mandatory requirements.

- Legislate only after thorough investigation of industry practices and market conditions, to ensure the legislation is scientific, rational and fair.
- 6. Enhance the Transparency and Consistency of Law Enforcement, and Facilitate Communication with the Industry

Concern

Significant changes to infant formula and FSMP regulations, and the rising number of technical review and approval requirements, combined with the lack of transparency and openness throughout the legislative and regulatory process, have brought considerable challenges in terms of compliance and registration.

Assessment

The current technical review requirements for infant formula and FSMP registration are increasing gradually and changing frequently. Some of these requirements are not required in registration management methods or their supporting documents. Moreover, there are currently no clear corresponding regulatory requirements, resulting in a decrease of transparency during technical reviews, and unpredictability during the longer registration period.

Overseas onsite inspections are difficult to carry out within the time limit prescribed by the regulations, due to factors such as the lack of available staff and financial resources, a situation that will be exacerbated by COVID-19 travel restrictions. These factors significantly add to the amount of time required for registration and harm the interests of the enterprises involved. Furthermore, uncertainties may arise during overseas inspections, especially in terms of the detailed requirements under the Chinese inspection system, due to the different backgrounds, scales and habits of inspection experts, as well as any local production regulation requirements imposed on overseas production organisations. Moreover, cultural differences are likely to cause misunderstandings during inspections, so regulations and training for overseas onsite inspectors are necessary.

Recommendations

 Improve the openness and transparency of legislation concerning major decisions that may affect industry development and seriously impact enterprise interests, and actively communicate with the industry, giving enterprises opportunities to voice their opinions.

 Publicise specific technical review and administrative approval requirements for registration to improve the overall transparency and fairness of the review and approval process.

7. Publish New Administrative Measures on the Sale of Breast Milk Substitutes (3)

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, which might have a negative impact on encouraging breastfeeding and spreading awareness of nutritional issues.

Assessment

Formulated and released in 1995 by the former Ministry of Health (MOH), the *Administrative Measures on the Sale of Breast Milk Substitutes* was subsequently abolished in December 2017 by the former NHFPC.¹¹ 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 relies on extensive scientific research and clinical evidence. Production also requires advanced technology. In practice, infant and young children formula products, especially those for special medical purposes, need to have their recipes adjusted according to an infant's actual condition. Thus, medical and health specialists need to fully understand a specific product's 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 helps medical and healthcare specialists give



¹¹ Administrative Measures on the Sale of Breast Milk Substitutes, Central People's Government of the People's Republic of China, 13th June 1995, viewed 20th April 2020, <http://www.gov.cn/banshi/2005-08/23/content_25511.htm>



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,¹² 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 the 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.
- 8. Optimise the Requirements for Clinical Trials of FSMP (3)
- 8.1 Rationalise the Requirements Placed on Trial Participants

Concern

Unified 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 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 2016) clearly stipulates that, in designing clinical trials for drugs to be used in paediatric populations, the principle of "smallest sample size, fewest specimens and least pain" shall be observed, while ensuring that the evaluation needs are met.¹³ Based on these guiding principles, application channels need to be provided for either exemption from clinical trials or a 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 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.

8.2 Adopt Hierarchical Management to Verify FSMP Clinical Effectiveness

Concern

Although premarket clinical trials are required under *GB* 29922-2013 National Food Safety Standard - General *Principles for Food for Special Medical Purposes* 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.

Assessment

Most of the imported disease-specific FSMPs currently on the Chinese market have been sold in many other markets for many years and have been clinically observed during that time. The working group therefore



¹² The first and foremost message that the infant formula industry wants to express is that breast milk is the best food for infants and it should be protected. Thus, breast milk substitutes should only be used when breast milk cannot meet the needs of an infant.

¹³ Announcement of CFDA on the Release of Technical Guiding Principles of Paediatric Group Drug Clinical Test (No.48 of 2016), CFDA, 7th March 2016, viewed 20th April 2020, <http://www.nmpa.gov.cn/WS04/CL2138/300128.html>



recommends recognising foreign clinical trial data for products that are able to meet Chinese national food safety standards without requiring any adjustments, as this will avoid resources being wasted on repeating clinical trials in China.

It is neither ethical nor practically feasible to carry out clinical trials using control groups made up of patients suffering from specific diseases, such as food protein allergies, kidney disease or diabetes, by giving them general nutrient-complete products. If the control group uses disease-specific FSMP or enteral nutrition formula, this would make it difficult for any nutritional improvements to show. Exempting such disease-specific FSMP from pre-market clinical trials for registration and verifying their clinical effectiveness through followup post-market evaluations are recommended. When establishing clinical regulations, combining both scientific and clinical research to design a scientific and reasonable evaluation plan that conforms to a patient's usage habits is recommended, rather than simply adopting the clinical trial method used in medicine and blindly expecting the excellent performance and noninferiority of effectiveness indicators.

Recommendations

- Request reasonable supporting materials, such as hierarchical management for clinical verification, and confirm the clinical effectiveness of diseasespecific FSMPs based on the specific disease characteristics.
- Consider the fact that FSMPs are only clinical nutritional support products, and design reasonable clinical observation indicators reasonably.

Abbreviations

| CFDA | China Food and Drug Administration |
|----------|------------------------------------|
| COVID-19 | Coronavirus Disease 2019 |
| DHA | Docosahexaenoic Acid |
| FSMP | Food for Special Medical Purpose |
| МОН | Ministry of Health |
| NHC | National Health Commission |
| OTC | Over-the-Counter |
| SAMR | State Administration for Market |
| | Regulation |





Automotive Working Group

Key Recommendations

1. Passenger Vehicles 13

- 1.1 Create a Predicable, Non-discriminative and Balanced Legislative Environment that is Conducive to the Sustainable Development of New Energy Vehicles (NEVs)
 - Provide the same incentives for imported and locally produced NEVs, ensure technical neutrality without distinction between EV classes and remove additional local requirements.

From demand side of the NEV market:

- Extend the 2020–2022 NEV subsidies and tax exemptions from 2023 onwards.
- Enhance local incentive measures, e.g. lifting licence plate restrictions.
- Ensure the development of charging infrastructure keeps pace with the increasing number of NEVs.

From supply side of the NEV market:

- Promulgate a NEV credit policy 2025 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 China Intelligent & Connected Vehicle (ICV) Development
 - Define the responsibilities of government bodies related to ICV development.
 - Release implementation guidelines for strategic policies, provide policy interpretations and improve communication with the industry.
 - Promulgate more detailed supportive policies, regulations and standards for ICV technologies.
 - Facilitate cross-borders data flows in order to allow continuous improvement of design, operations and maintenance of ICV.
- 1.3 Allow Flexibility for Corporate Average Fuel Consumption (CAFC) Compliance and Provide Reasonable Lead Time for Original Equipment Manufacturers (OEMs) to Adapt <a>3
 - Release the next phase of CAFC and NEV credit administrative rules as soon as possible, taking the following factors into consideration:
 - Retain the preferential treatment of NEVs to the greatest extent in recognition of the production challenges and in acknowledgement of NEVs' contribution to CAFC industry compliance.
 - Abandon relevant stipulations of the current administrative measures on affiliated enterprises and allow enterprises to freely pool for CAFC accounting.
 - Allow negative NEV credits to be carried forward to stabilise the product cycle change.
 - Introduce off-cycle technology (OCT) credit before 2022 to motivate original equipment manufacturers (OEMs) to apply more advanced OCTs to contribute to the whole industry's CAFC compliance.
 - Adopt incentives for low-fuel consumption vehicles (LFCVs) with the basic principle of technology neutrality, and define a LFCV threshold that is realistically achievable by the different technologies in order to improve energy saving across the whole Chinese vehicle fleet.
 - Supplement flexible measures for CAFC or NEV deficits compensation (e.g. credits pool) to ensure that a sufficient supply of NEV credits is available in the market.



- Take special measures to contain the negative impacts of COVID-19, including the following:
 - Postpone the 2019 deficit compensation to temporarily improve OEMs' cash flow.
 - Adjust NEV quota requirements for 2020, and consider allowing a certain reduction of CAFC requirements in 2020.
 - Allow CAFC and NEV deficits generated in 2020 to be banked for the next three consecutive years.

1.4 Encourage Automotive Consumption by Offering a Consumer-friendly Market and Supportive Policies

- Take a holistic approach to combat congestion rather than simply restricting vehicle purchases.
- Adopt incentive measures, like lowering automotive-related taxes, to encourage automotive consumption, and provide special support to first-time buyers in rural areas.
- Encourage diversified financial products in the market, and provide policy support to innovative business models.
- 1.5 Improve Coordination among Different Government Agencies that Regulate the Automotive Industry (3)
 - Improve coordination among relevant government agencies.
 - Avoid overlapping responsibilities of different government agencies and clarify which government agency will take the lead.

2. Commercial Vehicles (CVs)

2.1 Recognise Optimised Vehicle Specifications in the Regulation of Commercial Vehicles

- Involve the automotive industry early in the process of drafting and updating regulations for commercial vehicles.
- · Implement only one national standard covering commercial vehicles.
- Publish recommended standards (GB/T) and industry standards under the World Trade Organization (WTO) Publication System as mandatory standards.
- Grant sufficient time for manufacturers to adapt to new regulations.
- Apply a transition period of at least six months from the introduction of new rules and regulations until old stock can be cleared.
- 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

- 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 (GCW) depending on road and bridge conditions.
- Amend 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 (tkm).

2.3 Permit 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 an industry that has close linkages with a wide array of upstream and downstream industries. For decades, it has been contributing to China's development by generating employment opportunities and expertise, and by providing mobility for people and goods, without which modern societies could not function. Today, as China strives towards industrial transformation and upgrading, the automotive industry is committed to developing sustainable mobility solutions, while maintaining its crucial role in both the economy and society.

The Automotive Working Group is composed of European manufacturers and importers of passenger vehicles, commercial vehicles, automotive components (including tyres), special vehicles and automated systems. The Automotive Working Group works closely with the Auto Components Working Group, which consists of more than 80 European companies involved in the manufacture of auto-components, machine tools for production of auto-components and automotive assembly lines. The core members of the Automotive Working Group are also members of automotive associations at both the European Union (EU) and EU Member State levels.

Recent Developments

China's automotive market experienced a decline in 2019 that was even bigger than in 2018. This was followed by the unexpected outbreak of Coronavirus Disease 2019 (COVID-19), which has presented even greater challenges to the world's largest automotive market.

According to the China Association of Automobile Manufacturers, some 25.88 million automobiles were sold in 2019, a year-on-year decrease of 8.2 per cent. The drop widened from the 2.8 per cent fall in 2018, due to tighter emission standards, trade tensions and the general economic downturn. Sales of passenger cars (PCs) fell 9.6 per cent to 21.44 million units, while those of commercial vehicles (CVs) recorded a slight decrease of 1.1 per cent to 4.32 million units. The cutting of new energy vehicle (NEV) subsidies in 2019 cast a shadow over the market – NEV sales shrank by four per cent to 1.2 million, which will severely compromise China's target of selling two million units in 2020.¹

In the first quarter of 2020, manufacturers sold a total of 3.67 million vehicles in China, a year-on-year decrease of 42.4 per cent. Among them, PC sales stood at 2.88 million units, down 45.4 per cent year-on-year; CV sales reached 794,000 units, down 28.4 per cent year-on-year. NEV sales (excluding Tesla) dropped to 114,000, down 56.4 per cent year-on-year. While March 2020 marked the 21st consecutive monthly plunge, it was less dire than February. China suffered the bleakest ever quarter in the first quarter of 2020, but the market is expected to recover slowly, while the pandemic will continue to cause economic damage globally.²

Consequently, the Chinese central government and local governments have introduced various stimulus policies, such as extending NEV subsidies and the vehicle purchase tax exemption, and the reducing value-added tax (VAT) for used car businesses.³ As of mid-April 2020, more than 25 provinces and cities have introduced local subsidies for car purchase and replacement in an effort to promote automobile sales.

The automotive industry is highly globalised. Though China seems to have successfully controlled the spread of COVID-19, and has resumed production step-bystep, supply chains are still being impacted as the virus continues to spread worldwide, reducing transport volume and depressing consumer confidence. It will take a long time for the market and industry to recover, therefore policy support is absolutely essential.

Policy and Regulatory Development

The Automotive Working Group Position Paper 2019/2020 noted that China cancelled the ratio restriction of foreign shares for manufacturers of special-purpose vehicles and NEVs in 2018, and will cancel the restriction for CVs in 2020 and PCs in 2022. The paper also expressed the working group's expectations that the rule that foreign original equipment manufacturers (OEMs) can only have a maximum of two joint venture (JV) partners when they enter the Chinese market would be removed by 2022. The working group saw

¹ Automotive Industrial Operation Status in 2019, China Association of Automobile Manufacturers, 13th January 2020, viewed 2nd June 2020, http://www.caam.org. cn/chn/4/cate_39/con_5228367.html>

² Ibid.

³ Notice on Adjustment and Improvement of New Energy Vehicle Subsidy Policy, MIIT, 26th April 2020, viewed 2nd June 2020, <http://www.gov.cn/zhengce/ zhengceku/2020-04/23/content_5505502.htm>

Section Three: Goods

this as a significant and important development in the history of China's opening-up. However, the National Development and Reform Commission's (NDRC's) *Administrative Provisions on Investment in the Automotive Industry*, released in December 2018, appeared to place new obstacles in the way of any new investment in automotive manufacturing, thus sending a signal that investment approval would be tightened rather than relaxed.⁴

In January 2020, the Ministry of Industry and Information Technology (MIIT) promulgated a second draft for public consultation of the *Administrative Provisions on NEV Manufacturer and Product Admission.*⁵ A positive change found in the draft is the waiving of the requirement for auditing NEV manufacturers' research and development (R&D) capabilities. The working group would suggest the Ministry revise Administrative Measures on Road Motor Vehicle Manufacturer and Product Admission (also of December 2018) as well as to keep the access requirement consistent for all manufacturers.

On 3rd December 2019, the MIIT released the draft *Development Plan for the NEV Industry (2021–2035)* (*Development Plan*).⁶ This important document is aimed at contributing to a cleaner and greener society. The working group welcomes and supports the MIIT's *Development Plan*, and calls for coordination among relevant national and local government departments to promote NEV development.

In July this year, MIIT finally released 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 is still missing. Without knowing how exactly the Dual Credits Measures will be implemented, automotive OEMs cannot optimise production and sales plans in a short period remaining before the measures come into effect. As subsidies for NEV purchases are being reduced and sales have fallen as a result, the government's ambitious

targets for the NEV market uptake are being sorely tested. This, combined with COVID-19, will cast a long shadow over the market outlook for 2020 and beyond. Nevertheless, huge investment by all OEMs in NEV development has created a situation where the success of NEVs is as important to the industry as it is to the government, hence the rapid release of the new *Dual Credits Measures* is crucial. So far, the government has not published policies on financial incentives for buying CAFC and NEV credits. In 2019, sales of CAFC and NEV credits was far behind target, and in 2020, the situation has been aggravated by the COVID-19 crisis. A considerably higher market share of CAFC and NEV credits is not achievable by market forces alone, making government incentives necessary.

The Intelligent Vehicle (IV) Innovative Development Strategy was promulgated in February 2020.⁷ Compared with the previous version, it set fewer rigid targets by replacing explicit quantitative indictors with more generic requirements. However, the working group is concerned that so-called 'Chinese IV standards' will be included in the policy. With implementation details for this strategic guideline still pending, the working group advocates technology neutrality and equal participation of all manufacturers in the development of Chinese IV standards.

The working group welcomes the Foreign Investment Law (FIL), which pledges intellectual property rights (IPR) protection and bans forced technology transfer. Since the law has been implemented, some foreign companies have successful litigated against IP infringers by applying the new law. The working group expects the FIL to be fully implemented at all government levels.

To alleviate the drop in NEV sales caused by the COVID-19 pandemic, the working group recommends a delay in the implementation of China-6 emission standards, especially the requirement for a reduction of particle numbers.

⁴ Provisions for the Administration of Investment in the Automotive Industry, NDRC, 18th December 2020, viewed 2nd June 2020, <https://www.ndrc.gov.cn/xxgk/zcfb/fzagwl/201812/W020190905495164515512.pdf>

⁵ Administrative Provisions on NEV Manufacturer and Product Admission, MIIT, 17th January 2017,viewed 2nd June 2020, <http://www.miit.gov.cn/n1146295/ n1652858/n1652930/n3757018/c5466114/content.html>

⁶ Development Plan for the NEV Industry (2021-2035), MIIT, 3rd December 2019, viewed 2rd June 2020, http://www.miit.gov.cn/n1278117/n1648113/c7553623/ content.html>

⁷ IV Innovative Development Strategy, NDRC, 24th February 2020, viewed 2nd June 2020, https://www.ndrc.gov.cn/xxgk/zcfb/tz/202002/ P020200224573058971435.pdf>



Key Recommendations

1. Passenger Cars (1)3

1.1 Create a Predicable, Non-discriminative and Balanced Legislative Environment that is Conducive to the Sustainable Development of New Energy Vehicles (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, is adding market uncertainty to NEV development.

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, so in the absence of a predictable way to determine whether a NEV product will be able to fulfil new regulatory requirements, OEMs will remain cautious about investing in and developing new models.

Equal Treatment

NEV subsidy policies draw a distinction between units manufactured in China and those that are imported, with central and local subsidies 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 the fact that, in the European Union (EU), subsidies are available for both imports and locally-manufactured NEVs.

There is a trend towards abandoning 'technology neutrality', as the government is promoting electric cars only. Both battery electric vehicles (BEV) and plugin hybrid electric vehicles (PHEV) 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

On 16th April 2020, the Ministry of Finance, the National

Bureau of Taxation and MIIT jointly released the *Notice* of *Exemption of Purchase Tax of NEVs.*⁸ The incentive will be valid till 31st December 2022, which allows manufacturers time to adjust their sales plan, alongside recovering losses and market share post-COVID-19.

Licence Plate Quotas

To promote 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.

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)*, issued jointly in October 2015 by the National Development and Reform Commission (NDRC), the Ministry of Energy (MOE), the MIIT, and the Ministry of Housing and Urban Development (MOHURD), calls for building at least 120,000 electric charging stations and 4.8 million charging posts by 2020.⁹

To sustain the continuous effort in constructing EVcharging infrastructure, the Automotive Working Group recommends that adequate electric charging infrastructure plans are put in place, to support the increasing shift toward an electric future after 2020. Despite the *Guidance* being issued in 2015, there has been a lack of national focus on the development of charging infrastructure. In order to meet the goals laid out in the *Guidance*, the working group recommends rolling out concrete measures for the planning of EVcharging infrastructure, and enhancing the feasibility of existing charging infrastructure, e.g. maintenance, quality, and to avoid charging facilities being occupied by internal combustion engine (ICE) vehicles.

NEV Credits

Given current market uncertainty and the mounting impact of the COVID-19 pandemic, the NEV credit rules will substantially increase the burden of automotive manufacturers. Therefore, it is important to adopt more flexible NEV credit policies.

⁸ Notice of Exemption of Purchase Tax of NEVs, 16th April 2020, viewed 10th June 2020, <http://www.chinatax.gov.cn/chinatax/n810214/n810641/n2985871/n2985888/n2985983/c5148809/content.html

⁹ Guidance for Developing EV Charging Infrastructure for 2015-2020, National Energy Administration (NEA), 9th October 2015, viewed 2nd June 2020, <http://www.nea.gov.cn/134828653_14478160183541n.pdf>



On 11th September 2019, the MIIT released the second revised draft of the *NEV Credit Rules for 2021–2023* for public consultation,¹⁰ however the final version is yet to be promulgated.

Recommendations

 Provide the same incentives for imported and locallyproduced NEVs, ensure technology neutrality without distinction between EV classes and remove additional local requirements.

From the demand side of the NEV market:

- Extend the 2020–2022 NEV subsidies and tax exemptions from 2023 onwards.
- Enhance local incentive measures, e.g. lifting licence plate restrictions.
- Ensure the development of charging infrastructure keeps pace with the increasing number of NEVs.

From the supply side of the NEV market:

- Promulgate a NEV credit policy 2025 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 China Intelligent & Connected Vehicle (ICV) Development

Concern

In China, many government ministries are engaged in ICV industry policies, but their roles and responsibilities often overlap, leading to confusion and a lack of coordination.

Assessment

In the past few years, the Chinese ICV industry has developed rapidly, with different policies, plans and guidelines being issued by different ministries. Unfortunately, sometimes objectives have not been sufficiently communicated with the industry, official policy explanations on many issues are still missing, and there is a lack of coordination between different government agencies.

In February 2020, 11 ministries jointly issued China's

first national strategy for ICVs.¹¹ The strategy lists overall requirements, the vision, mission and principles, key tasks and supporting measures. However, it is unclear what each involved ministry is responsible for. Neither does it elaborate how strategic goals are to be implemented. The industry is not sure what the longterm effect of this document will be and how to ensure future compliance.

By promoting NEV development, China has dramatically reduced the gap between the local and international automotive industry. At the same time, the ICV industry is still in an early phase of development. As a result of using different technologies, ICV manufacturers are facing huge legal and standardisation challenges. Meanwhile, existing wide-reaching data collection policies have not been carefully considered in terms of their potential impact on the protection of enterprises' trade secrets and IPR, as well as their further influence on the whole industry.

Operation of ICVs implies the collection of huge amounts of data. An adequate legal environment and reliable technical solutions are therefore necessary to protect trade secrets, IPR and data privacy.

Recommendations

- Define the responsibilities of government bodies related to ICV development.
- Release implementation guidelines for strategic policies, provide policy interpretations and improve communication with the industry.
- Promulgate more detailed supportive policies, regulations and standards for ICV technologies.
- Facilitate cross-borders data flows in order to allow continuous improvement of design, operations and maintenance of ICV.
- 1.3 Allow Flexibility for Corporate Average Fuel Consumption (CAFC) Compliance and Provide Reasonable Lead Time for Original Equipment Manufacturers (OEMs) to Adapt (3)

Concern

China has set challenging CAFC targets and NEV quotas with demanding technical requirements that could potentially lead to significant compliance risks for the whole industry.

¹⁰ Solicits for comments for Paralleled Management Measures on CAFC and NEV Credits, MIIT, 11th September 2019,viewed 2nd June 2020, http://www.miit.gov. cn/n1146285/n1146352/n3057254/n3057254/n3057260/c7408130/content.html>

¹¹ IV Innovative Development Strategy, NDRC, 24th February 2020, viewed 2nd June 2020, <https://www.ndrc.gov.cn/xxgk/zcfb/tz/202002/P020200224573058971435. pdf>



Assessment

The CAFC targets set by the government are four litres (L) per 100 kilometres (km) in 2025, and 3.2L/100 km in 2030.¹² These targets are ambitious, and it is impossible for traditional vehicles to meet the target alone. In fact, these targets are based on an assumption that NEVs will comprise 20 per cent of the entire automotive market by 2025 and 40 to 50 per cent by 2030.

Given that China has only released CAFC administrative rules for 2021–2023,, and that the rules for 2024–2025 have not yet been discussed, developing a stable and predictable regulatory environment is essential for healthy industry development, especially under the huge downwards pressure caused by the COVID-19 crisis. The working group recommends clarifying regulatory requirements, and releasing the regulation as soon as possible, in order to provide sufficient time for enterprises to adequately prepare.

The Automotive Working Group suggest that the government should consider the following points:

- The estimation of the improvement of fuel consumption for traditional vehicles needs to be realistic. While it is technically feasible for OEMs to improve traditional vehicle fuel consumption by reducing overall vehicle weight or using transmission technologies, costeffectiveness goals cannot be met, making fuel consumption improvements of traditional vehicles increasingly difficult. Over the past five years, China's industry CAFC declined by four per cent annually, whereas traditional vehicle CAFC only fell by two per cent annually. Without the tremendous contribution from NEVs, the industry could not have met its 2018 CAFC target.
- 2) While fuel consumption reduction heavily relies on the development of NEVs, China's NEV market will face great uncertainties with the complete phase-out of subsidies after 2022. Therefore, NEV incentives, such as super credit multipliers (two for 2020),¹³ should be preserved to the greatest extent possible

to recognise the vehicles' overall contribution to final CAFC and NEV credit compliance.

- 3) The rules for 2021–2023 allow positive NEV credits to be carried forward. The working group would like to propose that negative NEV credits be allowed to be carried forward as well, to avoid potential NEV credit supply shortages and price fluctuations as a result of the carry-forward of positive NEV credits.
- 4) The government should allow flexibility for compliance. For example, off-cycle technology (OCT) can help reduce fuel consumption and improve CAFC performance. However, OCT credits are currently not recognised, although they are planned in the Phase IV (2015–2020) CAFC policy. The working group suggests that OCT credits be included and recognised in the CAFC policy for 2021–2025. In the meantime, more energy-saving technologies should be included in the OCT list.
- 5) Incentive policies should stimulate various potential energy-saving technologies, rather than encouraging only one specific technology route. Therefore, it is suggested to adjust the definition and incentive measures of low fuel consumption vehicles (LFCVs) in the dual credit rules, in order to recognise and encourage all efforts for fuel efficiency improvement.
- 6) While the current rules allow CAFC credit transfers among affiliated OEMs, these rules are complicated and difficult for OEMs to comprehend. In practice, some foreign-affiliated OEMs are still not allowed to transfer CAFC credits. The working group therefore recommends simplifying existing rules so that OEMs, both local and foreign, can benefit from such flexibility.

Furthermore, enough lead time should be given to the industry when CAFC administrative rules for 2021–2025 are implemented. The automotive industry needs details on the implementation plan for the next phase of CAFC rules, so market players can make business plans and investment decisions in time. It is therefore critical for the government to introduce the updated rules as early as possible and to give the industry at least two years of lead time to adjust. In particular, discussions on the rules for 2024–2025 should be initiated immediately instead of waiting for the rules for 2021–2023 to be implemented.



¹² Interpretation of the Fourth Stage Standard of CAFC, MIIT, 26th January 2015, viewed 2nd June 2020, http://www.miit.gov.cn/n1146285/n1146352/n3054355/n3057585/n3057589/c3616946/content.html

¹³ A super credit policy provides favourable accounting rules for extremely low emission vehicles under several passenger vehicle fuel economy regulations: Wang, Sinan, Zhao, Fuquan, Liu, Zongwei and Hao, Han, Impacts of a super credit policy on electric vehicle penetration and compliance with China's CAFC regulation, Energy, vol. 155, 15th July 2018, viewed 2rd June 2020, pp. 746–762, https://www.sciencedirect.com/science/article/abs/bii/S0360544218308624>



Finally, China's NEV industry has suffered from weaker demand due to COVID-19. Although the Chinese automobile industry been on track to recover since March 2020, the global pandemic has severely impacted the liquidity of manufacturers. Postponement of 2019 deficits compensation or partial exemption of 2020 NEV quota requirements would allow carmakers to improve cash flow and overcome the difficulties caused by the outbreak.

Recommendations

- Release the next phase of CAFC and NEV credit administrative rules as soon as possible, taking the following factors into consideration:
 - Retain the preferential treatment of NEVs to the greatest extent in recognition of the production challenges and in acknowledgement of NEVs' contribution to CAFC industry compliance.
 - Abandon relevant stipulations of the current administrative measures on affiliated enterprises and allow enterprises to freely pool for CAFC accounting.
 - Allow negative NEV credits to be carried forward to stabilise the product cycle change.
 - Introduce OCT credit before 2022 to motivate OEMs to apply more advanced OCTs to contribute to the whole industry's CAFC compliance.
 - Adopt incentives for LFCVs under the basic principle of technology neutrality, and define a LFCV threshold that is realistically achievable by the different technologies in order to improve energy saving across the whole Chinese vehicle fleet.
 - Supplement flexible measures for CAFC or NEV deficits compensation (e.g. credit pool) to ensure that a sufficient supply of NEV credits is available in the market.
- Take special measures to contain the negative impacts of COVID-19, including the following:
 - Postpone the 2019 deficit compensation to temporarily improve OEMs' cash flow.
 - Adjust NEV quota requirements for 2020, and consider allowing a certain reduction of CAFC requirements in 2020.
 - Allow CAFC and NEV deficits generated in 2020 to be banked for the next three consecutive years.

1.4 Encourage Automotive Consumption by Offering a Consumer-friendly Market and Supportive Policies

Concern

The implementation of measures that restrict automotive sales in some cities has impacted consumer purchasing, a trend that has been exacerbated by the economic impact of the unexpected COVID-19 outbreak.

Assessment

The automotive industry has seen weak consumer confidence since 2018. This has caused consumers to hold back on vehicle purchases, which are the secondlargest investment for most families. The situation could be exacerbated by the economic impact of the COVID-19 outbreak.

To help China's economy recover in 2020, the priority should be given to encouraging auto consumption and enhancing consumer confidence. China did initiate measures at both the central and local levels in a bid to spur consumption, such as an extension of NEV subsidies for two more years to 2022, and monetary incentives in various locations, albeit mostly to locallybuilt vehicles. The working group encourages policies that provide market participants a level playing field regardless of the location of manufacture, to ensure sustainable development in the long run.

To combat congestion, local authorities tend to take a simple and direct approach to control vehicle population. Restrictions have alleviated pressures caused by traffic and environmental concerns, but they have also largely distorted the automotive market, while restraining consumption demand. Central government agencies, industry associations and experts have all been recommending that local governments take a more holistic approach, but little has been done so far.

Some cities not only restrict the number of conventional vehicles but also limit NEV growth by imposing quotas or other specific local requirements. This runs against the national strategy to promote the development of NEVs and their adoption in the market.

Those that own vehicles with small engines are generally sensitive to the price. Permanently cutting vehicle consumption tax and purchase tax for engines of 1.6L or below would help ordinary households save costs and spur consumption in this sector. Statistics show that after purchase tax was reduced to per five cent for passenger vehicles with displacement of 1.6L or below



in 2015–2016, sales growth increased to 22.65 per cent from 3.95 per cent before the cut.¹⁴

If potential car buyers in Tier-1 or Tier-2 cities are mainly upgrading car owners, then there is growth potential for first-time buyers in tier-four and tier-five cities. Go-torural incentives, which grant subsidies and purchase tax concessions to rural consumers, would benefit those looking for their first car purchase, and would make the policy support more meaningful. Go-to-rural incentives and halved purchase tax for small engine vehicles adopted in 2009 boosted automotive sales growth to 46 per cent in 2009, from 6.7 per cent in 2008. Compared to the global financial crisis in 2008, the economic impact of COVID-19 is much more negative.

NEV output will be increasing rapidly to meet prevailing policy targets. It is anticipated that NEVs will account for approximately 20 per cent of total new vehicle sales by 2025, and continue on an upward trend for the following decade. OEMs face compliance and financial challenges if consumers do not purchase as many NEVs as anticipated, especially if NEV incentives are reduced or eliminated.

Leasing of NEVs could help promote sales by making NEV ownership more affordable and less risky for consumers, by allowing both low down-payments and low monthly payments. This business model also helps to simplify used-car disposal for consumers, which promotes development of the used-car market, and allows consumers to re-enter the new vehicle market more frequently (as lease terms are generally shorter) and facilitates consumption upgrades (as leasing generally provides 'more vehicle for the money'). Additionally, automotive OEMs with captive finance/ leasing companies are better positioned to manage vehicle residual values—how much a vehicle will be worth post-lease—and the associated risks.

Although China's automotive loan penetration is catching up with that of developed markets after years of development, leasing penetration is still much lower. In this regard, leasing with reasonable residual values accounts for only 0.8 per cent of the total 'leasing' business. Today, most leases in China are financial leases, which restricts the ability to set reasonable residual values. Financial leases, in their current format, are not effective in driving sustainable growth and further development of the automotive industry, particularly NEVs.

Policy support and coordination among relevant government stakeholders is critical to the development of automotive leasing business in China. The working group welcomes policies that: 1) promote the development of used car sales and simplify title transfers; and 2) encourage business innovation and allow OEMs to run leasing businesses more efficiently, e.g. by allowing leasing companies to acquire adequate vehicle registration plates, set market-driven residual values and allow OEM-JV leasing companies to better leverage the borrowing power of existing OEM-JV financial companies.

Recommendations

- Take a holistic approach to combat congestion rather than simply restricting vehicle purchases.
- Adopt incentive measures, like lowering automotiverelated taxes, to encourage automotive consumption, and provide special support to first-time buyers in rural areas.
- Encourage diversified financial products in the market, and provide policy support to innovative business models.

1.5 Improve Coordination among Different Government Agencies that Regulate the Automotive Industry 3

Concern

Multiple government agencies regulate the automotive industry in an uncoordinated manner, causing obstacles for the future development of the industry.

Assessment

The automotive industry is subject to many regulations, like fuel consumption limits, emission norms and measures to promote NEVs. Indeed, the consensus view of what the future automotive industry will bring cannot possibly be translated into reality without concerted government action. The great challenges of the current age—decarbonisation, digitalisation, automatisation—that will result in cleaner, safer and less congested mobility in an increasingly urbanised society, amount to a paradigm shift for the automotive industry. At the same time, it poses a challenge to



¹⁴ Purchase Tax Halved for Passenger Vehicles with Displacement of 1.6L or Below in 2015–2016, State Council, 1st October 2015, viewed 2nd June 2020, http://www.gov.cn/xinwen/2015-10/01/content_2941767.htm

Chinese (and other) government(s), as coordinated regulation spanning different sectors is a prerequisite to achieve this transition.

Governments need to foster R&D into automated driving technologies and standards. It is essential to review, adapt and harmonise all relevant regulations to create the right legal framework for deployment, as well as to upgrade, adapt and harmonise physical and digital road infrastructure to make it suitable for automated driving. Additionally, the ability to perform large-scale testing of automated systems on open roads across China should be facilitated. The MIIT has the natural advantage of administering the automotive, telecommunication and information industries under one roof. However, it is clear from the basic requirements just listed, that the need for coordination among government agencies also extends to at least the NDRC, the Ministry of Transport (MOT), the Ministry of Public Security (MPS) and the Ministry of Science and Technology (MOST). However, the current lack of coordination causes obstacles for the future development of the industry.

While the Automotive Working Group has witnessed commendable recent progress, with moves to streamline vehicle annual safety inspections between the MOT and the MPS, or to amalgamate certification and homologation systems between the State Administration for Market Regulation (SAMR) and the MIIT (although both these developments are still worksin-progress), the to-do list for the immediate future calls for far greater ambition on the part of China's lawmakers. R&D in the automotive industry would be all the better for it, as would the probability of China seeing safe and viable mobility solutions that can navigate an adapted urban traffic environment in a not-too-distant future.

Recommendations

- Improve coordination among relevant government agencies
- Avoid overlapping responsibilities of different government agencies and clarify which agency will take the lead in each area.
- 2 Commercial Vehicles
- 2.1 Recognise Optimised Vehicle Specifications in the Regulation of Commercial Vehicles (CVs)

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 PCs. While the sales volume of heavy-duty CVs is less than five per cent of that of PCs, 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 wreckers, vacuum tanks, bridge inspection vehicles, sky lifts, cranes and snow ploughs. As a consequence, CVs comprise a much wider variety of models and variants per vehicle type compared to PCs, yet China's vehicle homologation and registration system makes no distinction between them. The system is also overly complicated, slow and costly, which holds back the time to market for vehicles that could provide crucial services to society. In addition, the introduction of new technologies gets delayed and stock management of CVs becomes impossible when new regulations are introduced too quickly.

By continuing to regulate CVs in the same way as PCs, without taking into account the vast differences between these distinct categories, overall 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 commercial vehicles is kept at a minimum. Only then can the transport industry get the most optimised transport solutions.

As a member of the World Trade Organization (WTO), China implements its obligation to invite WTO member states' comments on new national 'mandatory' standards (*guobiao*, or GB) that in China have the

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binding force of technical regulations. 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) as well as industry standards, because they often become mandatory in practice by executive order.

Companies should be given 24 months to prepare for the implementation of any new rules and regulations. The China V, China VIa and China VIb introductions are examples of regulations that have caused immense costs and complications due to too-short implementation times.¹⁵

Recommendations

- Involve the automotive industry early in the process of drafting and updating regulations for commercial vehicles.
- Implement only one national standard covering commercial vehicles.
- Publish recommended standards (GB/T) and industry standards under the WTO Publication System as mandatory standards.
- Grant sufficient time for manufacturers to adapt to new regulations.
- Apply a transition period of at least six months from the introduction of new rules and regulations until old stock can be cleared.
- 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

Since commercial vehicles consume X litres of fuel to transport Y tonnes of goods over 100 kilometres (km), reducing X (litres of fuel, carbon emissions) while ignoring factor Y (payload) creates false incentives.

Assessment

Although modern society cannot survive without transportation, there is a serious need to minimise the impact that it has on our environment and the world's finite resources. Regulators, OEMs, operators and consumers therefore need to work together to reduce the negative impact of transportation: this must become an integral part of corporate social responsibility.

The lowest-hanging fruit when it comes to reducing the carbon foot print 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, adhering to all relevant standards.

Urban vehicle distribution in China allows two-axis, 18-tonne vehicles to operate. Within the limits of allowed outer dimensions and axle loads, society and industry should always seek optimised transport solutions. In other countries, up to 12 axles and over 100 tonnes gross combination weight (GCW) is allowed on certain routes, which provides even greater opportunities to carry more goods with fewer engines.¹⁶

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 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 (tkm).

2.3 Permit 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

Commercial vehicles need professional and timely service and repair in 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



¹⁵ China Light Duty Emissions, TransportPolicy.net, 20th April 2020, viewed 2nd June 2020, https://www.transportpolicy.net/standard/china-light-duty-emissions/>

¹⁶ Enough empirical studies show that this has no negative impact on road safetyrather 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>

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more expensive and closer to city centres than industrial land. This is counter-intuitive from an operational point of view, as it leaves commercial vehicle 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 heavyduty commercial vehicle 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 into high-quality 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.

Abbreviation

| BEV Ba | ttery Electric Vehicles |
|----------|------------------------------------|
| CAFC Co | prorate Average Fuel Consumption |
| CV Co | ommercial Vehicle |
| EU Eu | ropean Union |
| FIL For | reign Investment Law |
| GCW Gro | oss Combination Weight |
| ICV Inte | elligent & Connected Vehicle |
| IPR Inte | ellectual Property Right |
| IV Inte | elligent Vehicle |
| KM Kile | ometre |
| L Litr | re |
| LFCV Lov | w Fuel Consumption Vehicles |
| MIIT Mir | nistry of Industry and Information |
| Teo | chnology |
| MOST Mir | nistry of Science and Technology |
| MOT Mir | nistry of Transport |
| MPS Mir | nistry of Public Security |
| NDRC Na | tional Development and Reform |
| Co | ommission |
| NEV Ne | w Energy Vehicles |
| OCT Off | f-cycle Technology |
| OEMs Ori | iginal Equipment Manufacturers |
| PCs Pa | ssenger Cars |
| PHEV Plu | ug-in Hybrid Electric Vehicle |
| R&D Re | esearch and Development |
| SAMR Sta | ate Administration for Market |
| Re | gulation |

| TBT | Technical Barriers to Trade |
|-----|-----------------------------|
| VAT | Value-Added Tax |
| WTO | World Trade Organization |





Auto Components Working Group

- 1. Strengthen Relevant Enforcement of Anti-Counterfeiting Laws and Regulations, and Apply Emerging Technologies to Protect the Legitimate Interest of Intellectual Property Right (IPR) Owners (5)
 - Strengthen relevant enforcement of anti-counterfeiting laws and regulations to combat the sale of counterfeit parts on e-commerce platforms.
 - Lower the threshold for Internet Content Provider (ICP) licences as well as the foreign ownership limits.
- 2. Promote the Development of the Remanufacturing Industry and Strengthen Relevant End-of-life Vehicle Policy Enforcement <a>2
 - Accelerate the implementation of the *Measures for Administration of Recycling Scrapped Motor Vehicles* and formulate relevant implementation rules to promote the development of the domestic scrapped auto parts recycling market, and ease the burden on enterprises in importing second-raw materials for remanufacturing while also reducing the waste arising from end-of-life vehicles' auto parts.
 - Accelerate the formation and improvement of tax policies to support the development of a remanufacturing and recycling system, and reduce the cost of remanufacturing for qualified enterprises.
 - Formulate subsidies and preferential policies for qualified remanufacturing enterprises to promote the development of the overall industry.
- 3. Promote the Development of the Intelligent Connected Vehicle (ICV) Industry, and Facilitate the Implementation of Relevant Testing Standards
 - Accelerate the construction 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 in order to allow continuous improvement of design, operations and maintenance of ICVs.

Introduction of the Working Group

The auto components industry complements the automotive industry in helping to provide mobility for people and goods, which is essential in today's interconnected world. The heavy reliance on road-freight transportation and light vehicles for trade and travel naturally creates a demand for both original equipment (OE) parts and aftermarket parts. As such, the industry has become extremely important, both to the economy in general and as a significant driving force for scientific and technological transformation. The industry's societal benefits fit perfectly with China's development goals, and with the Chinese Government labelling the automotive sector (including auto components) a pillar industry. The Auto Components Working Group urges the government to consistently launch and commit to its economic development plans. These plans devote particular attention to areas that help the industry thrive, such as technological innovation and industrial cooperation in new energy vehicles (NEVs), autonomous driving, and electric vehicle (EV) battery recycling and remanufacturing.



The Auto Components Working Group was created in 2000. It consists of around 80 international companies involved in the manufacturing of auto components, machine tools for producing auto components and automotive assembly lines. Members also import and distribute auto components and provide after-sales services in China. This working group has fostered ties with various organisations and governmental bodies in Europe and China.

Recent Developments

The year 2019 saw pressure on China's auto industry increase, with both production and sales, and the industry's main economic efficiency indicators, showing negative growth. A total of 25.721 million and 25.769 million automobiles were produced and sold respectively, a decrease of 7.5 per cent and 8.2 per cent respectively year-on-year, continuing the downward trend from 2018.¹ The worsening of the outbreak of COVID-19 at the end of January 2020 had a negative impact on the Chinese automobile consumer market, and the knock-on effect on the auto industry started to emerge in February.² With the butterfly effect rippling through the entire auto industry chain, the negative influence of the epidemic will remain for some time to come.³

The rapid growth of the NEV market in previous years was mainly due to the support of national and local subsidy policies. Affected by a drop in subsidies, the market fell short of expectations in 2019 and continued to decline compared with the same period in 2018. In 2019, the production and sales of NEVs were 1.242 million and 1.206 million units respectively, down 2.3 per cent and 4.0 per cent year-on-year. Breaking those figures down further, 1.02 million battery electric vehicles (BEV) were produced, up 3.4 per cent year-onyear, and 972,000 units sold, down 1.2 per cent yearon-year. The production and sales of plug-in hybrid electric vehicles (PHEV) achieved 0.22 million and 0.23 million units respectively, decreasing by 22.5 per cent and 14.5 per cent; that of fuel cell vehicles (FCV) reached 2,833 and 2,737 units, increasing by 85.5 per cent and

79.2 per cent respectively.4

Policy Environment

The national policies for NEVs are gradually shifting from 'complementary vehicles' to 'subsidiary applications', such as strengthening the construction and operation of charging infrastructure.⁵ On 4th March 2020, the Standing Committee of the Political Bureau of the Communist Party of China Central Committee proposed to "accelerate the construction of new infrastructure".⁶ New infrastructure construction (referred to as 'New Infrastructure') includes seven major areassuch as 5G infrastructure, charging points, big data centres, artificial intelligence and industrial Internetcovering transportation and other aspects.⁷ One of the key projects is to accelerate the construction of NEV charging points. With the help of 'new infrastructure', China's NEV market will achieve further development and prosperity.

With the growth of NEVs, the coordinated development of parts suppliers and vehicle manufacturers has also received attention. The need to place equal emphasis on vehicle and component technology innovation, and build a key component technology supply system for NEVs, was pointed out by the Ministry of Industry and Information Technology (MIIT) and relevant departments on 3rd December 2019, in the *New Energy Vehicle Industry Development Plan (2021–2035) (Draft for Comment) (Plan).*⁸ The *Plan* mainly lays out the research and development (R&D) plan of NEV core components and technologies from three aspects: the battery and power management system; motor drive and electronics; and networked and intelligent technology. China's policies protect parts suppliers less than vehicle Section Three: Goods

¹ Automotive Industry Economic Operation in 2019 (Announcement of China Automobile Industry Association Information Conference), China Automotive Industry Association Industry Information Department, 13rd January 2020, viewed 26th March 2020, <http://www.auto-stats.org.cn/ReadArticle.asp?NewsID=10704>

China Automobile Industry Association and Auto House Jointly Released (2020 COVID-19 Outbreak China Automobile Consumption Insight Report), China Automobile Industry Association, 10th March 2020, viewed 26th March 2020, http://www.caam.org.cn/chn/1/cate_3/con_5229082.html
 Ibid.

⁴ Automotive Industry Economic Operation in 2019 (Announcement of China Automobile Industry Association Information Conference), China Automotive Industry Association Industry Information Department, 13th January 2020, viewed 26th March 2020, <http://www.auto-stats.org.cn/ReadArticle.asp?NewsID=10704>

⁵ New Energy Vehicle Charging Infrastructure Industry Report (2020 Edition), Gasgoo, 20th March 2020, viewed 26th March 2020, <https://auto.gasgoo.com/ institute/2147.html>

⁶ The Standing Committee of the Political Bureau of the Central Committee of the Communist Party of China Holds a Meeting to Study the Current Key Work of Prevention and Control of the Outbreak of COVID-19 and Stabilise Economic and Social Operations. Xi Jinping, General Secretary of the Central Committee of the Communist Party of China, Presided over the Meeting, Xinhua, 4th March 2020, viewed 26th March 2020, <http://www.xinhuanet.com/politics/leaders/2020-03/04/ c 1125663518.htm>

^{7 &}quot;New Infrastructure" Boosts Autonomous Driving into Fast Lane, Tencent and Other Technology Enterprises Increase Investment, China Association of Automobile Manufacturers, 25th March 2020, viewed 26th March 2020, http://www.caam.org.cn/chn/38/cate_415/con_5229395.html>

⁸ New Energy Vehicle Industry Development Plan (2021-2035)" Exposure Draft Released: A Quick Look at Eight Key Points, Sohu, December 2019, viewed 20th May 2020, https://www.sohu.com/a/358839702_99893537>



manufacturers; however, auto parts manufacturing also plays an important role in the development of NEVs and smart vehicles. The highlights of the *Plan* include not only the development of batteries and fuel cells, but also focus on adjusting the development of cars and parts, and the integration of NEVs and artificial intelligence. If the policy is implemented, recognition of the importance of component manufacturers will be increased, thereby promoting their protection and facilitating the complete development of the upstream and downstream industrial chains of NEVs and smart vehicles.

In terms of environmental protection policy, on 23rd December 2016, the Ministry of Ecology and Environment (MEE) and the General Administration of Quality Supervision, Inspection and Quarantine jointly issued the Limits and Measurement Methods for Emissions from Light-duty Vehicles (China VI) (GB 18352.6-2016).9 In addition, according to the requirements of different standard limits, the 'National VI-a' and 'National VI-b' phases have been formulated to implement the National VI emission standards for light vehicles. From 1st July 2020, all light vehicles sold and registered must meet the requirements of the standard National VI-a phase. Under pressure to boost environmental protection, 15 provinces and cities in China started to implement the National VI emission standard on 1st July 2019.

Due to the impact of COVID-19, automobile enterprises were faced with the dilemma of product disassembly and the risk of high inventory.¹⁰ In an effort to stabilise and encourage the automobile consumption market, the China Automotive Industry Association (CAIA) proposed to delay the nationwide implementation of the National VI emission standard to reduce the burden on affected automobile companies. The National VI standard imposes stringent emission standards and technical requirements, especially regarding the core technologies of internal combustion engines (ICE). The working group believes that this standard will add a lot of pressure for local self-brand engine companies, but at the same time, the working group also realises that, for the implementation of National VI to succeed, the

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standard needs to improve not only a single component, but also reshape the power system and automotive industry supply chain. Therefore, in-depth cooperation between 'whole-vehicle and parts' enterprises in R&D, procurement and other aspects is crucial. Only in this way can a set of safety and controllable supporting measures for key parts be formed, and the effect of overall energy saving and emission reduction of the automobile be effectively realised.

The government should also consider supporting legislation that accelerates the development of the automotive aftermarket and overall automotive industry transformation, from being product-orientated to customer-orientated. Finally, new legislation encouraging the development of automotive finance, used cars, maintenance, car rental and other aftermarket services, as well as third-party logistics and e-commerce groups, would also be beneficial to the whole industry.

Key Recommendations

 Strengthen Relevant Enforcement of Anti-Counterfeiting Laws and Regulations, and Apply Emerging Technologies to Protect the Legitimate Interests of Intellectual Property Right (IPR) Owners 5

Concern

The growing sales of counterfeit auto parts circulated online through e-commerce platforms weaken the effectiveness of intellectual property (IP) protection of auto parts suppliers, are harmful to the reputation of the industry and put the general public at risk.

Assessment

China's independent automotive aftermarket (IAM) has been heavily disrupted by the widespread distribution of counterfeits, resulting in consumers' preferring authorised networks for repair, service and maintenance. As new technologies rapidly evolve, more platforms are being developed to facilitate online transactions, including private and public social media accounts and dedicated e-commerce stores. The circulation of counterfeit parts has moved from offline stores to online platforms, which makes it even more difficult for auto component suppliers (ACSs) to

⁹ Limits and Measurement Methods for Emissions from Light-duty Vehicles (CHINA 6), MEE, December 2016, viewed 20th May 2020, http://www.mee.gov.cn/ywgz/ fgbz/bz/bz/bb/dqhjbh/dqydywrwpfbz/201612/120161223_369476.shtml>

¹⁰ Zhang Xiaosha, Will National VI Emission Standard be Postponed Under COVID-19?, Auto Sales and Service, March 2020, viewed 26th March 2020, http://www.sg-auto.com.cn/List/ArticleView/2411



identify counterfeit parts, acquire evidence and track counterfeiters.

Currently, there are two ways to cope with the circulation of counterfeit parts on e-commerce platforms. ACSs that sell through existing online platforms often need to collect evidence for filing lawsuits as the burden of proof falls on them—including evidence acquisition, providing data and information to authorities, and counterfeit identification—making it difficult for ACSs to prosecute counterfeiters. Previously, because of the 'safe harbour' rule for online service providers,¹¹ ACSs had difficulty locating genuine data on counterfeiters' identities, business locations and illegal transaction histories. Furthermore, there is a lack of effective regulations to prevent the circulation of confiscated items. If the ACS does not pay for storage or destruction, confiscated items are likely to re-enter the market.

Because administrative regulations currently differentiate counterfeiting activities based on the quantity and value of fake items, counterfeiters have adopted methods of evading detection by manufacturing and distributing small quantities of lowquality fake goods. This means that, if they are caught by the local authority, the punishment is usually a minor fine and simple confiscation. Considering that the unit price of spare parts is generally relatively inexpensive, low-level punishment for such crimes may not be a deterrent to counterfeiters. The working group welcomes the government's work on amending the Patent Law in 2019 to substantially increase the cost of patent infringement.¹² Working group members expect the amended Patent Law will help fix these kinds of regulatory loopholes and stem the proliferation of counterfeiters and fake products.

In addition, ACSs can set up their own e-commerce stores to protect their IPRs. To operate e-commerce stores, the operator should have an Internet Content Provider (ICP) licence. However, Article 10 of the *Telecommunication Regulation of the People's Republic of China* requires that the operator be a sole purpose company legally established to engage in basic telecommunications business, and that stateowned equity interest or shares in the company shall not constitute less than 51 per cent.¹³ Accordingly, foreign-invested enterprises (FIEs) can only operate together with another domestic enterprise on China's e-commerce market, or they operate their business with an ICP-filing certificate offered by the MIIT. With more and more foreign investment flowing into China, there is an increasing need to incorporate FIEs into the development of e-commerce in the market. To form a better business environment for e-commerce, the working group suggests lowering the threshold for ICP licences as well as the foreign ownership cap.

In conclusion, the e-commerce platforms bring new challenges for IP protection in China's automotive aftermarket industry. Working group members are concerned with the enforcement of related anti-counterfeiting regulations on online transactions, because the counterfeit parts not only damage the reputation of original ACSs, but also pose a threat to the public safety.

Recommendations

- Strengthen relevant enforcement of anti-counterfeiting laws and regulations to combat the sale of counterfeit parts on e-commerce platforms.
- Lower the threshold for ICP licenses as well as the foreign ownership limits.
- 2. Promote the Development of the Remanufacturing Industry and Strengthen Relevant End-of-life Vehicle Policy Enforcement <a>2

Concern

With the number of end-of-life vehicles continuing to increase, the existing laws and regulations cannot effectively regulate the remanufacturing industry.

Assessment

In recent years, the automobile remanufacturing industry has developed rapidly in China. By the end of 2019, there were over 260 million automobiles registered in China,¹⁴ and the output value of the aftermarket exceeded trillions of Chinese yuan (CNY). China has more than 2,000 enterprises with production capacity

¹¹ Safe-harbour rule: in normal cases, online platforms do not disclose their clients' information until the case is placed on file by the courts.

¹² Draft Revision of China PATENT LAW BOOSTS FINES for IP Violations, Straits Times, 24th December 2018, viewed 14th April 2020, https://www.straitstimes. com/asia/east-asia/draft-revision-of-china-patent-law-boosts-fines-for-ip-violations>

¹³ Telecommunications Regulations of the People's Republic of China, China.org.cn, 20th January 2010, viewed 13th March 2020, http://www.china.org.cn/business/laws_regulations/2010-01/20/content_19273945_2.htm>

¹⁴ National Car Ownership Reaches 260 million by End of 2019, 66 Cities Have More than a Million, chanye.cwan.com, 8th January 2020, viewed 20th May 2020, http://chanye.cwan.com/qiche/2020/0108/7113.html>



in the remanufacturing industry. It is estimated that 100,000 engines, 200,000 automatic transmissions and 20 million steering gears were re-manufactured in 2018. The transaction volume of the entire auto parts remanufacturing industry may exceed 30 billion yuan in 2018.¹⁵ According to global aftermarket statistics released by consultancy firm McKinsey, China's auto aftermarket will maintain an average growth rate of 10–15 per cent between 2019 and 2035, when it is expected to reach about CNY 4.4 trillion.¹⁶ China has the potential to become one of the most important players in the global aftermarket industry.

As an advanced form of circular economy, remanufacturing plays an important role throughout the whole supply chain of the automotive and related parts industries, including end-of-life tyres. Inspection and analysis of the 'secondary-raw materials' (used parts) can help improve product design, and optimise component configuration. At present, the quality and performance of remanufactured products can often match that of the original product, and the industry has realised factory- and large-scale production.

Remanufacturing also has a significant effect on energy conservation and emissions reduction, which are key to green development. Compared with original products, producing remanufactured parts can reduce energy use by 60 per cent, raw materials by 70 per cent and costs by 50 per cent, with almost zero solid waste, while air pollutant emissions are reduced by more than 80 per cent.¹⁷

In 2019, there was a series of policy changes which boosted the remanufacturing industry in China. First of all, the *Decree of the State Council of the People's Republic of China* (No. 715) - *Administrative Measures for the Recovery of Scrapped Motor Vehicles*, which was released on 6th May 2019 and entered into force on 1st June 2019, made major policy adjustments to the recycling management of scrapped motor vehicles.¹⁸ This new legislation liberalises remanufacturing

restrictions on the 'five key assemblies' (engines, steering gears, transmissions, front and rear axles, and frames). It also eliminates the limitation on the number of remanufacturing enterprises, with the aim of promoting competition in and development of the scrap recycling industry. In addition, from 1st April 2019, the first remanufacturing group standard issued by the China Association of Automobile Manufacturers (CAAM), Requirements for the Management System of Auto Parts Remanufacturing Enterprises (Group Standard), was officially implemented.¹⁹ This group standard aims to structure the overall auto components remanufacturing management system, and acts as the basis for the government to regulate and manage the industry. Moreover, from 2nd to 11th December 2019, China's National Development and Reform Commission (NDRC) issued a call for comments on the Interim Measures for the Administration of Remanufacturing of Motor Vehicle Parts, which introduces the third-party quality certification for remanufacturing of motor vehicle parts.²⁰ Although this certification is not mandatory, remanufacturing companies without it might not benefit from future government preferential policies. In this sense, this third-party quality certification can be regarded as an access standard for entrance to the

However, there is still a lack of supporting policies for remanufacturing in China. In the context of economic globalisation, remanufacturing often requires global cooperation between ACSs and automobile manufacturers. The raw materials used in remanufactured products are mostly imported. Due to the nature of the trade in parts for remanufacturing, companies cannot enjoy export tax rebate incentives during the raw material procurement process. Moreover, as a considerable number of used parts recycling companies in the domestic market are unable to provide value-added tax (VAT) invoices, it is also not possible for them to enjoy the tax incentives for green industries.

automotive parts remanufacturing industry.

Although several government announcements have emphasised the importance of the circular economy, there are currently no specific preferential policies for the remanufacturing industry. Compared with



¹⁵ Auto Parts Remanufacturing Needs to Find a Way Out, finance.workercn, 18th December 2019, viewed 8th April 2020, <http://finance.workercn.cn/33005/20191 2/18/191218074907152.shtml>

¹⁶ Auto Remanufacturing Hope Coexists with Pressure, China Association of Automobile Manufacturers, 12th December 2019, viewed 13th March 2020, <http:// www.caam.org.cn/search/con_5227829.html>

¹⁷ Ibid.

¹⁸ Decree of the State Council of the People's Republic of China (No. 715)-Administrative Measures for the Recovery of Scrapped Motor Vehicles, State Council, 22nd April 2019, viewed 13th March 2020, http://www.gov.cn/zhengce/ content/2019-05/06/content_5389079.htm>

¹⁹ China's First Remanufacturing Group Standard Released, Clarifies the Identification and Traceability of Auto Parts Remanufacturing Products, China Economic Herald, 28th March 2019, viewed 13th March 2020, http://www.ceh.com.cn/shpd/2019/03/1125251.shtml>

²⁰ Interim Measures for the Administration of Remanufacturing of Motor Vehicle Parts (Call for Comments), 2nd December 2019, viewed 13th March 2020, <https://www.ndrc.gov.cn/yjzxDownload/jdcjibjzzzglzxbf.pdf>

other projects encouraged by the government, there are neither subsidies for remanufacturing and R&D processes, nor income tax deductions for R&D investment, nor special corporate income tax incentives for remanufacturing enterprises. This increases the costs of high-quality remanufactured products, making it difficult for manufacturers to compete with those that produce unqualified products.

On the European Union (EU) side, the European Commission launched the European Green Deal on 11th December 2019. Accordingly, the Commission's Circular Economy Action Plan includes not only a sustainable products policy, to support the circular design of all products based on a common methodology and principles, but also measures to encourage businesses to offer, and allow consumers to choose, reusable, durable and repairable products.²¹

In this light, the remanufacturing industry is an indispensable part of the circular economy. China's NDRC and the European Commission signed a Memorandum of Understanding (MOU) on the circular economy at the 20th EU-China Summit in 2018.²² However, this MoU didn't cover the remanufacturing industry. Despite this, the industry will be a part of the bilateral cooperation on the circular economy. To form a better business environment for remanufacturing, the working group suggests establishing a policy dialogue and best practice-sharing mechanism among relevant stakeholders to promote the direction the current European Green Deal platform is aimed at.

Recommendations

- Accelerate the implementation of the Measures for Administration of Recycling Scrapped Motor Vehicles and formulate relevant implementation rules to promote the development of the domestic scrapped auto parts recycling market, and ease the burden on enterprises in importing second-raw materials for remanufacturing, while also reducing the waste arising from end-of-life vehicles' auto parts.
- Accelerate the formation and improvement of tax policies to support the development of a

remanufacturing and recycling system, and reduce the cost of remanufacturing for qualified enterprises.

- Formulate subsidies and preferential policies for qualified remanufacturing enterprises to promote the development of the overall industry.
- 3. Promote the Development of the Intelligent Connected Vehicle (ICV) industry, and Facilitate the Implementation of Relevant Testing Standards

Concern

The existing test standards for safety remain not unified and relevant laws and regulations remain to be improved.

Assessment

In recent years, ICVs have become the strategic direction for the development of the global automotive industry, marking a major change in the automotive industry. Many domestic and foreign companies have invested a lot of labour and material resources in ICV technology, including autonomous driving and Vehicle to X (V2X). 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.²³ ICV has become an important strategic deployment at the national level.

Test standards and evaluation systems are essential to the industrialisation of ICVs. Testing the safety of ICVs is more complicated than that of general vehicles. During the process of the intelligent network industry development, different test standards need to be undertaken. The test standards and methods of traditional tests and advanced driver assistance system functional tests still apply at present for ICVs. In addition, there are international standards,²⁴ such as adaptive cruise control, autonomous emergency braking, forward collision warning, lane departure warning and lane-keeping assist.²⁵ Currently, the

²¹ The European Green Deal, European Commission, 11th December 2019, viewed 8th April 2020, https://ec.europa.eu/info/sites/info/files/european-green-deal-communication_en.pdf>

²² Memorandum of Understanding on Circular Economy between the European Commission and the National Development and Reform Commission of the People's Republic of China, Europa, 16th July 2018, viewed 8th April 2020, https://ec.europa.eu/environment/circular-economy/pdf/circular_economy_MoU_EN.pdf>.

²³ Innovative Development Strategy of Intelligent Vehicles, NDRC, 24th February 2020, viewed 9th April 2020, https://www.ndrc.gov.cn/xxgk/zcfb/tz/202002/ P020200224573058971435.pdf>

^{24 (}WP.29/GRVA) Working Party on Automated/Autonomous and Connected Vehicles (1st session), 25th September 2018, viewed 9th April 2020, https://www.unece.org/index.php?id=46755>.

²⁵ Hu Zhaozheng: Testing is an Urgent Problem to be Solved in the Intelligent Connected Automobile Industry, Sohu, 23rd September 2019, viewed 20th April 2020, <https://www.sohu.com/a/342444867_383324>



relevant laws and regulations for intelligent vehicle testing in China still need to be improved, and ICVs also lack unified test standards. This restricts the quantitative production of ICVs and makes it difficult to effectively advance industry development.

Taking ICV sensors as an example, V2X can easily obtain perception data at the kilometre level, while the current perception limit of radar and visual sensors is generally about 200 metres.²⁶ In addition, the blind spots problem that intelligent vehicles face will also be solved. The technological advancement stems from the extension of sensors; that is, a large number of sensors placed on the side of the road to transmit perception results to the vehicle, which will reduce the cost and difficulty of internal vehicle sensing, and improve the capacity beyond the field of vision. However, V2X as an 'over-horizon sensor' is limited by bandwidth and processing performance, and the ability of any vehicle to process information from nearby vehicles is limited. In such a case, the vehicle needs to filter information received and focus on potential threats to itself. In the context of a large number of nearby vehicles (such as a parking lot), how to selectively process data poses a great challenge for ICVs. In terms of safety, for an ICV with such functions to be approved for mass production requires the relevant test standards to be implemented as soon as possible. In addition, there are still many technical bottlenecks relating to the sensors upon which the ICV relies. The changes different sensors undergo vary greatly in different environments. It is difficult for a single technical route to adapt to the application of all scenarios, and the wide variety of Chinese roads also makes it impossible to exhaust all scenarios. This requires accelerating the formulation of relevant test standards and promoting the marketisation of ICVs.

Intelligent networking is the future of the automotive industry. Major multinational companies have made arrangements in the corresponding technical fields, and have considerable amounts of accumulation of best practices. Considering the versatility of many technologies, the experience and data of multinational companies will play a vital role in the development of intelligent network technology in China. The Auto Components Working Group recommends

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inviting multinational companies to participate in the development of testing standards in China by sharing their relevant experience. The rapid implementation of test standards can also help multinational companies adjust the technical direction and test scope of products in a timely manner, and promote the development of the ICV industry in China. In this respect, facilitation of cross-border data flows would further nurture the rapid enhancement of the industry,

Recommendations

- Accelerate the construction of test regulations and establish a complete test evaluation system.
- Actively cooperate with multinational companies to jointly develop test standards and realise experience- and datasharing.
- Facilitate cross-border data flows in order to allow continuous improvement of design, operations and maintenance of ICVs.

Abbreviations

| ACS | Auto Component Supplier |
|------|---------------------------------------|
| AEB | Autonomous Emergency Braking |
| BEV | Battery Electric Vehicles |
| CAAM | China Association of Automobile |
| | Manufacturers |
| CAIA | China Automotive Industry Association |
| EV | Electric Vehicle |
| FCV | Fuel Cell Vehicles |
| FIE | Foreign-invested Enterprise |
| ICE | Internal Combustion Engine |
| ICP | Internet Content Provider |
| ICV | Intelligent Connected Vehicle |
| MEE | Ministry of Ecological Environment |
| MIIT | Ministry of Industry and Information |
| | Technology |
| MOU | Memorandum of Understanding |
| NDRC | National Development and Reform |
| | Commission |
| NEV | New Energy Vehicle |
| OE | Original Equipment |
| PHEV | Plug-in Hybrid Electric Vehicles |
| R&D | Research and Development |
| VAT | Value-added Tax |
| V2X | Vehicle to X |
| | |

²⁶ 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 20th April 2020, <https://mp.weixin.qq.com/s/bHVnKY2_-4Ym27TYpgBrKQ>

Cosmetics Working Group

Key Recommendations

- 1. Encourage Innovation in the Cosmetics Industry to Boost Development and Effectively Promote its Recovery Following the COVID-19 Crisis
- 1.1 Establish a Comprehensive and Scientific Management System for Cosmetics Ingredients 18
 - Adopt a flexible access mechanism, putting in place informative notifications, and stipulate that the responsibility for non-high-risk ingredients lies with enterprises.
 - Draw upon and reference evaluation results of foreign authoritative bodies, and establish a special evaluation process for eligible high-risk ingredients.
 - Refer to and accept all scientific data of reference value, and propose information requirements for the registration or notification of raw materials that are scientific and reasonable, based on the principles of safety and risk assessment.
- 1.2 Encourage Innovation and Establish Management and Surveillance Mechanisms for Personalised Products
 - Establish for personalised products management and surveillance mechanisms that include administrative provisions on both registration and notification, and production and sales sites, 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, the 'clear responsible subject', '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.
 - Establish a system for registration and notification for the corresponding products and enterprises, based on different personalisation scenarios.

1.3 Evaluate New Technologies and Innovation in the Cosmetics Industry

- · Set up a system for the management of innovative products by type.
- Determine the product risks, and specify the registration and notification procedures and requirements, as well as the standards for the management of product claims, through the identification and assessment of new technologies for products.
- 1.4 Establish a Modern Risk Management System and Gradually Rescind the Mandatory Requirement for Animal Testing 14
 - Establish a scientific safety and risk assessment system, accelerate the validation and acceptance processes for alternative experimental methods and include innovative assessment approaches extensively used in the international community.
 - Include safety assessment reports based on innovative assessment approaches in administrative approvals/notifications for products/new ingredients, and gradually rescind the mandatory requirement for animal testing.





2. Implement the Reform Direction of the Cosmetics Supervision and Administration Regulations (CSAR), and Ensure the Smooth Transition of Secondary Legislation (32)

- Implement streamlining and delegation in secondary legislation to establish an efficient supervision system based on risk management, mainly in relation to market and post-market supervision, with companies bearing the responsibility for product quality and safety.
- Implement an effective system to record registration of special products, as well as a system to record informative notification of general products, to minimise the burden placed on enterprises in their production and operations brought by changes to regulations while also ensuring product quality and safety.
- Provide sufficient transition periods and policies for major changes that affect the industry in order to ensure a smooth and stable transition.

3. Improve Registration and Notification Processes for Cosmetics Products 13

3.1 Administrative Approval Time Limit and Review Standards

- Further specify the administrative licensing review time limit, especially for changes of hygiene permits and data supplementation.
- Improve and optimise review processes in accordance with the safety risk level of registration review opinions, provide quick and convenient reviews of data supplementation that are not related to product safety and enhance reporting efficiency.
- Establish detailed and transparent guidelines for review, adopt unified expert review standards, conduct investigations and publicly announce new review requirements ahead of their implementation.
- Give due consideration to changes from old to new regulations, strictly implement the time periods stated in the new regulations and allow enterprises sufficient time for transition.

3.2 Notification Management of Cosmetics Imported for Non-special Use

- Simplify the requirements for content, form review and review of materials after notification for nonspecial filed materials, so all companies can benefit fully from the change to notice filing.
- · Optimise the notification system to facilitate notification and ease the application process.
- Further improve local governments' supporting administration systems for supervision, both during and after notification, and standardise the criteria so that companies have a clear guideline on risk control and management.
- Establish detailed and transparent guidelines for evaluation, and adopt unified standards.

4. Improve the Management of Efficacy Claims and Labelling 16

4.1 Administration of Efficacy Claims

- Formulate efficacy management provisions, emphasising that efficacy claims are to be managed through enterprise self-discipline, and exempt efficacy claims that do not involve human safety from the scope of administrative licences, such as product notification and registration.
- Accept efficacy validation data and reports issued by overseas agencies, within reason.

4.2 Administration of Labelling

- Define the scope of requirements on label consistency, in order to ensure the new regulations issued are feasible and to avoid unnecessary ambiguity.
- Provide the industry with adequate transition periods when implementing new regulations on labelling.



5. Establish a Well-organised Post-marketing Surveillance System on Cosmetics' Adverse Effects <a>6

- Define clear standards for effective adverse effects reporting, and stipulate that reported cases should include the diagnosis of adverse events by medical institutions.
- Interpret and use, in a scientific manner, collected adverse effect cases and data, clarify the cause and
 effect relationship with cosmetics, systematically evaluate the statistical significance and clarify the
 application value of the information in determining the safety of either the registered products or the
 raw materials.
- Conduct regular exchanges of adverse effects data to provide enterprises with access to comprehensive adverse effects reports and data about their own products, and encourage the government to fully communicate with industry on the scientific legislative basis for changes in cosmetics and ingredients management.
- Hold a scientific and prudent attitude towards the disclosure of data on adverse effects, and avoid having specific data disclosed by a non-national competent authority.

Introduction to the Working Group

Cosmetics (herein refers to daily chemical products intended to be applied on external parts of the human body—e.g. skin, hair, nails, lips, mouth—by spreading, spraying or other similar ways for cleansing, protecting, beautifying or grooming purposes)¹ are used by individuals to improve both their appearance and wellbeing. Although once thought of as luxury products, cosmetics are now considered a daily necessity for most people. Thus, creating a sustainable cosmetics industry will help to improve people's overall standard of living.

The Cosmetics Working Group consists of more than 70 members, including a large number of internationally well-known cosmetics brands with a diverse range of business models. The majority of members have established research and development (R&D) and production facilities in China, and are industry leaders. Their expertise has been widely recognised by consumers, and they have contributed significantly to cosmetics development in China. The cosmetics industry has also acted as a catalyst for other related industries, such as fine chemicals, packaging, logistics and advertising.

The Cosmetics Working Group aims to:

- represent the interests of European cosmetics companies and facilitate information exchange among members, professional associations and regulatory bodies;
- promote the healthy and sustainable development of China's cosmetics industry and contribute to the formation of a fair, efficient and transparent regulatory environment; and
- ensure consumer safety.

European cosmetics companies possess cuttingedge 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 through exposure to competition, and provide Chinese consumers access to a variety of new and advanced products.

Recent Developments

China's cosmetics industry grew rapidly in 2019. According to the National Bureau of Statistics (NBS), cosmetics retail sales of enterprises above a designated size² reached Chinese yuan (CNY) 299.2 billion in 2019, a year-on-year increase of 12.6 per cent. This

¹ Cosmetic Supervision and Administration Regulation, State Council, 29th June 2020, viewed on 8th July 2020, <http://www.gov.cn/zhengce/content/2020-06/29/ content_5522593.htm>

² Cosmetics enterprises above a designated size means an enterprise group whose revenue of major business is above CNY 5 million; *Total Retail Sales of Consumer Goods Increased by 8.0% in 2019*, NBS, 17th January 2020, viewed 7th April 2020, <http://www.stats.gov.cn/tjsj/zxfb/202001/t20200117_1723391. html>



growth far exceeds the increase of eight per cent in total retail sales of consumer goods in 2019.³

Based on data from the General Administration of Customs (GAC), China's imports and exports of cosmetics and skincare products also maintained strong growth. From January to December 2019, the value of imports amounted to CNY 91.24 trillion, a cumulative increase of 38.8 per cent;⁴ and exports were valued at CNY 19.13 trillion, a cumulative increase of 17.1 per cent.⁵

In addition to these increases in volume and value, the cosmetics industry is seeing a trend of consumption upgrading in the Chinese market, particularly in highend skincare products and cosmetics. This indicates that breakthrough cosmetic products and technological innovations will be a huge potential driver for industry development. At the 2nd China International Import Expo in 2019, member companies of the working group presented the latest achievements in global cosmetics technologies, among which beauty care apparatus and personalised products attracted the most attention from consumers.

Following the long-term efforts of the National Medical Products Administration (NMPA), the working group was pleased to see that *Cosmetics Supervision and Administration Regulations* (CSAR) was finally released on June 29th 2020, with effective date on 1st January 2021. The working group applauds this new overarching China cosmetic legislation. It will facilitate Chinese cosmetic innovation and industry development in the following decades. The working group looks forward to the steady and orderly implementation of CSAR for a smooth transition with minimised disruption for the industry for those new requirements.

The State Administration for Market Regulation's (SAMR's) 2020 Legislative Work Plan, published in March 2020, lists the *Measures for the Management* of Cosmetics Registrations, the Measures for the Management of Cosmetics Labelling and the Measures for the Management of Cosmetics Production,

Operations and Supervision as primary legislative programmes.⁶ The working group will continue to focus on and support the formulation and revision of relevant regulations and standards, provide recommendations during the secondary legislative processes, and actively cooperate with authorities to ensure orderly and smooth implementation of the CSAR.

In early 2020, members of the working group actively supported the Chinese Government's efforts at all levels to combat the Coronavirus Disease 2019 (COVID-19) outbreak, while doing their best to resume normal business operations. While COVID-19 has brought great challenges to the socio-economic development of China, and the rest of the world, the Cosmetics Working Group looks forward to continuing to contribute to China's economic stability and consumption recovery post-pandemic.

The working group, therefore, expects that specific measures be introduced to encourage innovation, and new growth points nurtured and supported, in the cosmetics industry during the implementation process of the CSAR, especially in corresponding departmental regulations. At the same time, the industry anticipates being given a sufficient transition period for new regulatory changes that may have a greater impact on the production and operations, to avoid increasing the burden on enterprises.

Key Recommendations

- 1. Encourage Innovation in the Cosmetics Industry to Boost Development and Effectively Promote its Recovery Following the COVID-19 Crisis
- 1.1 Establish a Comprehensive and Scientific Management System for Cosmetics Ingredients (1) B

Concern

The rigid data acceptance rules, lengthy and complex evaluation processes and low approval rate have hindered licensing progress for cosmetics ingredients, thus further holding back the innovation of cosmetics products in China.

³ ibid.

⁴ List of Major Imported Goods in December 2019 by Value (CNY Value), GAC, 23rd January 2020, viewed 7th April 2020, <http://www.customs.gov.cn//custo ms/302249/302274/302277/302276/2851365/index.html>

⁵ List of Major Exported Goods in December 2019 by Value (CNY Value), GAC, 23rd January 2020, viewed 7th April 2020, <http://www.customs.gov.cn//custo ms/302249/302274/302277/302276/2851356/index.html>

⁶ Announcement on 2020 Legislation Plan by State Administration for Market Regulation, SAMR, 17th March 2020, viewed 8th July 2020, http://www.gov.cn/zhengce/zhengceku/2020-03/26/content 5495857.htm>

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As required by regulations in China, all new cosmetics ingredients must be registered and approved by NMPA before they can be used. Currently, the declaration process for new cosmetics ingredients is long and the approval rate low because of complicated requirements for registration materials and data, along with rigorous evaluation processes. This results in many ingredients widely available in the rest of the world not being permitted for use in China, negatively impacting both the domestic launch of global formulas and companies' global marketing and innovation efforts.

In other parts of the world, non-high-risk ingredients are managed under a system in which all relevant responsibility lies with the enterprise, which is where China's cosmetics industry diverges from global practices. Following implementation of the CSAR, cosmetics ingredients will be managed under different models appropriate to the level of risk, and non-highrisk ingredients will be managed through notification rather than registration, as is the norm internationally. This change will benefit China's cosmetics industry by introducing a new range of non-high risk ingredients. The working group hopes that informative notifications will be implemented in the management of ingredients notification, based on the system in which the responsibility lies with the enterprise to increase integration with international norms.

Some international toxicological test methods have not been included in Chinese technical regulations, causing a huge gap in the data on ingredient safety assessments. The working group suggests that a sufficient safety assessment be carried out on cosmetics ingredients when following the basic principles of safety and risk assessment, extensively including all scientific data available with reference values and setting the weight for different categories of data.

Cosmetics ingredients with special efficacies, such as hair dyes, preservatives and ultraviolet light absorbers, are managed with a positive list system in most other countries around the world. With comprehensive information provided through safety studies, the ingredients included in the list have all passed scientific assessment conducted by authoritative organisations in each respective country. The products containing these ingredients have been marketed accordingly. As a result, their safety has been subject to thorough market examination. A special reference, evaluation and inclusion process, established for the management of these new ingredients, has been widely adopted in other industries such as foods, flavours and fragrances. The working group recommends a similar system be established for the cosmetics industry.

Recommendations

- Adopt a flexible access mechanism, putting in place informative notifications, and stipulate that the responsibility for non-high-risk ingredients lies with enterprises.
- Draw upon and reference evaluation results of foreign authoritative bodies, and establish a special evaluation process for eligible high-risk ingredients.
- Refer to and accept all scientific and wellacknowledged data, and propose information requirements for the registration or notification of raw materials that are scientific and reasonable, based on the principles of safety and risk assessment.

1.2 Encourage Innovation and Establish 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 such products.

Assessment

It is an era of increasingly service-orientated economies across much of the world, with personalised services emerging as a dominant market trend. Consumers are now more likely to choose cosmetics according to their own skin conditions, for example, 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 by just 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 springing up in various cosmetics markets, with some being integrated with new technologies such as digitisation. During both of 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 cosmetics regulations.

Recommendations

- Establish for personalised products management and surveillance mechanisms that include administrative provisions on both registration and notification, and production and sales sites, 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, the 'clear responsible subject', '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.
- Establish a system for registration and notification for the corresponding products and enterprises, based on different personalisation scenarios.

1.3 Evaluate New Technologies and Innovation in the Cosmetics Industry

Concern

Although the CSAR set a clear direction for promoting innovation through regulatory reform, the latest innovative products cannot be marketed in China, or are heavily delayed compared with international markets, due to the lack of both a mature path for their classification and a system for relevant safety and risk assessment.

Assessment

The application of diversified technologies in cosmetics production is seeing the emergence of many innovative products to meet the new demands of consumers. They include new cosmetics that are personalised, regulate bacterial communities on the skin, use nanotechnology and protect against blue light, as well as those that are combined with electronic devices and information technologies. However, in China, there is no comprehensive compliance process that covers all innovative products, while those that do get launched are prohibited from advertising their respective efficacies. This is due to the fact that there is currently no suitable registration and notification approach for such innovative products, and their efficacies are not recognised by existing regulatory processes for cosmetics, depriving Chinese consumers of some of the most innovative products available.

Recommendations

- Set up a system for the management of innovative products by type.
- Determine the product risks, and specify the registration and notification procedures and requirements, as well as the standards for the management of product efficacies, through the identification and assessment of new technologies for products.
- 1.4 Establish a Modern Risk Management System and Gradually Rescind the Mandatory Requirement for Animal Testing

Concern

China's current cosmetics safety supervision system is largely based on animal tests rather than on product safety risk assessments, and innovative assessment approaches widely used by international organisations are not accepted in China, which hinders the fair trade of imported non-special cosmetics.

Assessment

As of 2019, several world economies have either banned or are in the process of setting up a timeline to ban animal testing for cosmetics. China is the only country which mandatorily requires animal testing in regulatory compliance processes for cosmetics products. This has a significant impact on the sales performance and reputation of Chinese cosmetics products launched in overseas markets, and prevents products that claim to not be tested on animals from entering the Chinese market.

Since November 2016, the NMPA (former China Food and Drug Administration (CFDA)) has published six alternative methods to animal testing, including the *Chemical Ingredients Used in Cosmetics – In Vitro 3T3 Neutral Red Uptake Phototoxicity Test.*⁷ This is a milestone in the provision of alternative methods to animal testing. Compared to the rest of the world, however, there remains a gap in both quantity and scale when it comes to alternative methods that China has validated and accepted, and these alternatives are only for cosmetics ingredients.

Instead of animal testing, common international practices focus on the use of scientific and modern methods and tools to evaluate formulations and ingredients, and compile corresponding safety assessment reports for reference. Nevertheless, at the end of 2015, the former CFDA published the Cosmetics Safety Risk Assessment Guideline (Draft for Comments),⁸ which did not specifically accept the use of modern safety evaluation principles, methods and tools that are based on various data sources, such as experiments that are alternatives to animal testing, computer models, principles of the weightage of evidence, history of safe use, toxicologyrelated threshold, and cross-reference/chemical group evaluation methods. This approach excluded a lot of data used in qualified industrial operations, making it extremely difficult to generate a complete safety assessment report in line with the guidelines.

Recommendations

- Establish a scientific safety and risk assessment system, accelerate the validation and acceptance processes for alternative experimental methods and include innovative assessment approaches used extensively in the international community.
- Include safety assessment reports based on innovative assessment approaches in administrative approvals/ notifications for products/new ingredients, and gradually rescind the mandatory requirement for animal testing.

Implement the Reform Direction of the CSAR, and Ensure the Smooth Transition of Secondary Legislation ¹

Concern

Since the CSAR form the basis of other cosmetics policies, inadequate streamlining and delegating of authorities in secondary legislation will hinder reform, while successful implementation of the regulations also requires an adequate transition period, which is particularly important for industry recovery and development after COVID-19.

Assessment

The working group was pleased to see that the longawaited CSAR finally released at the executive meeting of the State Council on 29th June 2020, with effective date on 1st January 2021. The CSAR show marked progress in administrative streamlining, decentralising authority and improving the risk-based classification management system, which is conducive to innovation and upgrading cosmetics R&D. However, secondary legislation and implementation details are required to create an informative notification administration system that will truly benefit the industry, companies and consumers.

At the same time, there are several major adjustments in the CSAR-including the definition and scope of cosmetics, the supervision of products with special efficacies and ingredients, and labelling requirementsthat will shape the supervisory framework and have a long-term impact on the industry. Among others, the Measures for the Management of Cosmetics Registrations, the Measures for the Management of Cosmetics Labelling and the Measures for the Management of Cosmetics Production, Operations and Supervision have been listed in primary legislation programmes and will be subsequently introduced. The working group hopes that full consideration will be given to the potential impact of these new regulations on companies and the industry in general, with provisions for a sufficient transition period and policies that prevent short-term industry fluctuations, to ensure smooth and complete implementation.

Recommendations

 Implement streamlining and delegation in secondary legislation to establish an efficient supervision system Section Three: Goods

⁷ Chemical Ingredients Used in Cosmetics – In Vitro 3T3 Neutral Red Uptake Phototoxicity Test, CFDA (now NMPA), 9th November 2016, viewed 12th May 2020, <http://www.nmpa.gov.cn/WS04/CL2193/300230.html >

⁸ The Pharmaceutical Registration Department of the China Food and Drug Administration Publicly Solicits Opinions on Cosmetics Safety Risk Assessment Guideline (Draft for Comments), CFDA (now NMPA), 10th November 2015, viewed 12th May 2020, <http://www.nmpa.gov.cn/WS04/CL2103/229204.html>



based on risk management, mainly in relation to market and post-market supervision, with companies bearing the responsibility for product quality and safety.

- Implement an effective system to record registration of special products, as well as a system to record informative notification of general products, to minimise the burden placed on enterprises in their production and operations brought by changes to regulations while also ensuring product quality and safety.
- Provide sufficient transition periods and policies for major changes that affect the industry in order to ensure a smooth and stable transition.
- 3. Improve Registration and Notification Processes for Cosmetics Products (1)
- 3.1 Administrative Approval Time Limit and Review Standards

Concern

Because the current cosmetics evaluation guidelines do not contain unified criteria and binding approval times, companies face uncertainties *vis-à-vis* product registration/notification that increase operational burdens and impact marketing plans.

Assessment

Administrative licensing reviews have been slow in recent years, often with no specified time frame or official deadline by which the process will be completed. During reviews for new product registrations or requests for extensions, companies are often caught in a situation where they do not have any definite outcome several months after submission. Furthermore, new review requirements are often put forward, even if there is no change to current regulations and standards. Sometimes new or differing review opinions are even received for the same product. Meanwhile, there is no specific timeframe given for the transition period from old to new regulations and the review opinions from experts are often not definitive. As a result, not only is additional data required for numerous product categories, but it is also common for applications to be suspended by reviewers during the review process. As companies can neither predict nor track the registration progress, new products-in particular seasonal products-may have to go to the market a year later if approved months after the due date. This severely impacts companies' marketing plans and may lead to a huge loss of revenue and opportunities for profitmaking.

Recommendations

- Further specify the administrative licensing review time limit, especially for changes of hygiene permits and data supplementation.
- Improve and optimise review processes in accordance with the safety risk level of required material for registration review opinions, provide quick and convenient reviews of data supplementation that are not related to product safety and enhance reporting efficiency.
- Establish detailed and transparent guidelines for review, adopt unified expert review standards, conduct investigations and publicly announce new review requirements ahead of their implementation.
- Give due consideration to changes from old to new regulations, strictly implement the time periods stated in the new regulations and allow enterprises sufficient time for transition.

3.2 Notification Management of Cosmetics Imported for Non-special Use

Concern

The procedure for examining imported non-special cosmetics is sub-optimal, and there are neither consistent standards nor a clear and complete administration system for supervision and verification after products are launched at the provincial level.

Assessment

When provincial-level authorities take charge of the notification of non-special cosmetics, review requirements and standards are implemented in an inconsistent manner. In some provinces, the processes at formal and post-notification information review stages are more complicated and stringent than at the national level, which runs contrary to the principle of informative notification. At the same time, uncertainties arise from the lack of review result and data archives, as some distributors refuse to sell approved products unless they see the data review.

Furthermore, the lack of post-notification management and incomplete administrative regulations leaves enterprises at high risk of non-compliance.

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Recommendations

- Simplify the requirements for content, form review and review of materials after notification for nonspecial filed materials, so all companies can benefit fully from the change to notice filing.
- Optimise the notification system to facilitate notification and ease the application process.
- Further improve local governments' supporting administration systems for supervision, both during and after notification, and standardise the criteria so that companies have a clear guideline on risk control and management.
- Establish detailed and transparent guidelines for evaluation, and adopt unified standards.

4. Improve the Management of Efficacy Claims and Labelling (1) 6

4.1 Administration of Efficacy Claims

Concern

Too specific requirements in the draft regulations on the classification and efficacy evaluation and inspection of cosmetics efficacy claims fail to consider the acceptance of verification data issued by overseas research institutions, and do not fit the actual situation where the content of claims is diverse and verification methods are continuously developed, which will hinder the simultaneous development and marketing of cosmetics at home and abroad.

Assessment

The CSAR imposes new requirements for supporting materials of cosmetics efficacy claims, and a summary must be both disclosed to the public and subjected to supervision from all parties involved.

In the Standards of Testing for Cosmetics Registration and Notification,⁹ issued by the NMPA in September 2019, products with claims of freckle whitening, hair loss prevention and new efficacies are included in the scope of administrative licensing inspection. The regulation also requires testing institutions to have China Metrology Accreditation (CMA).

Currently, sunscreen efficacy assessment reports issued by overseas laboratories that cannot obtain CMA are not accepted for special use cosmetics applications. Under such rules, efficacy claims for products other than sunscreen will also be affected. If the efficacy evaluation data and reports issued by overseas institutions are no longer to be accepted in the future, it will greatly increase the R&D costs of multinational companies, resulting in a waste of resources and hindering the global marketing of products.

The working group also notes that there has been a continuous introduction of group standards related to the evaluation of cosmetic efficacy throughout the country. It is hoped that the regulatory authorities can provide guidance to the industry, while steering the development and introduction of different evaluation methods and standards at home and abroad.

Recommendations

- Formulate efficacy management provisions, emphasising that efficacy claims are to be managed through enterprise self-discipline, and exempt efficacy claims that do not involve human safety from the scope of administrative licences, such as product notification and registration.
- Accept efficacy validation data and reports issued by overseas agencies, within reason.

4.2 Administration of Labelling

Concern

The requirement for consistency of label contents in the draft CSAR is currently too vague, while implementation will be too absolute, which increases the compliance risks of various stakeholders.

Assessment

It is unrealistic to maintain internationally uniform packaging for imported cosmetics, and ensure that the content of the Chinese label content is exactly the same as the original, given that cultural customs, language conventions and regulatory requirements vary across different countries. Because cosmetics are international, fast-moving consumer goods, maintaining the international unified packaging, to the greatest extent, is not only conducive to the global product marketing, planning and deployment of enterprises, but also in line with Chinese consumers' consumption philosophy, interests and benefits. The working group believes that the label content consistency requirements should be clarified. If the original packaging content does not contradict the content of the Chinese label,

⁹ Standards of Cosmetics Registration, Notification, NMPA, 11th September 2019, viewed 12th May 2020, <http://www.gov.cn/fuwu/2019-09/11/content_5428974. htm>



the content of the Chinese label should prevail, so as to facilitate implementation after the introduction of regulations. At the same time, any ambiguity that could arise from the different understandings of various parties or excessively large subjective interpretation space, should be avoided. Further clarifying the scope of requirements will reduce system costs and promote the development of the Chinese cosmetics industry.

Recommendations

- Define the scope of requirements on label consistency, in order to ensure the new regulations issued are feasible and to avoid unnecessary ambiguity.
- Provide the industry with adequate transition periods when implementing new regulations on labelling.
- 5. Establish a Well-organised Post-marketing Surveillance System on Cosmetics' Adverse Effects 66

Concern

Enterprises are unclear about the significance and requirements of the government's administration efforts on the monitoring and reporting of adverse effects and information exchange, due to the lack of scientific and effective working guidelines.

Assessment

The monitoring of adverse effects is an important part of the complete lifecycle safety management of cosmetics. The current lack of specific guidelines for scientific and effective adverse reaction monitoring, reporting and information exchange has resulted in incomplete uniformity in case reporting standards, data interpretation and product safety determinations among cosmetic manufacturing and operating enterprises, and local regulatory monitoring agencies. Communication between enterprises and regulators on adverse reaction monitoring is inadequate, and an effective security risk communication mechanism is needed. Furthermore, information use and disclosure of adverse reaction monitoring data is also not clearly defined, which carries the potential risks of information disclosure and misinterpretation.

Recommendations

 Define clear standards for effective adverse effects reporting, and stipulate that reported cases should include the diagnosis of adverse events by medical institutions.

- Interpret and use, in a scientific manner, collected adverse effect cases and data, clarify the cause and effect relationship with cosmetics, systematically evaluate the statistical significance and clarify the application value of the information in determining the safety of either the registered products or the raw materials.
- Conduct regular exchanges of adverse effects data to provide enterprises with access to comprehensive adverse effects reports and data about their own products, and encourage the government to fully communicate with the industry on the scientific legislative basis for changes in cosmetics and ingredients management.
- Hold a scientific and prudent attitude towards the disclosure of data on adverse effects, and avoid having specific data disclosed by a non-national competent authority.

Abbreviations

| CFDA | China Food and Drug Administration |
|----------|------------------------------------|
| CMA | China Metrology Accreditation |
| CNY | Chinese Yuan |
| COVID-19 | Coronavirus Disease 2019 |
| CSAR | Cosmetics Supervision and |
| | Administration Regulations |
| GAC | General Administration of Customs |
| NBS | National Bureau of Statistics |
| NMPA | National Medical Products |
| | Administration |
| R&D | Research and Development |
| SAMR | State Administration for Market |
| | Regulation |

Energy Working Group

Key Recommendations

1. Energy Transition

1.1 Push for the Transition from Coal to Gas in China's Energy Mix 1

- Effectively open the market to foreign-invested enterprises (FIEs), clarifying clear roles and market regulation to foster FIEs' direct investments in natural gas (NG) liquefaction, transportation and storage management to improve security of supply and reduce import needs.
- Proceed with gas market reform by identifying market authorities, progressing with midstream redesign, implementing third-party access for gas infrastructures and adopting non-discriminating rules for the sale of infrastructure capacity.
- Encourage the building of necessary energy infrastructure such as power and gas storage by setting tariffs to cover building costs while fairly remunerating investors and operators.
- Redesign return mechanisms for gas infrastructures to promote the effective development of new capacity, incentivise management efficiency of existing capacity, and promote innovation in construction and management.
- Consider the use of distributed energy (not only from renewable sources), integrated power generation and infrastructure building through careful planning and enforcement to make the energy system more flexible and efficient.
- Promote the bulk LNG supply by setting up national standards in line with international standards, while updating the current safety standard to ensure accessible and safe supplies, as well as fair market competition between pipeline gas and bulk LNG.
- Switch from coal to NG combined heat and power (CHP) plants that use flexible electricity, and heat-production grids where heat storage facilities can increase overall energy efficiency.
- Facilitate and support the adoption of advanced heat-storage technologies to develop localised solutions that match the current heat supply with public demand, and optimise the heating value chain by better integrating production with distribution.
- Switch from gas production based on coal gasification to biomethane and biogas production from biomasses.
- 1.2 Adjust the Energy System to Incentivise Decentralised Renewable Energy (RE) Development ()4
 - Establish a clear nationwide policy for RE implementation with a long-term tariff plan under which external environmental costs are reflected in pricing.
 - Implement green financing tools to facilitate investment from small and medium enterprises (SMEs)
 - Encourage a functioning market for green certificates, and set renewable portfolio obligations that enable industrial and commercial power consumers to differentiate power sources and manage emissions.
 - Pilot large-scale RE direct procurement and distributed models enabling industrial power users to source substantial amounts of power from renewable sources.

1.3 Continue Electrification of the Energy System 1.3

• Enact preferential policies for end-use electrification such as in transport, heat, buildings and manufacturing (especially energy-intensive manufacturing like steel, paper and glass) to subsidise





the conversion from coal-based to electricity supply; and develop a framework for energy modernisation of building stock and existing manufacturing facilities.

- Offer policy incentives that favour market-based growth of microgrids with digital demand-side response mechanisms.
- Implement framework regulation for decentralised electricity generation on buildings, and integration with micro-grid networks.
- Reform overall grid regulation to guarantee full absorption of renewable sources.

1.4 Promote the Role of Hydrogen in Optimising the Energy System 15

- Enact in the 14th Five-Year Plan the role of hydrogen as a needed energy carrier, not dangerous chemical gas, to reduce greenhouse gas (GHG) emissions and increase energy security.
- Encourage the use of hydrogen in fuel cells and develop a widespread and sustainable distribution network for new energy vehicles (NEVs) across different types of transportation, accelerating the development of hydrogen stations network in key urban areas to reduce the footprint of transport.
- Promote (re-)electrification from green or low-carbon hydrogen.
- Promote legislation, standards and remuneration to blend hydrogen into the NG pipeline while assessing network readiness for hydrogen blending and evaluating a minimum target needed to generate sufficient demand to allow the scale-up of hydrogen production.
- Implement relevant mechanisms to incentivise the large-scale production of low-carbon or renewable-based hydrogen by water electrolysis.
- Adopt a certification scheme aligned with international standards (e.g. CertifHy in Europe) to define low carbon and/or renewable hydrogen.
- Define and simplify specific safety standards regulations harmonised at the national level for hydrogen production, distribution and usage.
- Encourage and accelerate the development of regulations harmonised with international bodies for high pressure and liquid hydrogen as a way to efficiently transport hydrogen and to reduce total cost of ownership.
- Design a hydrogen-based storage system as a systemic 'buffer' for harmonising continuous production from coal and nuclear plants and intermittent production from renewables in order to optimise electricity supply/demand patterns at national and local levels.
- 1.5 Define Clear National Targets and Guidelines to Promote the Development of Bioenergy
 - Define national policies and guidelines for the development of biogas and biomethane (gas/ methane production from agricultural feedstock, food or waste) with identification of short- and medium-term targets.
 - · Promote the development of innovative waste treatment to generate energy.
 - Identify a portfolio of subsidies that provinces can adopt to foster the development of biogas and biomethane plants.
 - Accelerate government efforts to achieve the E10 policy target nationwide.

2. Energy Efficiency

2.1 Move to Increasingly Dynamic, Transparent and Liberalised Power Markets (1) 5

- Speed up the establishment of a more robust power trading system to guarantee real returns on investments and incentive energy savings by end-users.
- · Accelerate the creation of liberalised provincial and regional spot markets for wholesale



and retail power trading, transitioning state monopolies to independent suppliers and service operators, with a level playing field for third party entrants that ensures healthy and open competition, access to infrastructure, reasonable supply and demand data, confidentiality of transactions, non-discrimination and transparency.

 Offer flexible retail electricity tariffs to push for decentralised energy and storage; expand decentralised renewable trading platforms; build up the mechanisms for direct trading among users, provincial trading, and inter-provincial trading; and provide adequate local subsidies as national policies are phasing out.

2.2 Incentivise the Reduction of Energy Demand and Upgrade Existing Facilities 1

- Define a clear, regularly updated common methodology to assess energy/emissions intensity and make such data transparent.
- Increase the number of local incentives awarding preferential conditions for land acquisition to project owners who pursue green building certification.
- Issue renewable energy certificates (RECs) to enhance incentives for reducing energy demand and energy/emissions intensity for big enterprises.
- Help SMEs upgrade their energy consumption strategy and incentivise digital solutions.
- Define standards at the industrial level, providing cap limits for energy used per production output unit, by industrial sector, while setting up 'white certificate' mechanisms.
- Define cap limits of Tier-1 cities and connect the trading systems of RECs and white certificates.

2.3 Accelerate Investment in District Energy Infrastructure

- Develop a national roadmap for a rapid switch to cleaner fuels to reduce coal use in district energy systems (DES).
- Develop national pilots for comprehensive digital solutions to better meet DES demand.
- Encourage the development of energy service companies (ESCOs) to boost business innovation, improve comprehensive energy management and maintain locally-based, tailored solutions.
- Develop DES capacity-building and knowledge-sharing programmes with European companies and institutions, while publicising its advantages throughout all levels of government.
- Develop a secondary system as an intelligent pipe network to improve overall DES efficiency through proven approaches like hydraulic balancing and heat metering, especially for retrofitting projects in residential buildings.
- · Support application of locally available multi-energy sources to improve system flexibility.
- For new development areas, invite experienced companies to review and optimise network designs, provide franchises and create subsidies for network investment.
- Establish an industrial DES tariff structure with standards of capacity, consumption and connection rates to facilitate international investment.

3. Belt and Road Initiative (BRI)

- 3.1 Apply State-of-the-art, Efficient Technologies and Solutions to BRI Energy Projects
 - Guarantee that energy projects deployed among BRI countries fully comply with international agreements on sustainability and decarbonisation.
 - Guarantee sustainable and new technologies and standards for BRI projects, prohibiting the deployment of polluting technological solutions inconsistent with China's stated goal of 'greening' the BRI.
 - Issue 'minimum requirements' for sustainability standards and regulations for energy-related projects within the BRI, and enforce their execution.





• Guarantee the equal treatment of FIEs to participate in BRI projects through transparent, unbiased and open bidding processes.

Carbon Market Sub-working Group Key Recommendations

- 1. Increase the Accuracy, Transparency and Coherency of Greenhouse Gas (GHG) Emissions Data in China's National Emissions Trading System (ETS) (2)
 - Promote knowledge-sharing on GHG data collection, management and optimisation.
 - Intensify promotion of GHG reduction solutions for the manufacturing industry, buildings and private households.
 - Enhance the credibility of GHG data and the transparency of methods for collecting GHG data at the enterprise level.
 - Improve regulations, guidelines and tools regarding GHG emissions data collection and management.
- 2. Explore Synergies and Co-benefits Between the National ETS and Other Related Policy Instruments 3
 - Facilitate and support exchange among different relevant policy areas in terms of energy, environment and climate change.
 - Strengthen coordination among different governmental sectors regarding the implementation
 of energy trading, carbon emissions trading, green certificate trading and environment pollutant
 permit trading.
 - Promote systematic research on co-benefits in order to ensure the feasibility and effectiveness of policies in a synergic way.
- 3. Incentivise the Chinese Government to Work Alongside European Governments, Civil Society and Businesses to Strengthen its Actions in Line with the Objectives of the Paris Agreement <<a>2
 - Utilise the European Union (EU)-China Energy Cooperation Platform to share best practices in reducing GHG emissions.
 - Work jointly with EU counterparts at all levels to strengthen actions to achieve the targets for the reduction of GHG emissions in line with the Paris Agreement, in particular with Chinese nationally-determined contributions and the reform objectives highlighted in the 13th Five-year Plan, while putting China on a global clean energy transition and low carbon development pathway.
 - Create an accessible and business-friendly market for both European and Chinese industries and business to be part of joint solutions for a Green China's Policy Agenda.
- 4. Factor Market Liquidity into the Design of the National ETS Allocation Mechanism
 - Release the allowance allocation programme and the amount of allowance allocated to compliance companies as early as possible in a clear and transparent way.
- 5. Introduce Institutional Investor Trading Accounts to the Market to Improve Liquidity and Lower Risks
 - Encourage the participation of qualified institutional investors in the National ETS.



- Consider introducing market-makers by allocating them a certain number of allowances and providing incentives (such as reduced or waived exchange fees) for a guaranteed volume of bids/offers each trading day.
- Strengthen the integrity and stability of the ETS by increasing the minimum lot size to 1,000 tonnes to prevent excessive volatility in times of low liquidity.
- · Limit speculation by preventing the participation of individuals.

6. Establish an Auto-matching System to Reduce the Risk of Price Manipulation

- Mandate the automatic matching of bids and offers to reduce the risks of price manipulation and improve convenience for traders.
- Introduce well-designed and transparent settlement procedures for OTC spot and forward transactions.

Introduction to the Working Group

In 2014, President Xi Jinping called for an "energy revolution" in China.¹ As the top emitter of greenhouse gases (GHG), China has the unique responsibility of leading the rapid development and deployment of clean energy, and reduction of energy intensity, that is critical to combatting climate change. Drawing upon diverse technical and policy experience from around the world, will be crucial to this transition.

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 seeks to establish an effective and constructive dialogue on energy policies with relevant Chinese regulators, provide input on China's energy policy work and share best practices from European energy industries operating in China. The group also cooperates closely with the European Commission and proactively participates in the European Union (EU)-China Energy Cooperation Platform.

The working group's overall aim is to create a fair, transparent and level playing field to promote competition between European and Chinese companies, and to promote the development and integration of clean and renewable energies, and a circular economy, while supporting China in its energy transition. The working group is pleased to provide detailed recommendations derived from EU technology, solutions and applications that can be used in various degrees to address some of the fundamental challenges China is facing.

Recent Developments

China is the world's largest energy consumer, with an energy consumption level of 4.86 billion tonnes of standard coal equivalent in 2019, 3.3 per cent higher than in 2018. Clean energy consumption accounts for 23.4 per cent of China's energy share, as coal has reached a record low of 57.7 per cent,² in line with China's goal of coal use below 58 per cent by 2020. Yet in absolute terms, coal usage increased by one per cent, and China continues to fund coal technology on Belt and Road Initiative (BRI) projects abroad. Meanwhile, China's carbon dioxide (CO₂) emissions, estimated at 0.26 gigatonnes, almost singlehandedly led to a global increase.³

Although the COVID-19 pandemic reduced emissions by about 25 per cent, coal consumption at power plants and for oil refinery use returned to a normal range by

¹ Sheng, Gao, Xi Jinping Delivered a Speech Stressing the Active Promotion of Energy Production and Consumption Revolution, Sina Finance, 14th June 2014, viewed 14th July 2020, http://finance.sina.com.cn/money/fund/20140614/141319413598.shtml>

² China's Greenhouse Emissions Rise 2.6% in 2019: Research Group, Reuters, 18th March 2020, viewed 15th April 2020, ">https://www.reuters.com/article/uschina-environment-carbon-emission/chinas-greenhouse-emissions-rise-2-6-in-2019-research-group-idUSKBN2150YY>">https://www.reuters.com/article/uschina-environment-carbon-emission/chinas-greenhouse-emissions-rise-2-6-in-2019-research-group-idUSKBN2150YY>">https://www.reuters.com/article/uschina-environment-carbon-emission/chinas-greenhouse-emissions-rise-2-6-in-2019-research-group-idUSKBN2150YY>">https://www.reuters.com/article/uschina-environment-carbon-emission/chinas-greenhouse-emissions-rise-2-6-in-2019-research-group-idUSKBN2150YY>">https://www.reuters.com/article/uschina-environment-carbon-emission/chinas-greenhouse-emissions-rise-2-6-in-2019-research-group-idUSKBN2150YY>">https://www.reuters.com/article/uschina-environment-carbon-emission/chinas-greenhouse-emissions-rise-2-6-in-2019-research-group-idUSKBN2150YY>">https://www.reuters.com/article/uschina-environment-carbon-emission/chinas-greenhouse-emissions-rise-2-6-in-2019-research-group-idUSKBN2150YY>">https://www.reuters.com/article/uschina-environment-carbon-emission/chinas-greenhouse-emissions-rise-2-6-in-2019-research-group-idUSKBN2150YY>">https://www.reuters.com/article/uschina-environment-carbon-emission/chinas-greenhouse-emissions-rise-2-6-in-2019-research-group-idUSKBN2150Y">https://www.reuters.com/article/us-carbon-emission/chinas-greenhouse-emission/chinas-greenhouse-emissions-rise-2-6-in-2019-research-group-idUSKBN2150Y">https://www.reuters.com/article/us-carbon-greenhouse-emission/chinas-greenhouse-emission/chinas-greenhouse-emission/chinas-greenhouse-emission/chinas-greenhouse-emission/chinas-greenhouse-emission/chinas-greenhouse-emission/chinas-greenhouse-emission/chinas-greenhouse-emission/chinas-greenhouse

³ Analysis: Global Fossil-fuel Emissions up 0.6% in 2019 due to China, Carbon Brief, 4th December 2019, viewed 9th April 2020, <https://www.carbonbrief.org/ analysis-global-fossil-fuel-emissions-up-zero-point-six-per-cent-in-2019-due-tochina>



the end of March 2020.⁴ The virus has also engendered fears that the government will use coal to prop up economic growth.⁵ China's natural gas (NG) production increased 11.5 per cent year-on-year and NG import growth rose 6.5 per cent in 2019,⁶ but a drop in energy demand brought liquefied natural gas (LNG) imports down 35 per cent year-on-year in February 2020.⁷ Although Chinese demand had recovered significantly by March 2020,⁸ massive disruptions in the rest of the world will cause much uncertainty for sustained oil and LNG imports, upon which China is largely dependent.

Positive signs for energy sector reform include the opening up of oil and gas exploration to foreign firms in 2019 to further diversify the domestic energy supply;⁹ but reform must come at the midstream and downstream levels as well. Recent revisions to the Negative List for Foreign Investment¹⁰ allow radioactive mineral smelting and investments in nuclear power plants, and also open geodetic and aerial prospections for holders of mining licences, which is a positive sign for oil and gas exploration. These steps must be properly implemented to effectively guarantee market opening and fair competition with Chinese companies.

In April 2020, the National Energy Administration (NEA) released the first draft of a new national energy law.¹¹ This draft is a positive step towards effective energy system reform but it must be accompanied by

- 4 Analysis: Coronavirus Temporarily Reduced China's CO₂ Emissions by a Quarter, Carbon Brief, 19th February 2020, viewed 9th April 2020, https://www.carbonbrief.org/analysis-coronavirus-has-temporarily-reduced-chinas-co2emissions-by-a-quarter>
- 5 Hale, Thomas and Hook, Leslie, China Expands Coal Plant Capacity to Boost Post-virus Economy, Financial Times, 25th June 2020, viewed 6th July 2020, https://www.ft.com/content/cdcd8a02-81b5-48f1-a4a5-60a93a6ffa1e
- 6 China's Natural Gas Output Growth Quickens in 2019, China.org.cn, 25th January 2020, viewed 10th August 2020, http://www.china.org.cn/business/2020-01/25/ content 75647521.htm>
- 7 Coronavirus Slows Chinese Liquefied Natural Gas Shipments, Bloomberg, 9th March 2020, viewed 9th April 2020, https://www.bloomberg.com/professional/ blog/coronavirus-slows-chinese-liquefied-natural-gas-shipments/>
- 8 China's LNG Demand Makes a Comeback to Aid Virus-Hit Market, Bloomberg, 1st April 2020, viewed 9th April 2020, <https://www.bloomberg.com/news/ articles/2020-04-01/china-s-Ing-demand-makes-quiet-comeback-to-aid-virus-hitmarket>
- 9 Chen, Aizhu and Xu, Muyu, China Opens Up Oil and Gas Exploration, Production for Foreign, Domestic Firms, Reuters, 9th January 2020, viewed 11th April 2020, ">https://www.reuters.com/article/us-china-oil-mining/china-opens-up-oil-and-gasexploration-production-to-foreign-firms-idUSKBN1Z806Q>
- 10 The National Development and Reform Commission and the Ministry of Commerce Release the 2020 Version of the Negative List for Foreign Investment Access, National Development and Reform Commission (NDRC), 24th June 2020, viewed 29th June 2020, https://www.ndrc.gov.cn/xwdt/xwfb/202006/t202006/4_1231924.html>
- 11 Announcement of the National Energy Administration on the Public Solicitation of the "Energy Law of the People's Republic of China", NEA, 10th April 2020, viewed 24th April 2020, <http://www.nea.gov.cn/2020-04/10/c_138963212.htm>

transparent implementation rules and execution, as well as guidelines on how the generation and utilisation of renewable energy (RE) will be increased, supported and efficiently integrated within the energy system. The working group expects that the law's focus on energy transition and energy efficiency factor strongly into the development of China's upcoming 14th Five-Year Plan. The law should also open more market access to foreign-invested enterprises (FIEs) to strengthen international energy cooperation while accelerating overall system efficiency and guaranteeing energy security.

Unfortunately, the NEA's Key Work Objectives for Energy in 2020,¹² released in June 2020, appears to halt China's energy transition. Although it puts an understandably key focus on energy security, its push for "green coal", coal gasification and domestic production of fossil sources is not a positive step towards decarbonisation. While hydrogen development is highlighted, there is very little mention of bioenergy, which should play a key role in renewables development and coal substitution. Systematic reforms for decreasing energy demand and increasing energy efficiency through tariffs modulation are not stressed enough. The working group is disappointed that coal is still given an overwhelmingly central role in energy production, with its target energy share set at only 0.2 per cent lower than 2019.

Key Recommendations

1.1 Push for the Transition from Coal to Gas in China's Energy Mix

Concern

Unstructured planning, outdated and slow implementation of regulations, limited infrastructure and COVID-19 disruptions have all hindered China's transition from coal to gas.

Assessment

The COVID-19 pandemic, coupled with recent tensions and speculations on oil price,¹³ has drastically altered



¹² Notice of the National Energy Administration on Printing and Distributing the "Guiding Opinions on Energy Work in 2020", NEA, 22nd June 2020, viewed 29th June 2020, <http://www.nea.gov.cn/2020-06/22/c_139158412.htm>

¹³ Brower, Derek, Raval, Anjli, Seppard, David and Meyer, Gregory, Eight Days That Shook the Oil Market — and the World, Financial Times, 13th March 2020, viewed 8th June 2020, <https://www.ft.com/content/c9c3f8ac-64a4-11ea-a6cddf28cc3c6a68>

the NG market worldwide and curtailed demand in China. Yet, even before the virus outbreak, Chinese leaders signalled a slowing in the coal-to-gas transition, calling for a strengthening of the coal industry through clean coal.¹⁴ The working group believes that 'clean coal' techniques such as coal gasification can only be an intermediate step in the transition, to be combined with less polluting methods such as biogas or biomethane.

Boosting the NG share of the country's energy mix remains crucial for increasing baseload energy flexibility, improving energy efficiency and the overall reduction of energy intensity. COVID-19-led demand decreases of 10 billion cubic metres (bcm) will be minor compared to China's 300 bcm NG market,¹⁵ only a three per cent decrease, but China's commitment to purchase more American crude oil and natural gas under the United States (US)-China 'Phase One' Agreement will be challenged.¹⁶ China's NG transportation, distribution network and storage capacity are currently unable to satisfy the demand growth expected as the economy recovers from the pandemic. China had about 10.2 bcm of underground storage space in 2019,¹⁷ which—at four per cent of its annual demand¹⁸—is insufficient to avoid supply shortfalls in winter or optimise supply/demand balance. New investments in storage, pipeline and regasification capacity, as well as new policies for NG development must be further accelerated to develop more sustainable models for domestic production instead of relying on massive imports.

Positive signs for energy sector reform came with the planned creation of a pipeline company, the China Oil and Gas Piping Network Corporation (PipeChina). This reshuffling of assets would separate transmission and sales businesses, allowing for more market competition for third parties.¹⁹ The transfer of assets has

progressed, although it is also evident that these SOEs will have to share crucial infrastructure,²⁰ indicating a focus on supply security for natural gas.

The working group welcomes recent government recommendations to speed up and incentivise the development of new storage capacity in the first half of 2020²¹ and the new version of the central pricing catalogue set by the NDRC,²² which for the first time opens the door to city-gate gas prices formed by the market in provinces where competitive conditions are strong enough to allow it. Yet gaps remain, for example missing mid-stream energy infrastructure to transmit and store NG upsets the delicate balance between centres of production and consumption, the NG system's ability to face seasonal changes and peaks in demand, and the possibility of optimising LNG import costs during winter peaks. Although foreign companies can participate in oil and gas exploitation since 2019, they still lack midstream access, while indirect barriers such as licensing remain. Market opening must be further executed to allow for more flexibility and market mechanisms in the supply chains.

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 wellcoordinated, as both effectiveness and efficiency bottlenecks (e.g. third party access for LNG where SOEs are reluctant to free up terminal and pipeline infrastructures) restrict market opening, while damaging the diversification of supply and holding back a rapid energy transition. Distributed energy production should also be taken into consideration for the sake of designing efficient grids and contributing to the evolution of China's energy base.

Recommendations

 Effectively open the market to FIEs, clarifying roles and market regulation to foster FIEs' direct

¹⁴ Xu, Wei, Premier Urges Wider Access in Oil Sector, China Daily, 12th October 2019, viewed 24th April 2020, https://www.chinadaily.com.cn/a/201910/12/WS5da1134da310cf3e3557004c.html

¹⁵ Forbes, Alex, Covid-19 to Slash China's 2020 Gas Demand, Petroleum Economist, 25th February 2020, viewed 27th April 2020, https://www.petroleum-economist.com/articles/midstream-downstream/lng/2020/covid-19-to-slash-china-s-2020-gas-demand>

¹⁶ Johnson, Keith, Coronavirus Threatens to Blow Up Trump's Energy Trade Deal with China, Foreign Policy, 13th February 2020, viewed 24th April 2020, https://foreignpolicy.com/2020/02/13/coronavirus-trump-energy-trade-deal-china/>

¹⁷ China Lifted Underground Gas Storage Capacity to 10.2 bcm in 2019 - State TV, Reuters, 23rd January 2020, viewed 24th April 2020, https://www.reuters.com/ article/china-gas-storage-idAFL4N29S2CA>

¹⁸ Zheng, Xin, Lack of Natural Gas Storage Capacity Restricting Supply, China Daily, 10th July 2020, viewed 24th April 2020, https://www.chinadaily.com.cn/a/201907/10/WS5d2548d4a3105895c2e7cadf.html

¹⁹ China Announces Plan to Form National Oil & Gas Pipeline Company, Bloomberg, 5th March 2019, viewed 24th April 2020, <https://www.bloomberg.com/news/ articles/2019-03-05/china-announces-plan-to-form-national-oil-gas-pipelinecompany>

²⁰ China Forces Energy Giants to Share in Pipeline Reform Preview, Bloomberg, 23rd June 2020, viewed 29th June 2020, https://www.bloomberg.com/news/articles/2020-06-23/china-forces-energy-giants-to-share-in-pipeline-reform-preview

²¹ The State Issued Implementation Opinions to Accelerate the Construction of Natural Gas Reserves, NDRC, 21st April 2020, viewed 11th May 2020, https://www.ndrc.gov.cn/xwdt/xwfb/202004/120200421_1226216.html

²² Decree of the National Development and Reform Commission of the People's Republic of China No. 31, NDRC, 13th March 2020, viewed 18th May 2020, https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202003/t20200316_1223371.html



investments in NG liquefaction, transportation and storage management to improve security of supply and reduce import needs.

- Proceed with gas market reform by identifying market authorities, progressing with midstream redesign, implementing third-party access for gas infrastructure and adopting non-discriminating rules for the sale of infrastructure capacity.
- Encourage the building of necessary energy infrastructure such as power and gas storage by setting tariffs to cover costs while fairly remunerating investors and operators.
- Redesign return mechanisms for gas infrastructures to promote the effective development of new capacity, incentivise management efficiency of existing capacity, and promote innovation in construction and management.
- Consider the use of distributed energy (not only from renewable sources), integrated power generation and infrastructure building through careful planning and enforcement to make the energy system more flexible and efficient.
- Promote the bulk LNG supply by setting up national standards in line with international standards, while updating the current safety standard to ensure accessible and safe supplies, as well as fair market competition between pipeline gas and bulk LNG.
- Switch from coal to NG combined heat and power (CHP) plants that use flexible electricity, and heatproduction grids where heat storage facilities can increase overall energy efficiency.
- Facilitate and support the adoption of advanced heat-storage technologies to develop localised solutions that match the current heat supply with public demand, and optimise the heating value chain by better integrating production with distribution.
- Switch from gas production based on coal gasification to biomethane and biogas production from biomasses.

1.2 Adjust the Energy System to Incentivise Decentralised RE Development (3)4

Concern

A lack of clear RE utilisation guidelines in the nationwide energy framework, along with policies focused on reprioritisation of traditional energy maintenance and return-driven technologies has made the new energy sector unsustainable

Assessment

China's RE policy has caused great uncertainty for those adopting distributed generation. As subsidies decline,²³ RE generators struggle to compete with cheaper coal-fired electricity and gain financial returns. This issue is especially salient in light of depressed and swinging fossil fuel prices jeopardising the photovoltaic (PV) and wind grid parity achieved in 2019, and raises concerns that RE growth will continue to slow. Meanwhile, remaining feed-in tariff payments for incentivised power generation face backlogs, which are likely to continue into 2021. Specific financial incentives similar to those in the European Green Deal²⁴ would encourage companies, especially small and mediumsized enterprises (SMEs), to install their own power plants under self-consumption regulations rather than buy from the fossil fuel-sourced grid.

Furthermore, the draft Energy Law does not meet members' hopes for a thorough national plan to increase renewables, calling instead for the "rational development of fossil energy sources".²⁵ While Chinese industry experts reassure that strengthening fossil energy development does not clash with RE development,²⁶ the working group recommends stronger signals to foster the transition to clean energy through, for example, clarification on support and incentive structures for RE power generation and consumption, and market transparency to involve consumers in the energy source choice. The working group welcomes the May 2020 decision that fossil fuel projects will no longer be eligible for green bond financing, which aligns more with international definitions of 'green'.²⁷

RE certificates (RECs) are one way to incentivise the purchase of renewables. Their adoption in China is not

²³ Chen, Xuewan and Lu, Yutong, China to Slash Subsidies for Renewable Energy Amid Drive to Cut State Support, Caixin, 11th March 2020, viewed 24TH April 2020, <https://www.caixinglobal.com/2020-03-11/china-to-slash-subsidies-forrenewable-energy-amid-drive-to-cut-state-support-101527138.html>

²⁴ Keating, Dave, *EU Will Fight COVID Recession With Green Investment, Forbes*, 27th May 2020, viewed 14th July 2020, <https://www.forbes.com/ sites/davekeating/2020/05/27/eu-will-fight-covid-recession-with-greeninvestment/#59ff809d3bbd>

²⁵ Announcement of the NEA on the Public Solicitation of the, Energy Law of the People's Republic of China, NEA, 10th April 2020, viewed 24th April 2020, http://www.nea.gov.cn/2020-04/10/c_138963212.htm

²⁶ Li Junfeng on the Draft Energy Law: Renewable Energy Will Not See Explosive Development, China Energy Portal, 13th April 2020, viewed 24th April 2020, https://chinaenergyportal.org/en/li-junfeng-on-the-draft-energy-law-renewableenergy-will-not-see-explosive-development/>

²⁷ Peng, Qinqin and Tang, Ziyi, China to Make Fossil Fuel Projects Ineligible for Green Bond Financing, Caixin, 1st June 2020, viewed 3rd June 2020, https://www.caixinglobal.com/2020-06-01/china-to-make-fossil-fuel-projects-ineligible-for-green-bond-financing-101561695.html>



Section Three: Goods

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yet widespread, and the non-competitive price of the certificate makes it unattractive to small or mid-sized firms. While some FIEs operating in China show interest in paying a premium for renewable energy through REC purchases, many domestic companies are still reluctant to pay above-average rates for electricity that is produced from RE.²⁸

A widespread market for decentralised, direct electricity purchases is restricted by regulations preventing interprovincial procurement and self-consumption. This means that RE generators must be located within the province of the authorised companies to which they sell. In addition, the mechanism of electricity purchase through centralised biddings pose challenges for corporate buyers as the electricity cannot be traced, hence it is difficult to assess claims of renewable generation.²⁹⁸³⁰

Recommendations

- Establish a clear nationwide policy for RE implementation with a long-term tariff plan under which external environmental costs are reflected in pricing.
- Implement green financing tools to facilitate investment from SMEs.
- Encourage a functioning market for green certificates, and set renewable portfolio obligations that enable industrial and commercial power consumers to differentiate power sources and manage emissions.
- Pilot large-scale RE direct procurement and distributed models enabling industrial power users to source substantial amounts of power from renewable sources.

1.3 Continue Electrification of the Energy System 17

Concern

Market entry barriers, and a lack of supply-side adjustment and demand regulation, make it difficult to incentivise the electrification of energy final-uses in China's energy system, while electrification through various mechanisms, coupled with a reformed power market that sources from renewables, could pave the way towards energy transition.

Assessment

The electrification of transport, buildings, heating and industrial processes offer opportunities to improve the energy system and attract foreign investment. New tools are required to create a flexible and modern electricity grid that can meet the increase in RE and distributed generation, e.g. residential solar and energy storage and microgrids, while maintaining quality.

In transportation, China has committed to expand new energy vehicle (NEV) charging infrastructure within three years with the 2018 Action Plan for Enhancing the Charging Capacity of NEVs.³¹ To date, a total of 1.2 million public and private charging poles for NEVs have been built,³² but difficulties remain in installment and efficient operation, and the plan lacks clear guidance on regulating the energy supply. Paradoxically, a large proportion of the energy supply for NEVs is largely fuelled by coal-fired power plants and thus does not reduce emissions when evaluated from the overall energy lifecycle. Policies also lack guidance on asset management of a decentralised RE-electric vehicle fleet, related data acquisition and grid regulation, which might otherwise provide opportunities for both foreign and domestic private companies.

Electrification of buildings and low-temperature heating (e.g. in manufacturing), combined with decentralised renewables and energy storage such as through electric microgrids, can significantly increase the flexibility, resiliency and security of the energy system. The Energy Transitions Commission has demonstrated that in a near zero-carbon economy, electricity could supply nearly 100 per cent of heat demand in manufacturing and close to eighty per cent of building heat.³³ In practice, decentralised renewables such as rooftop solar are emergent but not yet sufficient, and the problem of intermittency still must be addressed.

²⁸ Chuang, Jules; Lien, Hsing-Lung; Roche, Akemi Kokubo; Liao, Pei-Hsuan; and Den, Walter, 2019, Consolidated climate markets mechanism analysis - case studies of China, Japan, and Taiwan, Sustainability, vol. 11, no. 11, viewed 23rd April 2020, MDPI, https://www.mdpi.com/2071-1050/11/22/6478>

²⁹ Yu, Xugang; Li, Gang; Cheng, Chuntian; Sun, Yongjun; and Chen, Ran, 2019, Research and application of continuous bidirectional trading mechanism in Yunnan electricity market, Energies, vol. 12, no. 24, viewed 23rd April 2020, https://www.mdpi.com/1996-1073/12/24/4663

³⁰ Accelerating Corporate Renewable Energy Engagement in China, Resource Solutions, November 2019, viewed 9th June 2020, https://resource-solutions.org/wp-content/uploads/2019/11/Accelerating-Corporate-RE-Engagement-in-China.pdf>

³¹ Notice on Printing and Distributing the Action Plan for Enhancing the Charging Capacity of New Energy Vehicles, NDRC, 10th December 2018, viewed 24th April 2020, <http://www.gov.cn/xinwen/2018-12/10/content_5347391.htm>

^{32 2019-2020} China EV Charging Infrastructure Development Report, China Industrial Economic Information Network, 13th March 2020, viewed 9th June 2020, <http://www.cinic.org.cn/xw/tjsj/755762.html>

³³ China 2050: A Fully Developed Rich Zero-Carbon Economy, Energy Transitions Commission, 22nd November 2019, viewed 24th April 2020, http://www.energytransitions.org/china-2050-fully-developed-rich-zero-carbon-economy>



Microgrids, particularly when combined with automated demand-response mechanisms and when integrated with central grids, can create a synergy between the control, balance, and utilisation of energy, reducing peak load capacity and optimising tariffs. When deployed together, central grids and microgrids can help promote the utilisation and absorption of renewables. At the national level, overarching policies could include incentives for energy storage and support for deployment of microgrid systems. At the local level, policies should encourage more participation by buildings and industrial users, as well as local roadmaps for microgrid development.

Recommendations

- Enact preferential policies for end-use electrification such as in transport, heat, buildings and manufacturing (especially energy-intensive manufacturing like steel, paper and glass) to subsidise the conversion from coalbased to electricity supply; and develop a framework for energy modernisation of building stock and existing manufacturing facilities.
- Offer policy incentives that favour market-based growth of microgrids with digital demand-side response mechanisms.
- Implement framework regulation for decentralised electricity generation on buildings, and integration with microgrid networks.
- Reform overall grid regulation to guarantee full absorption of renewable sources.

1.4 Promote the Role of Hydrogen in Optimising the Energy System (1)5

Concern

Decarbonisation in China is not possible without lowcarbon and/or renewable hydrogen, but China has not yet adopted the widespread use of hydrogen as an energy carrier, and supporting policies and legislation are inadequate.

Assessment

The use of hydrogen aligns well with China's national strategic priorities such as decarbonisation, selfsufficiency and energy independence, improvement of the overall energy system and becoming a leader in clean industry. Hydrogen's potential to reduce greenhouse gas (GHG) emissions and increase energy security should be promoted through low-carbon and renewable production, ensuring a level-playing field between pathways to leverage the plurality of resources available.

In recent years, Chinese policymakers have recognised the opportunities of using hydrogen in clean mobility, specifically the commercial mobility segment. Many provinces and cities have established their own hydrogen roadmap with clear targets, supports and mandates to companies.³⁴⁸³⁵ China should consider how to develop and incentivise the scaling up of hydrogen across other key sectors of the economy.

In the mobility sector, China should further encourage the use of hydrogen fuel cells while developing a widespread and sustainable distribution network for NEVs, focussing first on key urban areas.^{36&37} 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, optimising electricity supply and demand patterns.³⁸ In addition, re-electrification from green or low carbon hydrogen should be promoted, starting with pilot areas. In the heating sector, legislation, standards and remunerations to blend hydrogen into natural gas pipelines³⁹ should be further developed.

China has already passed a number of regulations on hydrogen. What it needs now is a consolidated roadmap that clarifies ambitions for hydrogen use, harmonising local and national regulations together and in line with international standards. Firstly, hydrogen must be redefined as an 'energy carrier' rather than as a 'hazardous chemical' when used as industrial feedstock. The recent categorisation of hydrogen as

³⁴ Shanghai Builds a "Hydrogen Energy Port" in Jiading: Forming a Complete Industrial Chain System for Hydrogen Fuel Cell Vehicles, Xinhua, 12th June 2019, viewed 24th April 2020, <http://sh.xinhuanet.com/2019-06/12/c_138135530.htm>

³⁵ Kirton, David and Liangzi, Sun, Shanghai Scales Up Hydrogen-Powered Car Development, Caixin, 14th June 2019, viewed 24th April 2020, https://www.caixinglobal.com/2019-06-14/shanghai-scales-up-hydrogen-powered-car-development-101427127.html>

³⁶ China's Father of Electric Cars Says Hydrogen is Future, Bloomberg, 12th June 2019, viewed 24th April 2020, <https://www.bloomberg.com/news/ articles/2019-06-12/china-s-father-of-electric-cars-thinks-hydrogen-is-the-future>

³⁷ Xin, Zheng, China to Boost Clean Energy Deployment, China Daily, 25th May 2019, viewed 24th April 2020, <http://www.chinadaily.com.cn/a/201905/25/ WS5ce89a74a3104842260bdb57.html>

³⁸ Harnessing the Full Power of Renewable Energy With Hydrogen, European Commission, 29th August 2016, viewed 24th April 2020, https://ec.europa.eu/ programmes/horizon2020/en/news/harnessing-full-power-renewable-energyhydrogen>

³⁹ McDonald, Jeff and Robinson, J.; Platts Expands Hydrogen Assessments; Efforts to Blend With Natural Gas Increasing, S&P Global Platts, 1st April 2020, viewed 24th April 2020, <https://www.spglobal.com/platts/en/market-insights/latest-news/ natural-gas/040120-platts-expands-hydrogen-assessments>

a type of energy within the draft Energy Law is an encouraging measure that should be followed up on in the 14th Five-Year Plan. A second necessary step will be the adoption of a certification scheme aligned with international standards, such as the EU's CertifHy,⁴⁰ to define low-carbon and renewable hydrogen production, and to position China in the global market for hydrogen. Finally, proper regulations around high pressure and liquid hydrogen transportation must be developed to foster an efficient and scalable supply chain. In general, China has numerous codes and standards on hydrogen production, distribution and usage that should be simplified and aligned with those of internationallyrecognised bodies such as the International Standards Organization (ISO)⁴¹ to create a more sustainable and globally competitive hydrogen market.

Recommendations

- Enact in the 14th Five-Year Plan the role of hydrogen as a needed energy carrier, not dangerous chemical gas, to reduce GHG emissions and increase energy security.
- Encourage the use of hydrogen in fuel cells and develop a widespread and sustainable distribution network for NEVs across different types of transportation, accelerating the development of hydrogen stations network in key urban areas to reduce the footprint of transport.
- Promote (re-)electrification from green or low-carbon hydrogen.
- Promote legislation, standards and remuneration to blend hydrogen into the NG pipeline while assessing network readiness for hydrogen blending and evaluating a minimum target needed to generate sufficient demand to allow the scale-up of hydrogen production.
- Implement relevant mechanisms to incentivise the large-scale production of low-carbon or renewablebased hydrogen by water electrolysis.
- Adopt a certification scheme aligned with international standards (e.g. CertifHy in Europe) to define low carbon and/or renewable hydrogen.
- Define and simplify specific safety standards regulations harmonised at the national level for hydrogen production, distribution and usage.
- · Encourage and accelerate the development of

regulations harmonised with international bodies for high pressure and liquid hydrogen as a way to efficiently transport hydrogen and to reduce total cost of ownership.

 Design a hydrogen-based storage system as a systemic 'buffer' for harmonising continuous production from coal and nuclear plants and intermittent production from renewables in order to optimise electricity supply/demand patterns at national and local levels.

1.5 Define Clear National Targets and Guidelines to Promote the Development of Bioenergy

Concern

The development trends of bioenergy in China are unclear and delayed by the lack of clarity in national guidelines that are necessary to ease implementation at the regional level.

Assessment

Bioenergy (for electrical and non-electrical final-uses) has proven to be a significant driver for decarbonisation, offering complementary support to other industries such as agriculture and waste, and acting as a lever to increase domestic energy supply. Despite some growth, biomasses still account for a negligible share of power capacity (about 15 gigawatts, or about 0.75 per cent of total power capacity) in China. Theoretical biomass energy resources in China are about 5 billion tonnes of coal equivalent, or four times total energy consumption.⁴²

Biomasses cover a very wide technology spectrum, including biofuels, biogas/biomethane, and waste to energy processes. Although their potential is huge in terms of volume and energy source, and contributions to national energy security, biomass development still struggles in China. Incineration, usually through non-CHP methods, is the only production stream with thorough regulations, but it produces high emissions.

Biofuels, particularly those from agricultural waste that do not compete with the food chain, help to increase farmers' income, diversify the energy supply, reduce dependence on fossil fuels and carbon emissions, and promote the development of the circular economy. The

⁴⁰ Project Description, Certifhy, n.d., viewed 24th April 2020, <https://www.certifhy. eu/project-description/project-description.html>

⁴¹ ISO/TC 197 Hydrogen Technologies, ISO, n.d., viewed 24th April 2020, <https:// www.iso.org/committee/54560.html>

⁴² Fernandez, Miriam, Biomass Energy in China, BioEnergy Consult, 20th February 2020, viewed 18th May 2020, <https://www.bioenergyconsult.com/biomassenergy-china/>



definition of clear targets at the national level in the 14th Five-Year Plan will be key for industry growth.

A recent study indicates that in Europe, biomethane can supply up to 1,000 terawatt-hours at heavily reduced costs and that, by 2050, all biomethane can be zero emissions renewable gas: any remaining lifecycle emissions can be compensated by negative emissions created in agriculture on farms producing biomethane.⁴³ The International Energy Agency (IEA) also reports that, at its full potential, bioenergy could cover around 20 per cent of the world's gas demand and that the largest opportunities come from the Asia-Pacific region, where natural gas consumption and imports have been growing rapidly in recent years.⁴⁴

In 2017, the State Council announced its *Implementation Plan on Expanding Biofuel Ethanol Production and Promoting the Use of Vehicular Ethanol Gasoline.*⁴⁵ The policy clarified the significance of expanding the production of biofuel ethanol and promoting the use of automotive ethanol gasoline with the specific target that by 2020, the E10 (10 per cent biofuel ethanol added into gasoline) policy will be applied nationwide. However, currently, only a few provinces like Liaoning, Heilongjiang, Jilin, Henan, Anhui and Tianjin have realised full coverage of E10, and the plan has been recently suspended in light of declining corn stocks.⁴⁶

Similar policies and targets have been preliminarily defined for biogas and biomethane with scattered implementation,⁴⁷ although it is a step in the right direction that the number of biogas plants has slowly grown and some pilot projects for biomethane have been launched as well.

China could also leverage bioenergy as an integrated part of its effort to more efficiently manage waste in metropolises and municipalities seeking a circular and low-emission approach.

Optimal exploitation of biomasses will require a holistic approach that considers all the variables within the energy system, with strong attention on environment protection. China's energy sector must adopt a new paradigm that prioritises circular economy processes, such as a vital role for biomasses. The working group believes that a strategy for exploitation and integration of biomasses, one that is transparent and fully accessible to European companies, should be part of forthcoming energy reforms.

Recommendations

- Define national policies and guidelines for the development of biogas and biomethane (gas/methane production from agricultural feedstock, food or waste) with identification of short- and medium-term targets.
- Promote the development of innovative waste treatment to generate energy.
- Identify a portfolio of subsidies that provinces can adopt to foster the development of biogas and biomethane plants.
- Accelerate government efforts to achieve the E10 policy target nationwide.

2. Energy Efficiency

2.1 Move to Increasingly Dynamic, Transparent and Liberalised Power Markets (1)5

Concern

Lack of competition in power markets, and ensuing limitations for end-user choice, skews energy pricing and disadvantages suitable electricity energy sources.

Assessment

China's energy market reforms aim to reduce energy intensity and improve economic resilience through increasingly competitive, market-based mechanisms. The State Council proposed an electricity spot market in 2015,⁴⁸ and in 2019, the NDRC further reiterated the intent to fully liberalise electricity use for power users, with a focus on clean energy generation.⁴⁹



⁴³ Gas for Climate: The Optimal Role for Gas in a Net-zero Emissions Energy System, Navigant, March 2019, viewed 22nd April 2020, https://www.gasforclimate2050.eu/files/files/Navigant_Gas_for_Climate_The_optimal_role_ for_gas_in_a_net_zero_emissions_energy_system_March_2019.pdf>

⁴⁴ Outlook for Biogas and Biomethane: Prospects for Organic Growth, IEA, 19th March 2020, viewed 22nd April 2020, <https://www.iea.org/reports/outlook-forbiogas-and-biomethane-prospects-for-organic-growth>

⁴⁵ Fifteen Departments Jointly Issue the "Implementation Plan on Expanding Biofuel Ethanol Production and Promoting the Use of Automobile Ethanol Gasoline", Xinhua, 13th September 2017, viewed 22nd April 2020, http://www.xinhuanet.com/energy/2017-09/13/c_1121650529.htm>

⁴⁶ Gu, Hallie, Xu, Muyu and Singh, Shivani, Exclusive: China Suspends National Rollout of Ethanol Mandate – Sources, Reuters, 8th January 2020, viewed 22nd April 2020, <

⁴⁷ Liu, Zhihua, Biomethane Efforts Gaining Traction, China Daily, 5th June 2019, viewed 22nd April 2020, <https://www.chinadaily.com.cn/a/201906/05/ WS5cf7252ca31051914270120c.html>

⁴⁸ Opinions on Further Deepening the Reform of Power System (Document No. 9), State Council, 15th March 2015, viewed 24th April 2020, http://tgs.ndrc.gov.cn/zywj/201601/t20160129_773852.html

⁴⁹ NDRC on the Full Liberalisation of Business; Notice of Power Users' Electricity Use Plan [2019] No. 1105, NDRC, 22nd June 2019, viewed 24th April 2020, http://www.ndrc.gov.cn/zcfb/zcfbtz/201906/t20190627_939771.html>

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Pilots have indicated that a market-based mechanism would increase utilisation of renewables, while having wholesale rather than state-set prices will allow grids to more efficiently meet demand.⁵⁰ This type of direct trading should be expanded to offer third-parties the chance to operate in a fair and open market while state monopolies transition to service operator roles.

Recent government focus has been on lowering enduse prices for commercial and industrial users, resulting in various incentives and subsidies. However, the overriding focus on reducing price leads to low and loss-making margins across the power sector without effectively preferring lowest cost, most efficient, least polluting, or system value-adding suppliers such as natural gas, or RE and power storage. All market players should be able to efficiently conduct operations based on clear wholesale price signals to better meet demand.

Recommendations

- Speed up the establishment of a more robust power trading system to guarantee real returns on investments and incentive energy savings by endusers.
- Accelerate the creation of liberalised provincial and regional spot markets for wholesale and retail power trading, transitioning state monopolies to independent suppliers and service operators, with a level playing field for third party entrants that ensures healthy and open competition, access to infrastructure, reasonable supply and demand data, confidentiality of transactions, non-discrimination and transparency.
- Offer flexible retail electricity tariffs to push for decentralised energy and storage; expand decentralised renewable trading platforms; build up the mechanisms for direct trading among users, provincial trading, and inter-provincial trading; and provide adequate local subsidies as national policies are phasing out.

50 Lin, Ruosida and Wetzel, Dan, *Implications of Energy Spot Markets in China*, Rocky Mountain Institute, July 2019, viewed 22nd April 2020, <https://rmi.org/ insight/energy-spot-markets-in-china/>

2.2 Incentivise the Reduction of Energy Demand and Upgrade Existing Facilities 34

Concern

To achieve energy transition and meet the objectives set out in the 2015 Paris Climate Conference of the Parties (COP21), and reiterated in COP25 (Madrid), China must focus on energy intensity reduction and create a market for upgrading existing facilities with new efficient and digital technologies.

Assessment

As energy demand returns to pre-virus levels, China should accelerate investment in upgrading existing facilities to reduce energy consumption. China has not yet established a framework to control industries' and buildings' energy intensity. Measures such as energy service company (ESCO) subsidies for distributed RE generation equipment, pricing reform and green building label certification have had limited results. Further efforts to reduce emissions should implement realistic and efficient measures that can bring about a reduction in energy and emissions intensity.

Authorities should standardise methodology to evaluate energy demand performance, which may be used to offer incentives based on the evolution of energy demand or retro-finance energy actions. Such incentives could be proactively extended, for example to industrial parks, to award preferential land acquisition to businesses that are committed to low energy consumption. China should consider the example of European countries that use energy passport systems⁵¹ and 'white certificates'⁵² to mandate energy efficiency baselines and reward energy saving.

A transparent platform for best practice and standards sharing for individual industry or buildings should be open to the public, to provide companies with clear energy reduction standards. It is also important to give direct support to SMEs to upgrade their energy consumption.^{53&54} A national level certificate for RE

⁵¹ Understanding the Energy Passport, My Life, 25th May 2018, viewed 24th April 2020, <https://my-life.lu/en/understanding-the-energy-passport-10015/>

⁵² What is a White Certificate? Kyos, n.d., viewed 24th April 2020, <https://www. kyos.com/faq/white-certificate/>

⁵³ Xin, Dong, State-owned Enterprises' Energy Saving Exceeded the "13th Fiveyear" Schedule Last Year, Requiring SMEs' Energy Saving Potential to be Tapped, Yicai, 27th December 2017, viewed 22nd April 2020, <https://www.yicai. com/news/5386986.html>

⁵⁴ Xie, Qingyu, Statistical Analysis of the Latest Survey Shows that 52% of SMEs do not Understand Carbon Trading, Nanfang Daily, 18th January 2014, viewed 22rdApril 2020, <http://www.tanpaifang.com/tanguwen/2014/0118/28188.html>



trading will be crucial; for example, large companies in Tier-1 cities could purchase RECs from SMEs or poorer areas to offset their emissions.

Recommendations

- Define a clear, regularly updated common methodology to assess energy/emissions intensity and make such data transparent.
- Increase the number of local incentives awarding preferential conditions for land acquisition to project owners who pursue green building certification.
- Issue RECs to enhance incentives for reducing energy demand and energy/emissions intensity for big enterprises.
- Help SMEs upgrade their energy consumption strategy and incentivise digital solutions.
- Define standards at the industrial level, providing cap limits for energy used per production output unit, by industrial sector, while setting up 'white certificate' mechanisms.
- Define cap limits of Tier-1 cities and connect the trading systems of RECs and white certificates.

2.3 Accelerate Investment in District Energy Infrastructure

Concern

Despite the potential for district energy systems (DES) to serve a key role in cleaner energy within urban development, district heating remains ineffective and district cooling systems largely absent in Chinese cities.

Assessment

Unlocking the potential of cleaner DES is critical for China's urban development strategy. One huge advantage is that DES can move 'free energy to a useful place', i.e. use local renewable or surplus and waste energy as much as possible. Accordingly, this fundamental idea of district energy should be vigorously highlighted in China. According to a recent UN report, implementing modern DES in cities globally would lead to 50 per cent energy saving and 60 per cent emission reduction by 2030, indicating great potential for China if an adequate district energy is in place.⁵⁵

Modern DES can provide reliable heating and cooling plus domestic water services while improving energy efficiency. However, the current district heating systems – a public service by which large-scale central heating is offered in cities north of the Yangtze River - are inefficient, while district cooling systems are largely absent. For instance, in items of the district heating transmission and distribution network, research from Tsinghua University reveals that more than 30 per cent of the total generated heat is wasted to ensure the most distal users' comfort.⁵⁶ The main reason for this wastage is a lack of automatic control measures in the district heating network. National pilots for comprehensive digital solutions could include a full-range solution such as energy metering, hydraulic dynamic balancing, automatic control, valves, and Al-based operation/ management system, coupled with enforcement of payper-use regulations.

Recommendations

- Develop a national roadmap for a rapid switch to cleaner fuels to reduce coal use in DES.
- Develop national pilots for comprehensive digital solutions to better meet DES demand.
- Encourage the development of ESCOs to boost business innovation, improve comprehensive energy management and maintain locally-based, tailored solutions.
- Develop DES capacity-building and knowledgesharing programmes with European companies and institutions, while publicising its advantages throughout all levels of government.
- Develop a secondary system as an intelligent pipe network to improve overall DES efficiency through proven approaches like hydraulic balancing and heat metering, especially for retrofitting projects in residential buildings.
- Support application of locally available multi-energy sources to improve system flexibility.
- For new development areas, invite experienced companies to review and optimise network designs, provide franchises and create subsidies for network investment.
- Establish an industrial DES tariff structure with standards of capacity, consumption and connection rates to facilitate international investment.



⁵⁵ District Energy in Cities, United Nations Environmental Programme, viewed 22nd April 2020, <http://wedocs.unep.org/handle/20.500.11822/9317>

⁵⁶ China Building Energy Saving Annual Development Research Report, Tsinghua University Building Energy Conservation Research Centre, Beijing, 2017, viewed 24th April 2020.



3. Belt and Road Initiative (BRI)

3.1 Apply State-of-the-art, Efficient Technologies and Solutions to BRI Energy Projects 3

Concern

The use of outdated, non-energy efficient technologies by Chinese firms for projects under the BRI relocates pollution from China to host countries and deters European firms with state-of-the-art, sustainable designs and technologies from participating, while a lack of transparency in project tendering precludes a level playing field.

Assessment

About two-thirds of Chinese investment in completed BRI projects, around US dollars (USD) 50 billion, is for energy sector projects.⁵⁷ China has advocated a 'greening' of the BRI⁵⁸ to promote sustainable development in compliance with international standards.⁵⁹ The Asia Infrastructure Investment Bank (AIIB) also aims to support investments in sustainable energy projects to increase access to clean, safe and reliable electricity in conformity with the Paris Agreement, financing BRI projects only if they meet overall sustainability requirements.60 Yet the bulk of these energy investments are going into coal-fired power plants rather than renewable or sustainable power plants. Often using outdated coal-based technologies, Chinese energy giants have pushed into developing markets, where tendering processes can be skipped, and developed markets, where they take on riskier challenges, in order to gain market share.⁶¹

China must avoid transferring polluting solutions to BRI countries. Creating a level playing field for European companies would bring state-of-the-art project designs and solutions to the BRI, ensuring that international

- 58 Goh, Brenda and Cadell, Cate, China's Xi Says Belt and Road Must be Green, Sustainable, Reuters, 25th April 2019, viewed 26th April 2020, <https://www. reuters.com/article/us-china-silkroad/chinas-xi-says-belt-and-road-must-begreen-sustainable-idUSKCN1S104I>
- 59 Belt and Road Cooperation: Shaping a Brighter Shared Future, Joint Communique of the Leaders' Roundtable of the 2rd Belt and Road Forum for International Cooperation, Ministry of Foreign Affairs, 27th April 2019, viewed 26th April 2020, <https://eng.yidaiyilu.gov.cn/qwyw/rdxw/88230.htm>
- 60 Energy Sector Strategy: Sustainable Energy for Asia, AIIB, 18th April 2011, viewed 26th April 2020, https://www.aiib.org/en/policies-strategies/strategies/strategies/sustainable-energy-asia/.content/index/_download/energy-sector-strategy.pdf
- 61 Eder, Thomas S. and Mardell, Jacob, *Powering the Belt and Road*, MERICS, 27th June 2019, viewed 26th April 2020, https://www.merics.org/en/bri-tracker/ powering-the-belt-and-road>

sustainability standards are met.

Recommendations

- Guarantee that energy projects deployed among BRI countries fully comply with international agreements on sustainability and decarbonisation.
- Guarantee sustainable and new technologies and standards for BRI projects, prohibiting the deployment of polluting technological solutions inconsistent with China's stated goal of 'greening' the BRI.
- Issue 'minimum requirements' for sustainability standards and regulations for energy-related projects within the BRI, and enforce their execution.
- Guarantee the equal treatment of FIEs to participate in BRI projects through transparent, unbiased and open bidding processes.

Abbreviations

| AIIB | Asian Infrastructure Investment Bank |
|-----------------|--------------------------------------|
| bcm | Billion Cubic meters |
| BRI | Belt and Road Initiative |
| CHP | Combined Heat and Power |
| CO ₂ | Carbon Dioxide |
| DES | District Energy Systems |
| ESCO | Energy Service Companies |
| EU | European Union |
| FIEs | Foreign-invested Enterprises |
| GDP | Gross Domestic Product |
| GHG | Greenhouse Gas |
| IEA | International Energy Agency |
| LNG | Liquefied Natural Gas |
| NDRC | National Development and Reform |
| | Commission |
| NEA | National Energy Administration |
| NEV | New Energy Vehicle |
| NG | Natural Gas |
| PV | Photovoltaic |
| RE | Renewable Energy |
| RECs | Renewable Energy Certificates |
| SME | Small and Medium-sized Enterprises |
| SOE | State-Owned Enterprises |
| UN | United Nations |
| USD | United States Dollars |

⁵⁷ Eder, Thomas S. and Mardell, Jacob, *Powering the Belt and Road*, MERICS, 27th June 2019, viewed 26th April 2020, <https://www.merics.org/en/bri-tracker/ powering-the-belt-and-road>



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 to decarbonisation. These activities take place within the context of meeting the challenge of addressing climate change. The working group also wishes to share its emissions trading system (ETS) experiences from other markets 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 more than 40 company members that represent all aspects of the carbon market sector, including project developers, carbon funds, investors, lawyers, auditors and consultants, as well as financial institutions and companies under compliance obligations.

The sub-working group will provide support for the relevant Chinese stakeholders on development of a well-functioning Chinese nationwide carbon market, which will serve to reduce China's carbon dioxide (CO_2) emissions and resolve other environmental issues in a synergic way. With the pilot ETS presently in operation and the national ETS scheduled to start in 2020, the working group is focussed on enhancing understanding and providing recommendations from the perspective of European business in China.

Recent Developments

China has the ambition and the responsibility to switch to a low-carbon development pathway. Building an 'ecological civilisation' was advocated by President Xi Jinping at the National Ecological Environment Protection Conference¹ in May 2018, for the purpose of combatting climate change, pushing for energy transformation, and promoting the renewable energy sector.² A wide range of measures have been put in place to implement these targets across different sectors.³ While energy and industrial policies have played an extremely important role thus far, there is an increasing emphasis on market-based instruments notably the ETS pilots—since 2010.⁴

Since 2019, the Ministry of Ecology and Environment (MEE) has been working on the construction of the national carbon trading system in terms of establishing and improving the institutional system, constructing a basic support system, and carrying out capacity-building.⁵ The ministry also promoted an open legislative process for the *Provisional Regulations on the Administration of Carbon Credit Trading*.

In addition, the MEE has also drafted the National Scheme for Total Quotas Setting and Quotas Allocation of Carbon Credits, Technical Guidelines for Quota Allocation in the Power Generation Industry, as well as supporting policies and regulations, including the management measures for reporting, auditing, and trading of greenhouse gases (GHG) emissions of key emission units.⁶ The MEE also issued the Notice on Doing a Good Job in the 2018 Carbon Emission Report and Verification and Emission Monitoring Plan Preparation, requiring all provinces (including autonomous regions and municipalities) to organise key emission units to continue their carbon emission data

¹ XI Jinping's Idea on Ecological Civilization Leads the Construction of Beautiful China, Xinhua, May 22nd 2018, viewed 10th June 2020, http://www.xinhuanet. com/politics/xxjxs/2018-05/22/c_1122866707.htm>

² China's Wisdom to Promote the Transformation of the World's Energy, People.cn, 3rd July 2017, viewed 2rd June 2020, http://theory.people.com.cn/n1/2017/0703/ c40531-29377926.html>

³ Decision of the Central Committee of the Communist Party of China on Deepening the Reform of the Party and State Institutions. State Council, 4th March 2018, viewed 2nd June 2020, <http://www.gov.cn/zhengce/2018-03/04/ content 5270704.htm>

⁴ Notification On the Launch of ETS Pilots, NDRC, 29th October 2011, viewed 2nd June 2020, <http://zfs.mee.gov.cn/hjjj/gjfbdjjzcx/pwqjyzc/201411/ t20141126_292037.shtml>; Interim Measures on the Carbon Emission Rights

⁵ Key Works Completed by MEE, Most Related to the Development of a Nationwide ETS, published by MEE, viewed 2rd June 2020, http://www.mee.gov.cn/ywgz/ydqhbh/wsqtkz/index.shtml>

⁶ Trial Plan on Allowance Allocation of Power Sector, MEE, 25th September 2019, viewed 2nd June 2020, http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/201909/120190930_736483.html; Notification on the Working of Accounting, Reporting and Verification of GHG Emission for Key Sectors in the Year 2019, MEE, 27th December 2019, viewed 2nd June 2020, http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/202001/2020017_757969.html.



monitoring, reporting and verification.⁷

As a result, the construction of the national carbon market registration system and trading system has steadily advanced. In May 2019, the MEE issued the *Notice on Effective Submitting of the List of Key Emission Units from the Power Generation Sector in the National Carbon Credit Trading Market and Relevant Materials,* requiring provincial-level departments to submit data on units to be included in the power sector's national key emission units in the carbon market.⁸ This data provides a solid foundation for registration and trading systems accounts, quota allocation, carbon market test runs and online trading.

Meanwhile, the pilot carbon markets in Beijing, Tianjin, Shanghai, Chongqing, Hubei, Guangdong and Shenzhen have shown positive initial results in emissions reduction. The institutional system has been deepened in the pilot carbon markets, gradually expanding coverage while exploring methods to: optimise quota allocation; improve technical specifications and data quality management of carbon emission monitoring, accounting, reporting and auditing; and strengthen comprehensive measures like management of honouring an agreement.⁹ Quota trading in the seven pilot carbon markets has run smoothly so far, with the cumulative spot goods trade volume of the quotas reaching approximately 330 million tonnes of CO₂, and the cumulative trade amount reaching approximately Chinese yuan (CNY) 7.11 billion as of June 2019.

The MEE has reformed the trading mechanism for Chinese Certified Emission Reduction (CCER) of GHG, based on the relevant requirements of the State Council "to delegate power, improve regulation, and upgrade services".¹⁰ CCER were utilised in pilot carbon markets for honoured agreements on carbon offsetting. By August 2019, about 18 million tonnes of CO₂ had been used in the pilot carbon market for quota offsetting with agreement honouring, accounting for about 22 per cent of the total issued CCER so far.¹¹ In June 2019, the *Implementation Guidelines for Carbon Neutrality of Large-Scale Events (Trial)* was issued, aiming at standardising the basic principles, evaluation methods, relevant requirements and procedures for implementing carbon neutrality in large-scale events, and laying a foundation for promoting CCER to be used in 'carbon neutrality' in large-scale events and ecological poverty alleviation.¹²

Looking to the future, although there has undoubtedly been progress in the development of a national ETS, there are still some key tasks on the agenda, such as legislating regulations, accelerating the development of market infrastructure, promoting proper reporting, carrying out verification and carbon management for key enterprises, and strengthening capacity-building activities. Simulation trading in the power sector is expected to start in 2020. For many of the necessary policies and actions needed to strengthen the system, the experience and involvement of European companies will be valuable, particularly to figure out viable solutions for potential challenges ahead of the Chinese ETS.

Section Three: Goods

Key Recommendations

Increase the Accuracy, Transparency and Coherency of GHG Emissions Data in China's National ETS ¹

Concern

Despite the efforts and progress made by the Chinese Government to improve the accuracy, transparency and coherency of data that will be applied in the forthcoming nationwide ETS, challenges still exist in areas such as legal foundations, guidelines and supervision.

Assessment

The reliability of GHG emissions data is the cornerstone of any carbon pricing policy tool. To increase reliability at the enterprise level, between 2013 and 2015, the Chinese Government released 24 national guidelines

⁷ Notice on Doing a Good Job in the 2018 Carbon Emission Report and Verification and Emission Monitoring Plan Preparation, MEE, 17th January 2019, viewed 2nd June 2020, http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/201901/t20190124 690807.html>

⁸ Notice on Effective Submitting of the List of Key Emission Units from the Power Generation Sector in the National Carbon Credit Trading Market and Relevant Materials, MEE, 27th May 2019, viewed 2nd June 2020, http://www.mee.gov.cn/ xxgk2018/xxgk/xxgk06/201906/t20190603_705419.html>

⁹ China has Fulfilled 2020 International Commitment to Carbon Sustainability Ahead of Schedule, Xinhua, 25th November 2019, viewed 2nd June 2020, <http:// www.xinhuanet.com/energy/2019-11/28/c_1125283156.htm>

¹⁰ Notice of the General Office of the State Council on Printing and Distributing the National Task Plan for Deepening the Reform of 'Releasing Services' and Optimising the Business Environment Video and Telephone Conferences, 1st August 2019, viewed 2nd June 2020, http://www.gov.cn/zhengce/content/2019-08/12/ content_5420694.htm>

¹¹ China's Policies and Actions for Addressing Climate Change (2019), MEE, November 2019, viewed 2nd June 2020, p. 18, http://english.mee.gov.cn/ Resources/Reports/reports/201912/P020191204495763994956.pdf>

¹² Implementation Guidelines for Carbon Neutrality of Large-Scale Events (Trial), MEE, 14th June 2019, viewed 2nd June 2020, <http://www.mee.gov.cn/xxgk2018/ xxgk/xxgk01/201906/t20190617_706706.html>



for calculating and reporting GHG emissions in various industrial sectors. These guidelines steered the industrial enterprises covered by the ETS to account for and submit their GHG emissions data to the authorities on an annual basis from 2013 to 2018.¹³ A web-based national GHG emission reporting system was implemented in 2018 to facilitate more efficient and streamlined data transfer and management. The MEE has improved the GHG data accounting and reporting system since taking over this duty from the National Development and Reform Commission (NDRC).¹⁴ However, despite these efforts and some progress, challenges still exist.

Accuracy: improving monitoring, reporting and verification

In order to increase the credibility of ETS data, it is important that an effective and accountable regulatory framework for monitoring, reporting and verification (MRV) is developed and enforced in relation to CO_2 emissions. It is also important to introduce an appeal mechanism to allow disputes arising from enforcement be solved in a fair and efficient way. The following challenges still exist:

- The need to establish an effective legal foundation for conducting MRV—including legal measures and technical standards at the national level—to regulate and supervise the performance during the MRV process, and legitimise the obligations and duties of all stakeholders. The legislation related to MRV, which was expected to be released within 2019, is still under preparation, according to a draft of the *Interim Regulations on the Management of Carbon Emissions Trading* that was disclosed for public consultation in April 2019, and yet to be promulgated.¹⁵
- 2) The 24 technical guidelines issued on MRV need to be modified in response to problems that arose in practice. The MRV of GHG emissions is related

to many industrial production procedures, including some fairly 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 few years of measuring GHG emissions since the first guideline was issued, manufacturers in these industrial sectors have provided a great deal of tangible feedback and suggestions based on their experiences, which should be taken into account in the modification of technical guidelines before the launch of the nationwide ETS.

- 3) The supervision of the performance of verification agencies needs to be strengthened. The introduction of independent third-parties to help the government verify the GHG emissions data reported by enterprises is a common method. The professionalism, compliance and technical capability of verifiers will affect to a large extent the credibility of the result. Taking into account the fact that 7,000 enterprises are to be covered by the first phase of the nationwide ETS, there will be a large demand for qualified verification agencies. However, currently, each province selects verification agencies based on their own criteria, due to the absence of a unified national rule. The draft Interim Regulations on the Management of Carbon Emissions Trading states that the central government will disclose a list of recognised verification agencies and provide financial support from the national treasury for verification, but more details are yet to be released. ¹⁶
- 4) The capacity of enterprises on MRV still needs to be enhanced. As the most important stakeholder in the process of MRV, enterprises must understand how to apply the guidelines in their own factories or installations, and how to respond to the requests of verifiers and authorities. Despite 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.

Transparency: promoting the sharing and disclosure of climate-related information at the enterprise level In order to run effectively, markets rely on an unimpeded flow of information, clear rules and rigorous oversight.

¹³ I. Guidelines on GHG Emission Accounting, Reporting, and Verification in 10 Sectors, NDRC, 4th November 2013, viewed 2nd June 2020, <http://www.gov. cn/zwgk/2013-11/04/content_2520743.htm>; II. Guidelines on GHG Emission Accounting, Reporting, and Verification in 4 Sectors, NDRC, 3rd December 2014, viewed 2nd June 2020, <http://www.ncsc.org.cn/SY/tpfqjy/202003/ t20200319_769745.shtml>; III. Guidelines on GHG Emission Accounting, Reporting, and Verification in 10 Sectors, NDRC, 11th November 2015, viewed 2nd June 2020, <http://news.163.com/15/1111/15/B85BHSIS00014JB5.html>.

¹⁴ Decision of the Central Committee of the Communist Party of China on Deepening the Reform of the Party and State Institutions. State Council, 4th March 2018, viewed 2nd June 2020, http://www.gov.cn/zhengce/2018-03/04/content_5270704.htm

¹⁵ Interim Regulations on the Management of Carbon Emissions Trading (Call for Comments), MEE, 3rd April 2019, viewed 2rd June 2020, http://www.mee.gov.cn/ hdjl/yjzj/wqzj_1/201904/l20190403_698483.shtml>

¹⁶ Interim Regulations on the Management of Carbon Emissions Trading (Call for Comments), MEE, 3rd April 2019, viewed 2rd June 2020, <http://www.mee.gov.cn/ hdjl/yjzj/wqzj_1/201904/20190403_998483.shtml>

The Carbon Market Sub-working Group therefore advocates for more transparency in aggregated market activities.

It is encouraging that Article 5 of the draft *Interim Regulations on the Management of Carbon Emissions Trading* states that the MEE, under the State Council, shall regularly disclose information on carbon emission allowance trading and on the completion status of carbon emission allowances submitted by entities each year.¹⁷ If this article is included in the final version of the law, the transparency and confidence of China's carbon market will be reinforced significantly.

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 early exposure to systemic risks.

Furthermore, stakeholders need market information regarding supply and demand imbalances and CO_2 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 that are regulated by the national ETS should be prevented from profiting from 'inside information'.

The government-imposed obligation to disclose information on GHG emissions, combined with the efforts of some international non-governmental organisations (NGOs) to promote climate data disclosure, has led to a recent increase in the number of enterprises that pay attention to this issue. However, the latest review by the Task Force on Climate-related Financial Disclosures (TFCD) indicates that climate-related financial disclosures are still in the early stages.¹⁸ Companies are also in the early stages of evaluating the impact of climate change on their businesses and strategies. Those that have determined that climate-related issues are not material to their operations are encouraged to disclose information on their governance and risk management practices.

Coherency: integration of MRV of GHG emissions at national and provincial level

Despite significant progress in most of China's ETS pilot regions, one challenge cannot be ignored: how to integrate the key characteristics of pilot markets into the upcoming nationwide ETS, including a unified MRV system. In the beginning, each pilot market formulated its own MRV regulations and standards that reflected the specific conditions of each region. The challenge now is how to ensure a smooth transition to the national system.

Another significant challenge will be the successful integration of the national online GHG reporting system and provincial online GHG reporting systems. Digital reporting of GHG emissions is the most efficient and applicable method for the nationwide ETS. However, several provinces already established online reporting platforms, through which enterprises manually submit their GHG data to authorities. Therefore, this integration must be addressed in terms of the transformation of data.

Apart from integration of the national and provincial systems, considering the advantage and experience of the MEE in environmental pollutant data accounting and reporting, the working group recommends examining ways to integrate various data from enterprises in a more consolidated and efficient way.

Recommendations

- Promote knowledge-sharing on GHG data collection, management and optimisation.
- Intensify promotion of GHG reduction solutions for the manufacturing industry, buildings and private households.
- Enhance the credibility of GHG data and the transparency of methods for collecting GHG data at the enterprise level.
- Improve regulations, guidelines and tools regarding GHG emissions data collection and management.

2. Explore Synergies and Co-benefits Between the National ETS and Other Related Policy Instruments 3

Concern

There are many different policy mechanisms aimed at simultaneously achieving higher air quality, energy development and carbon emissions targets more

¹⁷ Interim Regulations on the Management of Carbon Emissions Trading (Call for Comments), MEE, 3rd April 2019, viewed 2nd June 2020, http://www.mee.gov.cn/hdjl/yjzj/wqzj_1/201904/t20190403_698483.shtml

¹⁸ TCFD: 2019 Status Report (June 2019), Task Force on Climate-Related Financial Disclosures, 31st May 2019, viewed 2nd June 2020, <https://www.fsb-tcfd.org/ publications/tcfd-2019-status-report/>

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effectively but which are not streamlined, making it difficult to clearly identify the co-benefits when introducing the ETS into the policy roadmap for developing a society based on ecological civilisation.

Assessment

The ETS by itself may not be able to realise the Paris Agreement target of global warming levels of "well below 2° Celsius"¹⁹ at the pace and scale required without unacceptable costs and impacts. It is theoretically both unsound and impracticable to only rely on CO_2 pricing, as this should be complemented by other well-designed policies. All issues related to existing market-based and policy failures could influence the policymaking process, and if they are not properly addressed, the effectiveness of the ETS and other policy measures will be compromised.

Some complementary policies that could address these issues include: the introduction of different marketbased mechanisms and performance standards; new rules for city design, land and forest management, and infrastructure investment; the use of financial instruments to foster private sector participation; and reducing the risk-weighted capital costs of low-carbon technologies and projects. These policies would work alongside the establishment of carbon prices in an ETS system and would lower the costs associated with reducing emissions.

The bureaucratic complexity currently faced by stakeholders in the Chinese carbon market is also something that needs to be addressed. Since 2011, the NDRC has been pushing for the ETS to move from its pilot stage into the national market. At the beginning of 2017, the NDRC, the Ministry of Finance (MOF) and the National Energy Administration (NEA) jointly launched the programme Green Certification Trading in the Power Sector, which is aimed at replacing financial subsidies for renewables with market-based trading.²⁰ In 2016, the NDRC initiated the pilot programme on energy allowance trading in four provinces to realise its control

19 The Paris Agreement, The United Nations Framework Convention on Climate Change, 22rd October 2019, viewed 2rd June 2020, https://unfccc.int/processand-meetings/the-paris-agreement/the-paris-agreement> target for total energy consumption.²¹ Even with this new trading mechanism, environmental pollutant trading is still in the policy toolkit of the MEE. Therefore, having various market-based policies implemented in parallel is recommended, and continuing with this practice will have a significant positive effect on the development of the environmental sector.

One important change to note is that the functions of addressing climate change has been shifted from the NDRC to the MEE as of March 2018.²² This increases the possibility of harmonising GHG emission reduction with environmental pollutant control, and also strengthens the capacity of the MEE's Climate Change Department to execute related laws and regulations with the support of environmental supervision and investigation taskforces.

In this regard, the working group could play a positive role by sharing with Chinese partners the EU's experience of integrating similar market-based policies.

Recommendations

- Facilitate and support exchange among different relevant policy areas in terms of energy, environment and climate change.
- Strengthen coordination among different governmental sectors regarding the implementation of energy trading, carbon emissions trading, green certificate trading and environment pollutant permit trading.
- Promote systematic research on co-benefits in order to ensure the feasibility and effectiveness of policies in a synergic way.
- Incentivise the Chinese Government to Work Alongside European Governments, Civil Society and Businesses to Strengthen its Actions in Line with the Objectives of the Paris Agreement ⁽³⁾

Concern

Despite recent domestic achievements, China still needs to cooperate with European partners to jointly achieve the targets set out in the Paris Agreement.

²⁰ Notice on the Trial Implementation of the Green Certificates Issuance and Voluntarily Subscription Trading System of Renewable Energy, NDRC, MOF and the NEA, 3rd February 2017, viewed 2nd June 2020, <http://www.gov.cn/ xinwen/2017-02/03/content_5164836.htm>

²¹ Letter of Launching the Pilot Programme of the Allowance and Trading of Energyconsumption Rights, National Development and Reform Commission, 28th July 2016, viewed 2nd June 2020, <http://www.ndrc.gov.cn/zcfb/zcfbtz/201609/ t20160921_819068.html>

²² Decision of the Central Committee of the Communist Party of China on Deepening the Reform of the Party and State Institutions. State Council, 4th March 2018, viewed 28th May 2020, <http://www.gov.cn/zhengce/2018-03/04/content_5270704. htm>

Assessment

Climate change requires collective action on a global scale, because most GHG emissions accumulate over time and mix globally. Moreover, emissions by any agent-individuals, communities, companies or countries-affect other agents. International climate change negotiations have traditionally been driven at a national level, but the Conference of the Parties (COP) in Paris resulted in the recognition that an important role can and should be played by local governments, cities, the private sector and civil society.23 The Paris Agreement entered into force at the end of 2016.²⁴ 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,²⁵ but of course the responsibility for staying the course lies with everyone.

Only through ambitious and collective actions can the objective of keeping global temperatures between 1.5°C and 2°C be achieved. According to the Global Energy and CO₂ Status Report, released by the International Energy Agency (IEA), higher demand for energy in 2018 drove global energy-related CO₂ emissions to rise by 1.7 per cent to a historic high of 33.1 gigatonnes (Gt) of CO₂. While emissions from all fossil fuels increased, the power sector accounted for nearly twothirds of emissions growth. Coal use for power alone surpassed 10 Gt CO₂, mostly originating in Asia. China, India and the United States accounted for 85 per cent of the net increase in emissions, while rates declined for Germany, Japan, Mexico, France and the United Kingdom.²⁶ Against this backdrop, deeper and earlier cuts from countries, as well as proactive and early actions from the private sector, local governments and civil society, are badly needed.

The EU and China have a long-standing cooperation on climate change and have agreed to further step up joint efforts. Since 2005, the EU-China Partnership on Climate Change has provided a high-level political framework for cooperation and dialogue.²⁷ This was confirmed in the 2010 Joint Statement and enhanced in the 2015 Joint Statement and the 2018 Leaders' Statement.²⁸

Recommendations

- Utilise the EU-China Energy Cooperation Platform to share best practices in reducing GHG emissions.
- Work jointly with EU counterparts at all levels to strengthen actions to achieve the targets for the reduction of GHG emissions in line with the Paris Agreement, in particular with Chinese nationallydetermined contributions and the reform objectives highlighted in the 13th Five-year Plan, while putting China on a global clean energy transition and low carbon development pathway.
- Create an accessible and business-friendly market for both European and Chinese industries and business to be part of joint solutions for a Green China's Policy Agenda.

4. Factor Market Liquidity into the Design of the National ETS Allocation Mechanism

Concern

Entities assuming the compliance obligation have often faced low or no liquidity in China's pilot ETS markets, meaning that they do not know the extent to which they need to buy or sell allowances until uncomfortably close to the compliance deadline, and may therefore be forced to buy allowances at very high prices.

Assessment

The purpose of a carbon market is to use marketbased mechanisms to direct resources in an optimal way to achieve CO_2 reduction. Although having healthy liquidity is not the ultimate goal, it is a necessity for any ETS to be successful and to provide viable options for compliance entities.

The historical data from the pilots shows that liquidity has been low across all pilots.²⁹ The working group observed three main issues about liquidity. First, liquidity concentrates in the first half of each calendar year,

²³ One example of this multi-stakeholders and bottom-up initiative is the US Climate Alliance created on 1st June 2017: US States Form Alliance to Meet Paris Climate Commitments, Financial Times, 6th June 2017, viewed 2nd June 2020, https://www.ft.com/content/27c5bad2-4895-11e7-919a-1e14ce4af89b?mhq5j=e3>

²⁴ Adoption of the Paris Agreement, UNFCCC, 2015, viewed 2rd June 2020, <https:// unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf>

²⁵ 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.

²⁶ Global Energy and CO₂ Status Report, IEA, March 2019, viewed 5th July 2020, https://www.iea.org/reports/global-energy-co2-status-report-2019/emissions>

²⁷ Joint Statement on the 8th China-EU Summit, Ministry of Foreign Affairs, 5th September 2005, viewed 2nd June 2020, <https://www.fmprc.gov.cn/ce/cebe/chn/ zozyzcwi/celdr/t541016.htm>

²⁸ China's Relations with the EU, Ministry of Foreign Affairs of the People's Republic of China, April 2019, viewed 2nd June 2020, https://www.fmprc.gov.cn/web/ gjhdq_676201/gjhdqzz_681964/1206_679930/sbgx_679934/>

²⁹ Poor Liquidity in the Carbon Market, Tanpaifang, 29th February 2020, viewed 2rd June 2020, http://www.tanpaifang.com/tanguwen/2020/0229/68490.html>



long before the compliance deadline. For a company to decide whether to sell or buy allowances, they should know as early as possible how many free allowances they will be allocated. In the pilot phase, such information is not easily accessible in a timely manner, as the market caps (total allowances in the market) are often not set until the deadline for compliance draws near.

Second, the cap and benchmark in certain pilots another measure that greatly affects the free allocations companies receive—are publicly announced only weeks before the compliance deadline. Companies can therefore identify a risk (carbon compliance cost) but are not given a tool to effectively manage it. This situation is particularly unfair for entities that find out at the last minute that they need to buy allowances for higher prices, as liquidity increases are often coupled with price increases, sometimes to a dramatic extent. An even worse scenario is when compliance entities short on allowances are ultimately not able to buy enough, leaving them exposed to large fines, negative credit and poor public relations.

The third issue is that if liquidity becomes low enough, regional regulators must introduce emergency auctions so that compliance entities short on allocations can access liquidity in order to comply. Changing rules on the fly significantly damages the integrity and credibility of the market, and is unfair to the companies that have complied with the original regulations.

Recommendations

- Release the allowance allocation programme and the amount of allowance allocated to compliance companies as early as possible in a clear and transparent way.
- 5. Introduce Institutional Investor Trading Accounts to the Market to Improve Liquidity and Lower Risks

Concern

Without institutional investors to facilitate the flow of trade, potential buyers face heavy compliance risks.

Assessment

Institutional investors contribute to market liquidity and help spread trading activity throughout the compliance cycle, reducing liquidity and price risks for participating emitters. The South Korean ETS is an example of how participation in the market was initially limited to compliance entities only. As a result of this restriction, most compliance entities were reluctant to sell long positions in anticipation of a tightening market, and if they did sell, it was usually only towards the end of the compliance cycle. This approach led to low liquidity throughout the year, making it hard or impossible for compliance companies to hedge their positions in a spot market. Additionally, the low liquidity also decreased the strength of the price signal and increased price risks resulting from corrections late in the compliance cycle.

The Korean regulators recognised the problem and addressed it by introducing selected financial institutions to the market, as well as limiting banking of allowances to encourage long emitters to sell their positions. As a result, liquidity improved markedly.

The Chinese regional ETS pilots all allow institutional investors to participate in their schemes, which contributes to liquidity and allows short emitters to cover their compliance needs ahead of the compliance deadline if they wish to. This lowers price and compliance risks and even allows companies to manage their compliance obligations on an ongoing basis throughout the compliance year, as most of their European peers do under the EU ETS. This positive experience in China's ETS pilots serves as another example of the benefits of including institutional investors from the inception of an ETS.

Recommendations

- Encourage the participation of qualified institutional investors in the National ETS.
- Consider introducing market-makers by allocating them a certain number of allowances and providing incentives (such as reduced or waived exchange fees) for a guaranteed volume of bids/offers each trading day.
- Strengthen the integrity and stability of the ETS by increasing the minimum lot size to 1,000 tonnes to prevent excessive volatility in times of low liquidity.
- Limit speculation by preventing the participation of individuals.

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Source: KRX. KAU19 shows distributed liquidity in off-season months (compliance deadline Q2 2020), facilitated by the introduction of financial institutions.³⁰

6. Establish an Auto-matching System to Reduce the Risk of Price Manipulation

Concern

The lack of auto-matching between buyers and sellers increases the likelihood of market price manipulation and mismatching among traders.

Assessment

Most trading platforms deployed in the pilot schemes do not utilise an automatic matching between bids and offers. In some cases, it is possible to accept the second-best bid or offer, opening the door for potential price manipulation and circumvention of exchange rules.

It is also possible for market participants to side-step the requirements for settling OTC block trades by repurposing the spot product to carry out a bilateral trade previously agreed between them. At the very least, this makes the process of matching several bids or offers at the same time inconvenient and error-prone because each bid or offer must be accepted individually. This slows down trading activity and hinders liquidity. The Hubei Emission Exchange is one example of a trading platform where automatic matching is used, and it vastly improves the experience for traders, while also discouraging abovementioned irregular trading activities, reducing compliance risks for all participants and strengthening the healthy development of the market.

Recommendations

- Mandate the automatic matching of bids and offers to reduce the risks of price manipulation and improve convenience for traders.
- Introduce well-designed and transparent settlement procedures for OTC spot and forward transactions.

Abbreviations

| CCER | Chinese Certified Emission Reduction |
|-----------------|--|
| CNY | Chinese Yuan |
| CO ₂ | Carbon Dioxide |
| COP | Conference of the Parties |
| ETS | Emissions Trading System |
| EU | European Union |
| GHG | Greenhouse Gas |
| Gt | Gigatonnes |
| IEA | International Energy Agency |
| MEE | Ministry of Ecology and Environment |
| MOF | Ministry of Finance |
| MRV | Monitoring, Reporting and Verification |
| NDRC | National Development and Reform |
| | Commission |
| NEA | National Energy Administration |
| NGO | Non-governmental Organisation |
| OTC | Over-the-Counter |
| TFCD | Task Force on Climate-related |
| | Financial Disclosures |
| | |

³⁰ Daily/Closing price, KRX. KAU19, 23th March 2020, viewed 2nd June 2020, <http:// global.krx.co.kr/contents/GLB/05/0506/0506030102/GLB0506030102.jsp>



Fashion and Leather Working Group

Key Recommendations

- 1. Amend the Product Quality Law (1)3
 - 1.1 Remove the Abstract Term 'Unqualified Product' and Introduce the Concept of 'Safe Product', and Confirm that a Product's Conformity with Mandatory National Standards and Whether the Product Having Unreasonable Risk can be used as the Criteria for Judging its Safety and Initiating Administrative Penalties
 - · Remove the term 'unqualified product' and introduce the term 'safe product'.
 - Implement voluntary standards so that they do not form the basis for administrative penalties.
 - 1.2 Confirm that Enterprises Only Assume Civil Responsibility in the Event that its Products Fail to Satisfy Their Declared Quality Standards, and Allow Multiple Methods in Addition to Product Labelling to Publicise Product Quality Information
 - Clarify that enterprises shall only bear civil liability for a safe product that does not meet the quality standards claimed by the enterprise, and shall not be subject to administrative penalties.
 - Allow enterprises to disclose a product's quality standards information to the public through methods other than the product label.
- 2. Revise the Mandatory National Standard GB 18401-2010 National General Safety Technical Code for Textile Products 3
 - Follow the review period required by the *Measures for the Administration of Mandatory National Standards* to begin revision of GB 18401-2010.
 - Increase the number of chemical safety standards that properly safeguard personal health, life and property safety in line with international market practices.
 - Remove the non-safety-related requirements on colour fastness and peculiar smells, and move them to recommended national or industrial standards instead.
 - Improve the formulation and revision of the technical standards on the safety of raw materials in the textile industry.
- 3. Introduce the Implementation Rules of the E-commerce Law to Clarify the Liability and Responsibility of Social Platforms with E-commerce Functions with Regard to the Spread and Sale of Fake Products, and Promote Industry Self-governance <a>2
 - Formulate the *Implementation Rules of the E-commerce Law* so that they regulate the responsibility for the sale of counterfeit goods on social platforms, or formulate guiding opinions or voluntary industry standards in relation to this issue.
 - Classify platforms (e.g. 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.
 - Remove Article 43 on counter-notification from the E-commerce Law.
 - Take heed of and respect effective intellectual rights property (IPR) protection models agreed between rights holders and platforms.
 - · Release relevant policies to ensure that social media or other online platforms that are weak or even



lax in regulating the sale of counterfeit goods increase penalties for counterfeit sellers, and encourage social governance and supervision with the cooperation of rights holders.

• Conduct comprehensive social surveys to gather industry views and use them to establish the *Implementation Rules of the E-commerce Law.*

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.
- 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.
- Ensure, by prioritising administration and strengthening regulation through legislation, the rights of
 consumers and citizens to be informed of and decline the collection, use and sharing of their personal
 information via the internet by enterprises and organisations, as well as the permanent removal of
 such information should they request it.
- Consider fully the daily management structure and data-sharing needs of multinational companies (MNCs), and conduct reasonable and effective in-market supervision through internal contracts and corporate commitments, to avoid dampening the enthusiasm of foreign-invested enterprises (FIEs) to invest in China, and any other negative impacts that may accelerate the withdrawal of global supply chains from China.
- 5. Clarify the Meaning of Article 14 of the Regulation for Implementing the Foreign Investment Law and the Circumstances in which Technical Requirements Higher Than Mandatory Standards Shall Not Be Applied to FIEs
 - Clarify Article 14 of the *Regulation for Implementing the Foreign Investment Law* to eliminate any ambiguity.
 - Do not mandatorily require FIEs, directly or indirectly, to apply voluntary standards beyond that technical requirements in the declared standards by FIEs are higher than in mandatory standards.

Introduction to the Working Group

The shift in China's economic and the expansion of its middle class, which now has more disposable income than ever before, has seen a large increase in the consumption of high-quality, luxury products. According to independent research:

"Chinese customers accounted for 90 per cent of the global market growth in 2019, reaching 35 per cent of the value of luxury goods sold in the world. Mainland China has been a growth driver for the luxury industry

in the recent past, and 2019 was no exception, with the market growing by 26 per cent to reach euro (EUR) 30 billion, sustained by governmental policies and a shift in Chinese consumer flows repatriating spending from overseas (including from Hong Kong)."¹

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,

Chinese Luxury Market Keeps High Growth, Generation Z to Lead Future Consumption, Bain & Company, 1st January 2020, viewed 4th April 2020, https://www.bain.cn/news_info.php?id=1013



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 focused 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 Developments

1. Regulation on the Implementation of the Law on the Protection of Consumers' Rights and Interests

Although included in the State Council's legislative work plan in both 2018 and 2019, the *Regulation on the Implementation of the Law on the Protection of Consumers' Rights and Interests (Regulation)* had not been enacted by the end of March 2020. The drafting of the *Regulation* began in 2015, with 1,665 pieces of feedback having been submitted during the first online public consultation. Over the following four years, dozens of rounds of discussion were conducted, indicating the complexity of the legislation.² However, as a comprehensive and instructive law, the *Regulation* is indispensable to the industry. The *Regulation* has been listed in the State Administration of Market Regulation's (SAMR's) 2020 legislative work plan, and the working group looks forward to its early promulgation.

2. Policy Changes Related to 'Professional Shoppers' The issue of 'professional shoppers'—people who purchase goods that do not meet standards in order to claim compensation—which for many years has been a major concern for the Fashion and Leather Working Group,³ has greatly improved due to recent policy changes and the strengthening of enforcement measures. After the government took a clear stance on the issue through regulation, court rulings and press releases, there has been a sharp decline in the number of 'professional shopper' cases. Although the Regulation is yet to be enacted-which should provide clear answers on whether 'professional shoppers' who profit by misusing the system of punitive damages can be classified as consumers under the law-on 2nd December 2019, the SAMR issued the *Interim* Measures for Handling Complaints and Reports Concerning Market Supervision and Administration. These state that market supervision and administration agencies should not accept complaints arising from circumstances such as "purchases not made for lifestyle and consumption needs",⁴ which is hoped to signal the end to profiteering through malicious complaints.

3. Standardisation-related Efforts

Since the beginning of 2019, the SAMR, the Standardisation Administration of China (SAC) and other relevant agencies have issued a number of regulations that prescribe detailed requirements for the further clarification of the formulation, implementation, supervision and administration of various standards.^{5,6&7} These include the Measures for the Administration of Mandatory National Standards (Measures),⁸ which came into force on 1st June 2020 and outline the rights of and methods for foreign-invested enterprises (FIEs) to participate equally in the formulation and revision of mandatory national standards. The Measures also guide the working group's next step in facilitating the revision of the GB 18401-2010 National General Safety Technical Code for Textile Products, as it clarifies that all parties including association, companies and individuals can propose new standards or to revise old items.



² Li, Xisheng, Status Quo, Misconceptions and Balance of the Legislation of the Regulationon the Implementation of the Law on the Protection of Consumers' Rights andInterests, www.cqn.com.cn, 29th July 2019, viewed 3rd April 2002, <http://www.cqn.com.cn/ms/content/2019-07/29/content_7361722.htm>

³ Please refer to Key Recommendation 2 in both the Fashion and Leather Working Group Position Paper 2018/2019 and the Fashion and Leather Working Group Position Paper 2019/2020 for more details.

⁴ Order of the SAMR (No. 20), SAMR, 2nd December 2019, viewed 4th April 2020, <http://gkml.samr.gov.cn/nsjg/fgs/201912/t20191202_308963.html>

⁵ Notice on the Issuance of the Administrative Regulations on Group Standards, SAC, Ministry of Civil Affairs, 9th January 2019, viewed 4th April 2020, <http:// www.sac.gov.cn/sbgs/flfg/fl/sjbzdfl/202003/P020200318543473734066.pdf>

⁶ Measures for the Administration of Mandatory National Standards, SAMR, 6th January 2020, viewed 4th April 2020, <http://www.sac.gov.cn/sbgs/flfg/fl/ sjbzdfl/202003/t20200318_346291.htm>

⁷ Measures for the Administration of Local Standards, SAMR, 16th January 2020, viewed 4th April 2020, <http://www.sac.gov.cn/sbgs/fifg/fi/sjbzdfi/202003/ t20200318_346292.htm>

⁸ Interpretation of the Measures for the Administration of Mandatory National Standards, SAMR 17th January 2020, viewed 4th April 2020, http://www.sac.gov.cn/sxxgk/zcjd/202003/t20200318_346287.html

The working group believes that efforts were made during the formulation of the *Foreign Investment Law*⁹ and the *Regulations for Implementing the Foreign Investment Law* (*Implementing Regulations*)¹⁰ to clarify the participation of FIEs in standardisation work, as well as the implementation of standards; however, the final version of the *Implementing Regulations* fail to give FIEs clearer guidance on the implementation of non-mandatory national standards,¹¹ which contrasts with the draft *version*. This will be elaborated on in detail in Key Recommendation 5.

4. The Product Quality Law

When revision of the Product Quality Law began in 2019, it heralded the first complete overhaul of the law since it came into force in 1993. China's increased economic strength, improved living standards of its people and rapid market innovation has made this revision an imperative. The revised Product Quality Law should become an important safeguard for maintaining quality and safety for consumers, starting with meeting people's desire for a better life and their demand for high-quality products. Other aims of the revision include: building a solid bottom line for product safety and promoting product 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 to bring greater focus to innovating regulatory mechanisms, optimising the market environment and improving the system for accountability.12 According to the SAMR's 2020 Legislative Work Plan,¹³ the revision of the Product Quality Law (Draft for Review) is expected to be completed within the year. The working group will continue to monitor for solicitations for comments on all relevant legislation, and actively participate in them.

5. Departmental Regulations for Market Supervision and Administration

In addition to the aforementioned laws and regulations, the SAMR issued two noteworthy regulations related to product supervision and administration in 2019, namely the *Interim Provisions on the Administration of Recall of Consumer Goods (Recall Provisions)*,¹⁴ and the *Interim Measures for the Administration of Supervisory Spot Checks on Product Quality (Spot Check Measures*).¹⁵ Both regulations came into effect on 1st January 2020.

'Recalls' within the *Recall Provisions* means "products purchased and used by consumers for their lifestyle needs", which naturally includes such things as apparel, bags and shoes. Defects in consumer goods are defined as "unreasonable dangers endangering personal or property safety". In practice, compliance with mandatory national standards will be used as the assessment criteria, but there also exist other unreasonable dangers beyond the scope of those standards. Therefore, the evaluation mechanism for what constitutes an 'unreasonable danger' needs to be further improved.

The promulgation of the *Spot Check Measures* integrated and unified the two previously existing sets of product supervision and spot-check mechanisms. The *Spot Check Measures* also clarify the methods and requirements for online sampling, which are consistent with the new supervision and administration requirements arising from the booming e-commerce industry. In addition, they expressly state that the re-examination body should not be the same as the one involved in the initial examination. All these systematic improvements are welcomed and commended by the working group.

Nevertheless, the working group also has some concerns about the clarity of the *Spot Check Measures* for implementation at the local level. For example, it is not clear whether or not "purchase of inspection samples" refers to an on-site transaction. Currently, the sampling official will take an on-site sample good without paying, and then usually bargain with the company about the price after the examination has taken place. In many cases, the company ends up

⁹ Foreign Investment Law of the PRC, Ministry of Justice, 18th March 2019, viewed 6th April 2020, <http://www.chinalaw.gov.cn/Department/ content/2019-03/18/592 230773.html>

¹⁰ Administrative Decree No. 723, State Council, 26th December 2019, viewed 6th April 2020, <http://www.gov.cn/zhengce/content/2019-12/31/content_5465449. htm>

¹¹ Notice of the Ministry of Justice (MOJ) on the solicitation of public comments on the Regulation for Implementing the Foreign Investment Law (Draft for Comments), MOJ, 2nd November 2019, viewed 6th April 2020, http://www.gov.cn/hudong/2019-11/02/content-5447867.htm

¹² Overall Launch of Work on the Revision of the Product Quality Law, SAMR, 25th April 2019, viewed 6th April 2020, http://www.samr.gov.cn/xw/zj/201904/t20190425_293135.html

¹³ Notice of the SAMR on Issuing the 2020 Legislative Work Plan, SAMR, 17th March 2020, viewed 6th April 2020, <http://gkml.samr.gov.cn/nsjg/fgs/202003/ t20200326_313464.html>

¹⁴ Order of the SAMR (No. 19), SAMR, 21st November 2019, viewed 6th April 2020, <http://gkml.samr.gov.cn/nsjg/zlfzj/201912/t20191220_309337.html>

¹⁵ Order of the SAMR (No. 18), SAMR, 21st November 2019, viewed 6th April 2020, <http://gkml.samr.gov.cn/nsjg/fgs/201911/t20191126_308823.html>



receiving no payment. To give another example, "the separated sampling and inspection rule" should entail a separation of the sampling and inspection agencies, as this is fairer and more transparent than a separation of the sampling and inspection staff (but from one single agency) as stated in the *Spot Check Measures* (Article 9).¹⁶

Key Recommendations

1. Amend the Product Quality Law 3

1.1 Remove the Abstract Term 'Unqualified Product' and Introduce the Concept of 'Safe Product', and Confirm that a Product's Conformity with Mandatory National Standards and Whether the Product Having Unreasonable Risk can be used as the Criteria for Judging its Safety and Initiating Administrative Penalties

Concern

Because the term 'unqualified product', referred to in the Product Quality Law, has not been clearly defined, considerable administrative resources that could be used to combat products in the market 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.

Assessment

The existing Product Quality Law uses the concept of 'unqualified products' and defines the legal responsibilities of producers and sellers with respect to "selling unqualified products in the name of qualified products".17 However, the term 'unqualified product' is not expressly defined in the Product Quality Law. In reality, its interpretation can vary depending on different subjects, standards and circumstances (for example, when a product does not fit with any particular standard, which can give rise to conflict between enterprises, consumers and local law-enforcement authorities). Furthermore, this practice is not in line with certain provisions of the World Trade Organization Agreement on Technical Barriers to Trade (WTO/ TBT). For instance, violation of a declared voluntary standard results in classification as an 'unqualified product', for which the enterprise is punished as 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.

When comparing foreign and domestic administrative priorities and practices related to product quality, it is clear that the European Union (EU), the United States and other developed countries put more focus on safety-related standards. In the textiles sector, for instance, there are more than a hundred safetybased criteria in Europe, derived from the General Product Safety Directive (GPSD)¹⁸ and the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH),¹⁹ 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 a lack of safety standards, China's market supervision and inspection authorities are not sufficiently able to protect consumers' health and safety. Meanwhile, the current government enforcement focus is more on non-safety-related standards, which hinders innovation and the development of the industry overall, as companies concentrate on conforming with 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.

The Standardisation Law²⁰ limits administrative responsibility for violations of mandatory national standards. This is a critical step in making administrative management more efficient and aligned with international practices. The working group welcomes the accurate scoping of voluntary standards in the Standardisation Law, and recommends the alignment of revisions to the Product Quality Law, and ensuring that voluntary standards are indeed, by definition, 'voluntary', to resolve current challenges faced by the industry, as detailed on the next page:

20 Standardisation Law, NPC, 4th November 2017, 23rd June 2020, http://www.npc.gov.cn/zgrdw/npc/xinwen/2017-11/04/content 2031606.htm>



¹⁶ Ibid.

¹⁷ See Article 12 of the Product Quality Law, SAMR, 25th June 2019, viewed 26th July 2019, <http://gkml.samr.gov.cn/nsjg/fgs/201906/t20190625_302770.html>

¹⁸ General Product Safety Directive, European Commission, 1st January 2018, viewed 22nd June 2020, <https://eur-lex.europa.eu/legal-content/EN/ ALL/?uri=CELEX:32001L0095 >

¹⁹ REACH, European Commission, 24th August 2016, viewed 13th May 2019, http://ec.europa.eu/environment/chemicals/reach/reach en.htm>



Challenge 1: 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 2: Despite the large number of voluntary standards, they do not actually address certain special characteristics of specific products. For example, the generalised assessment indicators for the colour fastness of leather products in QB/ T1333 Handbag and Knapsack—the widely applied standard for handbag and knapsack productsdid 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 shoppers 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 to take into consideration the special characteristics of all products will be an extremely onerous task.

Challenge 3: 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 (e.g. new material, innovated manufacturing process, etc.) or choose non-harmful natural colourants over artificial synthetic chemical colourants may face the risk of administrative penalties and professional shoppers. This leads to some enterprises opting 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 second and third challenges detailed here, if the Product Quality Law uses voluntary standards as a recommendation and reference—and an enterprise's civil liability can be based on whether a product or its description actually misleads consumers and causes them losses—it would be more in line with China's legal principles that administrative laws uphold justice, and punishment is proportional to the damage caused. Such application of the law would give enterprises more room to innovate independently and raise product quality, and would also be in line with the current reform blueprint for simplifying administrative procedures.

Recommendations

- Remove the term 'unqualified product' and introduce the term 'safe product'.
- Implement voluntary standards so that they do not form the basis for administrative penalties.
- 1.2 Confirm that Enterprises Only Assume Civil Responsibility in the Event that Products Fail to Satisfy Their Declared Quality Standards, and Allow Multiple Methods in Addition to Product Labelling to Publicise Product Quality Standards

Concern

When products fail to satisfy their claimed quality standards, apart from the civil liabilities set out in legislation, the responsible enterprise can be subject to extra administrative punishment, which overburdens enterprises, consumes resources and has little impact on quality.

Assessment

When a product does not meet the quality standards claimed by the enterprise (such as voluntary standards), but complies with mandatory national standards without unreasonable danger, China's Standardisation Law, Contract Law and Law on the Protection of Consumer Rights and Interests clearly state the enterprise has broken its commitment to the consumer on product quality, and should be then liable for liquidated damages. Moreover, if enterprises provide disqualified products with malicious intent, they must also pay punitive compensation. Therefore, if in addition to civil liability like paying compensation to the consumer, or repairing or returning goods, extra administrative punishment—such as fines, confiscation of goods, public announcement, etc—is added, it will



unfairly increase enterprises' contractual obligation and responsibilities, and unbalance regulation by the market.

Consumers 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 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 working group has also found that the traditional method of using labels to detail applicable effective standards on products or packages causes a lack of both flexibility and pertinence in implementation of the Product Quality Law. Traditional labelling methods cannot provide consumers with comprehensive and realtime updated product quality information due to various limitations, for instance, label size and the permanent nature of printed material. With the continuous development of information technology, enterprises can use other methods-such as websites or appsto disclose information on product quality standards to consumers more quickly and comprehensively. As the new Standardisation Law included provisions allowing enterprises to provide such information through methods other than the product label, the working group commends this move and recommends that the Product Quality Law also explicitly state the same.

Recommendations

- Clarify that enterprises shall only bear civil liability for a safe product that does not meet the quality standards claimed by the enterprise, and shall not be subject to administrative penalties.
- Allow enterprises to disclose a product's quality standards information to the public through methods other than the product label.

2. Revise the Mandatory National Standard GB 18401-2010 National General Safety Technical Code for Textile Products

Concern

In GB 18401-2010 National General Safety Technical Code for Textile Products, relevant technical specifications are out of date, which could ultimately damage consumers' health and hinder the development of innovative techniques in the industry.

Assessment

According to the *Measures for the Administration of Mandatory National Standards*, the review cycle of such standards should generally not exceed five years. Yet it has been nine years without an update since the *GB 18401-2010* was implemented on 1st August 2011, despite the rapid technological developments and progress that have taken place in the industry in the meantime.

There are more than a hundred safety-based criteria in Europe derived from the EU's GPSD and the REACH that deal with a hundred chemical indicators including carcinogens, mutagens, reproductive toxicity, sensitisation, endocrine disruption and environmental protection. The Substances of Very High Concern (SVHC) specified in the REACH are updated every two years. *GB 18401-2010* has only two safety-related chemical standards, which cannot fully protect the health and safety of consumers.

GB 18401-2010 also lacks safety indicators and includes irrelevant standards, which do not comply with the requirements for imposing mandatory standards as set out in Article 10 of the new Standardisation Law. Specifically, *GB* 18401-2010 contains requirements for colour fastness, which refers to a colour's resistance to fading during production or over the period of use.²¹ It is a performance index and will not directly impact personal health, life or property safety. In other words, the only concern should be whether the dye materials or solid dyeing processes are safe, which should be, and are, managed and controlled by related laws and regulations or standards (as specified in Table 1).



²¹ For more information on the term 'colour fastness', see item 2.53 of GB/T3291.31997 Texhiles-Terms of Textiles Material Properties and Test – Part 3: General, the Publication System for National Standards Full Text, 9th October 1997, viewed 13th April 2020, http://www.gb688.cn/ bzgk/gb/newGbInfo?hcno=153C7AAFB6AFB1A5DADBA46BC5E56ABB>

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| Name of standard/law and regulations | Formulated by | Status |
|--|---|------------------------------|
| Quantity Limit and Measurement of 23 Types of Harmful Aromatic Amine in Dye Products in GB 19601-2013 | Ministry of Industry and Information Technology (MIIT) | Effective |
| Quantity Limit and Measurement of Heavy Metal Elements in Dye Products in GB 20814-2014 | MIIT | Effective |
| Quantity Limit and Measurement of in Dye Products 4-Amino Azobenzene in GB/T 24101-2018 | TC134 | Effective |
| Quantity Limit and Measurement of Carcinogenic Dyestuffs in Dye Products in GB/T 37040-2018 | TC134 | Effective |
| Quantity Limit and Measurement of Allergenic Dyestuffs in Dye Products in GB/T 36908-2018 | TC134 | Effective |
| Quantity Limit and Measurement of Chlorine Benzene and Toluene Chloride in Dye Products in 20192264-T-606 | TC134 | Draft (recommended standard) |
| New Chemical Substances Environment Management Method | Ministry of Ecology and Environment (MEE) | Effective |
| List of Toxic Chemicals Strictly Limited in China | MEE | Effective |
| List of Hazardous Chemicals | Ministry of Emergency Management (MEM) | Effective |
| Measures on the Registration Administration of Hazardous Chemicals | MEM | Effective |
| Regulations on the Safety Administration of Hazardous Chemicals | State Council | Effective |

Many ecological, organic dyestuffs have remarkable safety performance, despite having only ordinary colour fastness, and are welcomed by consumers. In the laws and regulations related to textile products in other countries, colour fastness is included in voluntary standards, regulations or certifications and are not subject to compulsory enforcement. If a non-safety performance index, such as colour fastness, is still included in a mandatory national standard, it will hinder the development of the textile industry.

Likewise, the requirements for peculiar smells included in the GB 18401-2010 are irrelevant to personal health, life and property safety, and should be removed accordingly.

Recommendations

Table 1

- Follow the review period required by the *Measures for the Administration of Mandatory National Standards* to begin revision of GB 18401-2010.
- · Increase the number of chemical safety standards that

properly safeguard personal health, life and property safety in line with international market practices.

- Remove the non-safety-related requirements on colour fastness and peculiar smells, and move them to recommended national or industrial standards instead.
- Improve the formulation and revision of the technical standards on the safety of raw materials in the textile industry.
- 3. Introduce the Implementation Rules of the E-commerce Law to Clarify the Liability and Responsibility of Social Platforms with E-commerce Functions with Regard to the Spread and Sale of Fake Products, and Promote Industrial Self-governance <2

Concern

The rapid increase in both business identities and



private transactions taking place online makes routine administration with respect to combatting the sale of fake goods via e-commerce platforms and socialmedia platforms more difficult, and the lack of effective enforcement regulations means this situation will continue to deteriorate.

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, online platform owners and intellectual property right (IPR) holders themselves can run searches and monitor e-commerce platforms due to their openness for user access, 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, with sales volumes potentially far exceeding that of other online platforms.

Legislation of the e-commerce industry must therefore meet these challenges and propose targeted solutions. Although social media platforms are difficult to monitor, public accounts and their posts can still be categorised and monitored. Public accounts should carry responsibilities similar to general e-commerce platforms, and the sale of counterfeit goods via social media should never be tolerated, i.e. accounts should be closed as soon as such activity is reported. Social media platforms themselves should increase the penalties for counterfeit sellers, actively share information with rights holders and law enforcement authorities, and take more active measures to protect IPR.

The volume of e-commerce sales of counterfeit goods in China is far higher than in any other country,²² and the modes of promotion are constantly revamped, so the legislative authorities cannot mechanically copy foreign e-commerce infringement handling regulations. Doing so may result in the use of loopholes in designated procedures by counterfeit sellers, such as the use of 'counter-notifications' under Article 43 of the E-commerce Law,²³ to delay the processing of infringing links. Ultimately, this will be unconducive to China's IPR protection efforts.

Before a specific solution is proposed, the working group recommends that more guidance and encouragement on industry autonomy be provided. Legislators and law enforcers would benefit greatly from taking note of the IPR protection models of platforms recognised by rights holders, and learning from them. For example, Alibaba's active platform governance model has been highly recognised by law enforcement authorities and rights holders in both China and other countries.²⁴

Recommendations

- Formulate the *Implementation Rules of the E-commerce Law* so that they regulate the responsibility for the sale of counterfeit goods on social platforms, or formulate guiding opinions or voluntary industry standards in relation to this issue.
- Classify platforms (e.g. 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.
- Remove Article 43 on counter-notification from the E-commerce Law.
- Take heed of and respect effective IPR protection models agreed between rights holders and platforms.
- Release relevant policies to ensure that social media or other online platforms that are weak or even lax in regulating the sale of counterfeit goods increase penalties for counterfeit sellers, and encourage social governance and supervision with the cooperation of rights holders.

²² Deborah Williams, E-commerce in China: A Market Overview, Retail Insight Network, 7th October 2019, viewed 22nd June 2020, <https://www.retail-insightnetwork.com/features/e-commerce-in-china/>

²³ According to Article 43 of the E-commerce Law, the operator on an e-commerce platform may make a statement to the operator of such e-commerce platform that no infringement exists, upon receipt of a forwarded notice. The statement shall specify preliminary evidence that excludes the existence of any infringement. After receiving such statement, the operator of the e-commerce platform shall forward the statement to the IPR holder who sent out the notice, and inform the rights holder that he or she may make a complaint to the related competent authority or file a lawsuit with the People's Court. Where the operator of the e-commerce platform does not receive a notice from such rights holder that he or she has made a complaint or brought a lawsuit within 15 days of the statement having been successfully delivered to the IPR holder, it shall promptly lift all measures that it has taken: *E-commerce Law*, NPC, 31st August 2018, viewed 22rd June 2020, <htp://www.npc.gov.cn/npc/c30834/201808/5f7ac8879fa44f2aa0d52626757371bf.shtml>

²⁴ Alibaba Anti-Counterfeiting Alliance Now Protects 450 Brands, China's Website for Campaigns Against IPR Infringements and Counterfeits, 18th October 2019, viewed 8th April 2020, <http://www.ipraction.gov.cn/article/xwfb/ gnxw/202004/120389.html>

Section Three: Goods

- Conduct comprehensive social surveys to gather industry views and use them to establish the *Implementation Rules of the E-commerce Law*.
- 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 and hinder development and innovation in e-commerce due to a lack of necessary consumer data.

Assessment

During 2019 and early 2020, drafts of numerous regulations and rules on personal information were issued or released for comments.²⁵ The *Personal Information Protection Law* is currently under drafting and review,²⁶ showing that the supervision and administration of personal information by businesses in China is being increasingly strengthened.

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. 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, following public consultation, the Personal

Information Security Specification²⁷ has formed multiple versions with more balanced, detailed and specific requirements. However, some regulations under development have put unrealistically high requirements on operators, including FIEs. For example, Article 15 of the Measures for Data Security Management (Draft for Comments)²⁸ requires network operators that collect important data or sensitive personal information for business purposes to file the data with their local cybersecurity and informatisation department; while Article 28 stipulates that network operators-before releasing, sharing or trading important data, or providing such data overseas-should assess the possible security risks and submit a report to the competent sectorial supervision and administration agency or provincial cyberspace authorities for approval. The above provisions are not only groundless in law, but also too onerous, while serving to increase relevant agencies' enforcement powers. Once implemented, they will place a great burden on the daily management and operations of multinational corporations (MNCs). The working group therefore calls for a return to the legislative intent of the Cybersecurity Law, 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 selfexaminations.

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 consumer's 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

²⁸ Measures for Data Security Management (Draft for Comments), MOJ, 26th May 2019, viewed 22nd June 2020, <http://www.moj.gov.cn/news/content/2019-05/28/ zlk_235861.html>



²⁵ Measures on Security Assessment of the Cross-border Transfer of Personal Information (Draft for Comments), Measures for Data Security Management (Draft for Comments), and Cybersecurity Review Measures (Draft for Comments), Measures for Determination of Violations of Laws and Regulations in APPs' Collection and Use of Personal Information, Information Security Technology: and Personal Information Security Specification.

²⁶ NPC Adjusted Legislative Work Plan 2020 with Multiple Drafts to be Reviewed Including Personal Information Protection Law, NPC, 22nd June 2020, viewed 22nd June 2020, <http://www.npc.gov.cn/npc/c30834/202006/e16f8d15c9194d7 99fa50faa2dc97683.shtml>

²⁷ National Standards Gazette No. 1 of 2020, SAMR, 6th March 2020, viewed 22nd June 2020, ">http://std.sacinfo.org.cn/gnoc/ queryInfo?id=0AE6935BD02A3E8FDAAA2B8BAEE82B2C>



(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.

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.
- 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.
- Ensure, by prioritising administration and strengthening regulation through legislation, the rights of consumers and citizens to be informed of and decline the collection, use and sharing of their personal information via the internet by enterprises and organisations, as well as the permanent removal of such information should they request it.
- 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. Clarify the Meaning of Article 14 of the Regulation for Implementing the Foreign Investment Law and the Circumstances in which Technical Requirements Higher Than Mandatory Standards Shall Not Be Applied to FIEs

Concern

Article 14 of the Implementation Regulations of the Foreign Investment Law states that "no technical requirements higher than compulsory standards may exclusively apply to FIEs", which may cause confusion if it is mistakenly interpreted as "higher standards can apply to FIEs" as long as it does not exclusively target them.

Assessment

Due to requirements in the original mandatory national standard *GB* 5296.4-2012 Instructions for Use of *Products of Consumer Interest - Part 4: Textiles and Apparel*,²⁹ in the apparel industry, two standards have always been required for product labels: one being the mandatory national standard *GB* 18401-2010; and the other being the product standard, i.e., the voluntary national, industrial, local or enterprise standard. Therefore, when a mandatory standard requires a voluntary standard to be labelled, the voluntary standard becomes mandatorily enforced. Any inconsistency on the part of the enterprise will lead to administrative penalties.

According to the SAC's *Announcement No.* 7 of 2017,³⁰ the mandatory standard *GB 5296.4-2012* has been transformed into the voluntary standard *GB/T 5296.4-2012*. On 1st January 2018, the revised Standardisation Law was officially implemented, with Article 2 clearly stating that "mandatory standards must be implemented, and the State encourages the adoption of voluntary standards". However, the labelling requirements for certification in the apparel industry remain unchanged.

The mandatory enforcement of voluntary standards occurs frequently in commercial operations and statutory spot checks in the apparel industry. For instance, when a company wishes to open a store in a property, the property management often have unwritten requirements and creates obstacles through setting strict requirements on the labelling of standards on the certificate. Routine spot checks of product quality may also have the same requirements; therefore, a product standard is a must. Working group members have reported law enforcement personnel claiming that this is a requirement of the Product Quality Law, although the law does not appear to contain a clause requiring the labelling of a product standard on the certificate.



²⁹ In the GB 5296.4-2012 Instructions for Use of Products of Consumer Interest -Part 4: Textiles and Apparel, Section 5.6 states that "products shall be clearly labelled with the effective national, industrial, local or enterprise product standard codes", and Section 5.7 states that "the safety category of the product shall be clearly labelled in accordance with GB 18401".

³⁰ National Standards Announcement No. 7 of 2017 of the PRC, SAC, 23rd March 2017, viewed 8th April 2020, http://std.sacinfo.org.cn/gnoc/ queryInfo?id=4EBEA47E8BD1B921FC1E99294F4B8C29>

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The scope of interpretation of the Product Quality Law has been expanded in its enforcement, leading to the mandatory enforcement of voluntary standards. This is explored in Key Recommendation 1 of this paper.

In the apparel and leather industry, many products are manufactured abroad. Due to rapid updates and innovations in fabric design, it is difficult to fully implement all the voluntary national, industrial and local standards applicable in China, especially when they are outdated in terms of safety and performance requirements. Even if FIEs choose to implement enterprise standards, there are still unwritten obstacles for the formulation of such standards. Taking the textile industry as an example, standardisation experts believe that product standards provide a framework for basic requirements; therefore, enterprise standards should be consistent with the product standards in principle, and technical indicators shall not be lower. In other words, if enterprise standards match product standards but are not higher than the technical requirements in voluntary standards, there is no need to formulate new enterprise standards. This deviates from Article 21 of the Standardisation Law, which requires technical requirements in mandatory standards to be the benchmark for formulation of enterprise standards. While there are different items and technical requirements in foreign and the relevant Chinese production standards, importing enterprises still need to follow Chinese voluntary standards for conformity assessment and determining administrative responsibility in statutory spot checks. This is unfavourable for the introduction of excellent innovative products, prevents the provision of a variety of foreign products for Chinese consumers to choose from, and is not conducive to the realisation of China's vision of continuously satisfying the people's pursuit of a better life.

Recommendations

- Clarify Article 14 of the Regulation for Implementing the Foreign Investment Law to eliminate any ambiguity.
- Do not mandatorily require FIEs, directly or indirectly, to apply voluntary standards beyond that technical requirements in the declared standards by FIEs are higher than in mandatory standards.

Abbreviations

| EU | European Union |
|-------|---|
| EUR | Euro |
| FIE | Foreign-invested Enterprise |
| GPSD | General Product Safety Directive |
| IPR | Intellectual Property Rights |
| MEE | Ministry of Ecology and Environment |
| MEM | Ministry of Emergency Management |
| MIIT | Ministry of Industry and Information |
| | Technology |
| MNC | Multinational Company |
| MOJ | Ministry of Justice |
| NPC | National People's Congress |
| PRC | People's Republic of China |
| REACH | Registration, Evaluation, Authorisation |
| | and Restriction of Chemicals |
| SAC | Standardisation Administration of |
| | China |
| SAMR | State Administration for Market |
| | Regulation |
| SVHC | Substances of Very High Concern |
| ТВТ | Technical Barrier Treaty |
| WTO | World Trade Organization |
| | |





Healthcare Equipment Working Group

Key Recommendations

- 1. Strengthen Scientific Assessments and Market Forces in the Procurement of Medical Devices
- 1.1 Give Priority to Clinical Requirements and Increase Transparency in Volume-based Procurement
 - Designate clinical requirements of different patient groups as having the main weighting in deciding volume-based procurement tenders, and do not overvalue the sales price of devices.
 - Develop national guidelines for local sourcing authorities on how to conduct volume-based procurement in a fair and transparent way.
 - Start volume-based procurement in additional trial areas and conduct a thorough evaluation on the impact on patients, hospitals, manufacturers and other stakeholders.
 - Publish draft guidelines and procurement rules for volume-based procurement for public consultation.

1.2 Adopt Value-based Approaches in the Procurement of Medical Devices

- Create a database on the clinical efficiency of different medical devices as a basis for procurement, and establish a value appraisal mechanism based on international multi-centre studies.
- 1.3 Ensure Sufficient Hospital Financing and Scientifically Calculate Cost Factors in the Pricing of Medical Services
 - Set a nationwide standard for medical services.
 - Establish a mechanism for pricing of medical services by connecting pricing with the application of disposable medical devices, considering the difficulty of treating a specific disease and the applied technology for treatment, and reflecting both labour costs and the level of medical technology.
 - Establish a mechanism to add new medical services and update existing ones on the pricing list.

2. Increase the Efficiency of Medical Device Evaluations and Market Approval

- 2.1 Remove the Requirement for Country of Origin (CoO) Certification in Pre-market Approval (02)
 - Remove the requirement for CoO certification (pre-market approval in the country of origin) as a precondition for registration and filing of new medical devices.
- 2.2 Streamline Regulatory Requirements for Changing the Manufacturing Site from Outside China to Within China by Defining Relocation as a Non-significant Modification of a Registration
 - Refer to the registration process and documentation requirements for the change of manufacturing site between two sites outside China, and follow the timeline of a simple modification of registration for the change of manufacturing site outside China to inside China.

3. Reduce the Number of Mandatory Standards for Medical Devices 13

- Accelerate re-classification of mandatory standards into recommended standards.
- Allow market-approval of medical devices if a manufacturer can demonstrate that its non-standard solution guarantees at least the same safety and efficacy as that laid down in relevant standards.
- · Accelerate transformation of international standards into Chinese 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 (3)
 - Examine existing government procurement measures to check whether they contradict the Foreign Investment Law and the Ministry of Finance's (MOF's) *Notice No. 38.*
 - Eliminate discriminatory provincial and municipal regulations/policies and behaviours, including 'domestic brand' Class B medical equipment licences that prevent both access to local markets, and fair and equal competition.
- 5. Amend Policies to Allow the Transfer of Remanufactured/Refurbished Medical Equipment
 - Include remanufacturing/refurbishment of medical equipment in the 'developing remanufacturing' section of the 14th Five-year Plan.
 - Allow import and sales of refurbished and remanufactured medical devices that were originally manufactured in accordance with an accepted international quality management system, before being remanufactured/refurbished according to an international refurbishment standard (e.g. IEC 63077), and which meet the original manufacturer's safety and performance specifications.
 - Develop practicable measures to implement the policy regarding used medical equipment to be imported for repair, including remanufacturing/refurbishment, re-export and sale.
 - Take advice from qualified enterprises that offer their expertise in support of developing corresponding measures.
- 6. Promote Market Access for High-precision and Innovative In-vitro Diagnostics (IVDs)
- 6.1 Promote Market Access of Diagnostic Reagents with High Levels of Reliability and Accuracy (3) 2
 - · Accelerate approval of new medical service items and simplify market access procedures.
 - · Include different diagnostics methods and technologies in provincial procurement catalogues.
- 6.2 Establish a Fast-track Market Approval Mechanism for Urgently Needed and Innovative IVDs
 - Publish more detailed regulations on how to apply for fast-track approval of urgently needed medical devices, and provide a level playing field for local and imported device manufacturers.
- 6.3 Re-classify IVD Reagents (1)9
 - Refer to international rules of classification and continue to reclassify low-to-moderate risk IVD products into Class I or II.
- 6.4 Shorten the Time for Modification of Registrations of IVD-reagents (1)4
 - Establish a notification pathway for some simple, non-critical modifications, such as modified packaging and changes to the instructions for use (IFU).
 - Establish a unified procedure for domestic and imported IVD-reagents to allow change of site of manufacture through a notification to the responsible Medical Products Administration (MPA).
 - · Establish a simple fast-track procedure for evaluating and approving modifications.



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. During the peak of the Coronavirus Disease 2019 (COVID-19) crisis in China in early 2020, member companies donated large amounts of medical products and mobilised their worldwide procurement networks to buy urgently required protective equipment for China. 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

In the first half of 2020, the Chinese healthcare market was heavily affected by the COVID-19 pandemic. Like in Europe, all non-urgent surgeries were delayed or cancelled to make room for COVID-19 treatment, affecting patients, many of whom had to wait several months, for example, for ophthalmologic or orthopaedic surgery. While demand for protective equipment, ventilators and a few other types of medical devices surged, the suspension of non-essential surgeries resulted in a dramatic drop in revenue for many medical companies.

Health authorities bundled their efforts to cope with the epidemic; therefore in 2020, healthcare reform projects, like the further roll-out of diagnostic-related groups (DRG) for hospital payments, were delayed. To mitigate the influence of the epidemic on China's economy, the government decided to waive or reduce public health insurance fees from February to June 2020.² The industry is concerned that a drop in health insurance fees, in combination with the heavy burden of public health insurance caused by expenses for COVID-19 treatments, may lead to underfunding of China's health insurance.

The underlying challenges to China's healthcare system—a rapidly ageing population and an increase in chronic, expensive diseases—have become even more prominent. In 2019, China's overall public health expenses reached Chinese yuan (CNY) 6.52 trillion, an increase of 10.3 per cent compared with 2018,³ which is considerably higher than China's gross domestic product (GDP) growth of 6.1 per cent. The proportion of China's GDP spent on healthcare has increased steadily over the last two decades; in 2019, it reached 6.6 per cent, a level similar to developed markets like Singapore.

Since its establishment in March 2018, the National Healthcare Security Administration (NHSA) has increased its influence over the procurement of CDMD, mainly with the intention of controlling expenses. In late 2018, the NHSA introduced a new concept for

¹ Outlines of Healthy China 2030, State Council, 25th October 2016, viewed 23rd April 2020, <http://www.gov.cn/xinwen/2016-10/25/content_5124174.htm>

² Social Security Is Implementing Precise Measures To Stabilise Employment, State Taxation Administration, 10th March 2020, viewed 23rd April 2020, <http://www.chinatax.gov.cn/chinatax/c101589/c5145829/content.html

³ Statistics of China's Healthcare Development 2019 (in Chinese), National Health Commission, 6th June 2020, viewed 12th June 2020, <http://www.nhc. gov.cn/guihuaxxs/s10748/202006/ebfe31f24cc145b198dd730603ec4442. shtml>

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the procurement of pharmaceuticals: volume-based procurement, i.e. sourcing in large quantities and requiring adequate discounts. After a few pilot projects in 2019, in March 2020, the central government published an announcement, requiring local governments to speed up volume-based procurement for disposable medical devices.⁴

Volume-based procurement resumed in April 2020 at the provincial and municipal level. In the absence of national guidelines and regulations, submitting tenders in volume-based procurement projects in a very fragmented market has become a big challenge for medical device manufacturers. The working group supports the government's efforts to keep the increase of expenditure at a reasonable rate of approximately 10 per cent annually. However, volume-based procurement tenders are normally decided based on the purchase price of medical devices only, potentially compromising the quality of treatment. Using lower quality medical devices (often equating to a product's shorter life span) may lead to increased, not lower expenses. The working group therefore advocates for a value-based approach in tendering, taking into account the overall benefits and expenses of a treatment.

Regulatory Environment

The reform of the review and approval system for medical devices continues. After establishing fast-track approval for selected devices, in 2019, 19 innovative products and ten clinically urgently needed products obtained market approval.⁵ Electronic registration has been implemented, and the reform of clinical trial administration was a positive outcome for the industry.

The Marketing Authorisation Holder pilot programme has also been expanded. The Centre for Medical Device Evaluation (CMDE) of the NMPA established an Artificial Intelligence Medical Device Innovation and Cooperation Platform. The NMPA actively participated in the work of the International Medical Device Regulators Forum (IMDRF) and the Asia Harmonization Working Party, contributing Chinese expertise to global regulatory legislation. In 2020, the NMPA will push the promulgation of the revised *Regulation on the Supervision and Administration of Medical Devices*, the highest level regulation for medical devices, and subsequently revise supporting regulations and normative documents.⁶ The Healthcare Equipment Working Group hopes that the relevant government agencies will attentively "listen to the views of relevant enterprises, trade associations and chambers of commerce to make the decision keep in line with the reality and public will",⁷ including accelerating review and approval of innovative medical device products by the NMPA.

In order to prevent and control the COVID-19 pandemic, Medical Products Administrations (MPAs) are strengthening supervision of market approval and quality of exported medical devices. The working group has expressed appreciation for the intention to improve the supervision of the industry. However, in accordance with the common practice of international trade, the responsibility of supervising the quality and safety of imported products lies entirely with the importing country. The working group hopes that relevant departments eliminate these recent barriers for exported medical devices by waiving the request for prior registration in China, as well as commodity inspection before exporting.

The working group appreciates the initiative of the MPAs to explore the use of clinical real-world data. Establishing a unique device identifier (UDI) database for medical devices is another key task of the NMPA in 2020. The working group recommends the adoption of a globally harmonised approach to applying the UDI, based on the principles laid down in the general IMDRF *UDI System Application Guide.*⁸

⁴ Opinions of the Central Committee of the Communist Party of China and the State Council on Deepening the Structural Reform of the Healthcare Security Administration, State Council, 5th March 2020, viewed 23rd April 2020, <http://www.gov.cn/zhengce/2020-03/05/content_5487407.htm

⁵ Teleconference of National Medical Devices Administration, NMPA, 27th March 2020, viewed 27th April 2020, <http://www.nmpa.gov.cn/WS04/CL2578/376098. html>

⁶ Ibid.

⁷ Circular of the General Office of the State Council on Fully Listening to the Opinions of Enterprises And Trade Associations And Chambers Of Commerce In The Process of Formulating Administrative Normative Documents of Administrative Rules and Regulations, State Council, 13th March 2019, viewed 27th April 2020, <http://www.gov.cn/zhengce/content/2019-03/13/ content 5373423.htm?trs=1>

⁸ UDI System Application Guide, IMDRF, 21st March 2019, viewed 27th April 2020, http://www.imdrf.org/docs/imdrf/final/technical/imdrf-tech-190321-udi-sag.pdf



Key Recommendations

- 1. Strengthen Scientific Assessments and Market Forces in the Procurement of Medical Devices
- 1.1 Give Priority to Clinical Requirements and Increase Transparency in Volume-based Procurement

Concern

The planned nationwide roll-out of volume-based procurement and opaque criteria for winning tenders may result in an increased weighting being applied to purchasing prices at the expense of clinical requirements.

Assessment

Volume-based procurement for a limited range of high-value disposable medical devices started in 2019 in Anhui and Jiangsu. In April 2020, the Central Committee of the Communist Party of China and the State Council jointly published a document requiring local governments to apply value-based procurement to disposable medical devices.⁹ By May 2020, the working group had come to know of 23 volume-based procurement projects at provincial and municipal levels.

Different manufacturers' medical devices are never completely equal – different brands may fit individual patients' needs better. To meet various clinical requirements, more than one bidder is usually selected for volume-based procurement tenders. This means that the order volumes in many tenders are not really high; however, the procurement authorities still require hefty discounts, despite the fact that the actually sourced volumes do not justify such discounts.

The aim of volume-based procurement is to control expenses, so subsequently the main criteria for winning a tender is price, with differences in quality, effect on patients and hospitals and the overall long-term expenses of disease treatment, not being sufficiently considered.

In most cases, volume-based procurement regulations have not been published for public consultation,

and during some tenders, the rules have only be given orally, making the procurement process very opaque. Furthermore, tender procedures vary in each province and city, making it difficult for participating manufacturers to adapt.

Recommendations

- Designate clinical requirements of different patient groups as having the main weighting in deciding volume-based procurement tenders, and do not overvalue the sales price of devices.
- Develop national guidelines for local sourcing authorities on how to conduct volume-based procurement in a fair and transparent way.
- Start volume-based procurement in more trial areas and conduct a thorough evaluation on the impact on patients, hospitals, manufacturers and other stakeholders.
- Publish draft guidelines and procurement rules for volume-based procurement for public consultation.

1.2 Adopt Value-based Approaches in the Procurement of Medical Devices

Concern

Currently the prevalent criteria in procurement of disposable medical devices is the lowest price, disregarding the influence of their quality on overall expenses for treatment, the lifecycle costs of devices and different needs of individual patients.

Assessment

Because of a lack of established methods to evaluate the clinical use of medical devices, procurement authorities tend to adapt a 'price decides all' approach. However, to satisfy the increasing demands of the population for first-class healthcare, and to reach the targets set in *Healthy China 2030*, more sophisticated approaches to procurement need to be adopted.

In China, centralised purchasing started in 2002, and was rolled out nationwide in 2011. Since then, several rounds of price negotiations have eliminated the most unreasonable price mark-ups. However, in the same period, only very limited research has been done on assessing the clinical value of medical devices.

The price of medical devices should not be the main criteria for clinical use, as procurement of the most suitable devices may actually reduce the overall

⁹ Opinion of the Central Committee of the Communist Party of China and the State Council on Deepening the Structural Reform of the Healthcare Security Administration, State Council, 5th March 2020, viewed 27th April 2020, http://www.gov.cn/zhengce/2020-03/05/content_5487407.htm

healthcare expenses. In recent years, health-technology assessment (HTA), life-cycle costs and value-based payment have become hot topics in the international medical community. For example, in January 2018, the European Union (EU) initiated a programme on HTA.¹⁰ Similar initiatives have started in Chinese research institutes, but they have not yet influenced procurement policies.

Procurement policies for disposable medical devices have been developed based on those for pharmaceuticals. However, medical devices differ from pharmaceuticals in that there are very few identical medical devices. Deciding which one will have the best result depends largely on the individual medical condition of a patient. The ability to reach this decision requires comprehensive post-market clinical studies and corresponding databases to be created. To increase the number of cases and reliability of clinical data, product and technology assessments require international cooperation between all major stakeholders: healthcare authorities, hospitals and manufacturers.

Recommendation

 Create a database for clinical efficiency of different medical devices as a basis for procurement, and establish a value appraisal mechanism based on international multi-centre studies.

1.3 Ensure Sufficient Hospital Financing and Scientifically Calculate Cost Factors in the Pricing of Medical Services

Concern

In 2019, the NHSA started to revise local medical service pricing lists based on 2001 national guidelines, without taking into account the progress of medical technology and China's economic development, resulting in too-low prices for medical services, and a system that does not reflect the value of highly qualified medical personnel and advanced medical technologies.

Assessment

The medical pricing system in China is very fragmented, with different locations using different names for the same service, different codes and different prices. This makes cross-provincal reimbursement very difficult.

Service pricing is based on a hospital's expenses, mainly CDMD and labour costs; however, expenses for medical devices are often overrated and labour costs underrated. Service prices, especially for nursing and surgery, are often too low, and do not accurately reflect the value of human care during treatment.

Before new treatment methods can be applied, they need to be included in the public hospitals' price lists. However, price list updates are slow, delaying patients' access to state-of-the-art medical technology. Meanwhile, changes in expenses also lead to updates of pricing lists, resulting in financial deficits for public hospitals and affecting their regular operations.

Recommendations

- Set a nationwide standard for medical services.
- Establish a mechanism for pricing of medical services by connecting pricing with the application of disposable medical devices, considering the difficulty of treating a specific disease and the applied technology for treatment, and reflecting both labour costs and the level of medical technology.
- Establish a mechanism to add new medical services and update existing ones on the pricing list.
- 2. Increase the Efficiency of Medical Device Evaluations and Market Approval
- 2.1 Remove the Requirement for Country of Origin (CoO) Certification in Pre-market Approval (© 2)

Concern

Current Chinese medical device regulations hamper flexible, globalised marketing and production, with the requirement to obtain market approval in the CoO before starting registration in China delaying market access by at least 18 months.

Assessment

The CMDE of the NMPA has accumulated ample experience in medical device evaluation. Evaluation capacity has been expanded and new reviewers have become more professional. China's regulatory environment and level of standardisation is continuously improving. Under these circumstances, the CMDE is fully capable of conducting an independent evaluation

¹⁰ Proposal for A Regulation of the European Parliament and the Council on Health Technology Assessment and Amending Directive 2011/24/EU, European Commission, 31st January 2018, viewed 27th April 2020, https://ec.europa.eu/ health/sites/health/files/technology_assessment/docs/com2018_51_en.pdf>



of imported medical devices without relying on their CoO certificates. In addition, an independent review and approval by the NMPA, without relying on the the EU Notify Body's or other regulator's evaluation, will significantly enhance the position of the NMPA in the global regulatory community, making Chinese registration a reference standard for other countries.

Although innovation in Chinese medical devices has strongly improved in recent years, with the rapid development of the medical devices market in China, the demand for imported medical devices, and for international leading medical products in particular, remains unabated. The requirement for CoO certificates has delayed patients in China from accessing the world's leading medical products for years, making it more favourable for many patients to receive treatment abroad.

The working group welcomes the fact that CoO certification is no longer required for the registration of innovative medical devices, and recognises the determination and capacity of the NMPA to try and make new medical devices available as quickly as possible. However, limiting the scope to innovative devices means that supply is still not sufficient to meet market demand.

Recommendation

- Remove the requirement for CoO certification (pre-market approval in the country of origin) as a precondition for registration and filing of new medical devices.
- 2.2 Streamline Regulatory Requirements for Changing the Manufacturing Site from Outside China to Within China by Defining Relocation as a Non-significant Modification of a Registration

Concern

Current Chinese medical device regulations hamper globalised production, with registration requirements for changing the manufacturing site being as complicated as those for a new registration.

Assessment

Under the current regulatory regime, the registration cycle—including type testing, clinical evaluation, technical review, approval and onsite audit—for medical

device manufacturing site transfers from outside China to within China is longer than 18 months. This is a big difference compared to registration of manufacturing site transfers between two sites outside of China, which does not require type testing and site audit, and generally takes less than six months.

The transfer of medical device manufacturing from one overseas factory to another follows the pathway of modification of the registration item. Only the quality system certification of the new manufacturing site is required, proving that its quality system meets the legal requirements. However, if the manufacturing site is transferred from outside China to within, a new domestic registration is necessary. Similarly, the transfer of manufacturing sites from China to outside China also requires a new registration of an imported medical device.

Recently, the NMPA initiated a public consultation on the *Circular on Relevant Matters for Transferring the Manufacture of Products with Imported Medical Device Certificate to Enterprises in China (Call for Comments) (Circular).*¹¹ The *Circular* does not exempt type testing, which is a very time-consuming non-value-adding step. Thus, the registration time of such manufacturing site transfers may still take more than 12 months, especially for large medical devices. Compared to the procedure for manufacturing site transfers outside of China, there is still considerable room for improvement.

The manufacturing industry is the main body of the real economy and the key engine to promote long-term and stable economic growth. President Xi Jinping has often expounded on the need to revitalise the real economy and expanding the manufacturing industry.¹² To achieve this goal, it is necessary to formulate laws and regulations that encourage domestic production of medical devices, including supporting enterprises to transfer production of advanced medical devices to China. This will contribute to:

- reducing costs, such as production costs and tariffs, which will ease the financial burden of China's healthcare system;
- · attracting more experienced professionals to the

¹¹ Circular on Relevant Matters for Transferring the Manufacture of Products with Imported Medical Device Certificate to Enterprises in China (Call for Comments) (Circular), NMPA, 28th February 2020, viewed 27th April 2020, <http://www. nmpa.gov.cn/WS04/CL2102/375281.html>

¹² China's Manufacturing Industry Moves Towards the Middle and High End, people.cn, 3rd January 2020, viewed 27th April 2020, <http://finance.people.com. cn/n1/2020/0103/c1004-31533883.html>



medical device manufacturing industry, creating jobs for specialised professionals;

- improving the domestic medical device manufacturing industry, in terms of hardware facilities, management system and development of upstream suppliers; and
- enhancing the competitive strength of China's manufacturing and increasing exports.

Recommendation

 Refer to the registration process and documentation requirements for the change of manufacturing site between two sites outside China, and follow the timeline of a simple modification of registration for the change of manufacturing site outside China to inside China.

(1) 3 3. Reduce the Number of Mandatory Standards for Medical Devices

Concern

In China, medical devices have strict market access regulations based on mandatory national standards and industry standards, which are not synchronised with international standards or conducive to medical device innovation.

Assessment

On a global level, standards are formulated through consensus by international standardisation organisations, guaranteeing interoperability of different medical devices and developing rules and guidelines for manufacturers to ensure that devices are safe and efficacious. Chinese experts are increasingly participating in international standardisation organisations and are providing valuable contributions.

To avoid standards hampering innovations, in most major economies, including the EU and the US, the vast majority are recommended, not mandatory. This means a manufacturer may deviate from standards if it can demonstrate that its solution is at least as safe and efficacious as that laid down in the relevant standard.

Because of historical reasons—such as a huge number of medical device manufacturers, many of them with poor quality management—regulators in China still require mandatory compliance with most national standards. In recent years, both the technical and managerial levels of Chinese manufacturers, as well as the expertise of regulators, have increased dramatically. Chinese manufacturers are increasingly developing innovative medical devices. Therefore, mandatory standards as a regulatory tool are no longer necessary and have turned into an obstacle for the development of the industry.

Many of China's mandatory standards have been transformed from international standards, but lag far behind. This may lead to a situation in which manufacturers have to maintain two product versions, one for compliance with the international version of a standard and one for the Chinese version. This 'version discrepancy' discourages Chinese manufacturers from developing state-of-the-art devices and delays patient's access to the newest product version. See Table 1 for examples: the last four digits of the standard indicate the year of release; hence in the first example, the Chinese version is 16 years behind the international one, in the second example, 10 years.

Table 1

| China Current Version | Equivalent International Version | Current International Version | Торіс |
|-----------------------------|--|-------------------------------------|-------------------------------|
| GB 4793.1- 2007 | IEC 61010- 1:2001 | IEC 61010- 1:2017 | Electrical safety |
| YY 0505- 2012 | IEC 60601-1- 2:2004 | IEC 60601- 1-2:2014 | Electromagnetic compatibility |

In addition to national standards equivalent to international standards, there are additional industry standards, some of which are also classified as mandatory, especially product performance standards formulated in recent years. These mandatory standards are not in line with international standards, so international medical device manufacturers may have to develop special product versions for China.

Recommendations

- Accelerate the re-classification of mandatory standards into recommended standards.
- Allow market approval of medical devices if a manufacturer can demonstrate that its non-standard solution guarantees at least the same safety and efficacy as that laid down in relevant standards.
- Accelerate the transformation of international standards into Chinese standards.



 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 (3)

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 force on 1st January 2020.¹³ Articles 9 and 16 state that foreigninvested enterprises (FIEs) in China enjoy access to the same preferential policies as other 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.¹⁴

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:

- issuing Class B large medical equipment licences solely for 'domestic brand equipment', e.g. in Guangdong and Shanghai; and
- setting percentage targets for domestic equipment that hospitals are expected to meet, e.g. in Sichuan.

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. Such exclusion clearly demonstrates 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 the ensuring the best clinical outcomes for patients, instead of focussing solely on the origin of the brand. In the process of procurement, the government should give priority to patients' and clinical needs and conduct evidence and value-based procurement.

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 behaviours, including 'domestic brand' Class B medical equipment licences, that prevent both access to local markets, and fair and equal competition.

5. Amend Policies to Allow the Transfer of Remanufactured/Refurbished Medical Equipment

Concern

The draft Amendment of the Regulations on the Supervision and Administration of Medical Devices stipulates that business enterprises and users of medical devices shall not buy or sell used medical devices, which conflicts with the principle of establishing a circular economy in the field of remanufactured/ refurbished medical equipment.

Assessment

Developing a circular economy and building a conservation-orientated society is an important strategy of the Chinese Government,¹⁵ of which remanufacturing/

¹³ Foreign Investment Law, National People's Congress, 15th March 2019, viewed 27th April 2020, http://www.npc.gov.cn/npc/c30834/201903/121916e4943f416b 8b0ea12e0714d683.shtml>

¹⁴ Notice No. 38 on Promoting Fair Competition and Improving the Environment of Government Procurement, MOF, 30th July 2019, viewed 27th April 2020, <http:// www.gov.cn/xinwen/2019-07/30/content_5417344.htm>

¹⁵ Circular Economy Helps Transformation of Economic Development Mode and High-quality Development, NDRC, 30th September 2019, viewed 17th April 2020, https://www.ndrc.gov.cn/xwdt/gdzt/cl70zn/201909/t20190930_1197758.html

refurbishment industry is 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 dawn of the 14th Five-year Plan, the working group wants to use the opportunity to highlight the topic of developing remanufacturing, including remanufacturing/ refurbishment of medical equipment.

According to Order No. 106 on the Adjustment of the Catalogue of Used Mechanical and Electrical Products Prohibited from Import,¹⁶ jointly issued by the Ministry of Commerce (MOFCOM) and the General Administration of Customs (GAC), old medical equipment is not allowed to be imported. Moreover, Article 25 of the latest edition of the Regulation on the Supervision and Administration of Medical Devices (Revised Draft) (Draft for Consultation)¹⁷ specifies the requirements for importing medical devices and includes content prohibiting the sale and import of used medical devices.

Per international practices, original equipment manufacturers (OEMs) of large-scale medical imaging equipment, such as magnetic resonance imaging or computed tomography, have established mature quality control and standardised processes for equipment refurbishment. The standard *IEC 63077: 2019 Good Refurbishment Practices for Medical Imaging Equipment*, became an official international standard in 2019, published by the International Electrotechnical Commission (IEC). 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 as in its original registration.

Used equipment can be de-installed from hospitals by highly qualified personnel, transported to an OEM's refurbishment facilities, and then re-exported to any country in need of affordable, safe and effective medical equipment. However, while there is currently a large volume of installed medical imaging equipment in China that needs to be replaced by a new generation of products, import restrictions prevent global and cross-regional cooperation in the circular economy in the refurbishing/remanufacturing of medical imaging equipment.

The working group recommends that the management of used medical imaging equipment focus on safety and effectiveness, rather than implementing a one-sizefits-all solution. In fact, the conditions for reasonable and legal import and sale of used medical imaging equipment in the market already exist. For instance, in *Order No.* 7 published by the MOFCOM in 2018 on *Amending the Administrative Measures for the Import of Electromechanical Products*, Article 30 has been amended to "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".¹⁸

Recommendations

- Include remanufacturing/refurbishment of medical equipment in the 'developing remanufacturing' section of the 14th Five-year Plan.
- Allow import and sales of refurbished and remanufactured medical devices that were originally manufactured in accordance with an accepted international quality management system, before being remanufactured/refurbished according to an international refurbishment standard (e.g. IEC 63077), and which meet the original manufacturer's safety and performance specifications.
- Develop practicable measures to implement the policy regarding used medical equipment to be imported for repair, including remanufacturing/refurbishment, reexport and sale.
- Take advice from qualified enterprises that offer their expertise in support of developing corresponding measures.

¹⁶ Adjustment of the Catalogue of Used Mechanical and Electrical Products Prohibited from Import, MOFCOM and GAC, 29th December 2018, viewed 17th April 2020, <http://www.mofcom.gov.cn/article/b/c/201812/20181202821859. shtml>

¹⁷ Regulation on the Supervision and Administration of Medical Devices (Revised Draft) (Draft for Consultation), NMPA, 2019, viewed 17th April 2020, https://members.wto.org/crnattachments/2019/TBT/CHN/19_1434_00_x.pdf>

¹⁸ Order No.7, MOFCOM, 10th October 2018, viewed 26th April 2020, <http://www.mofcom.gov.cn/article/b/c/201811/20181102804608.shtml>



- 6. Promote Market Access for High-precision and Innovative In-vitro Diagnostics (IVDs)
- 6.1 Promote Market Access of Diagnostic Reagents with High Levels of Reliability and Accuracy (1)2

Concern

Cumbersome market access procedures and inflexible procurement regulations delay patients' access to most advanced diagnosis methods and frequently result in hospitals purchasing reagents with limited reliability and accuracy, possibly leading to erroneous diagnosis results and the delay of efficacious treatment.

Assessment

Approval by hospitals of new medical service items takes a long time, with each province having its own. complicated approval procedures. Different diagnostic methods and technologies should be applied depending on the different stages of a particular disease, e.g. prevention, initial diagnosis, treatment and followup care. The time needed to obtain diagnosis results may be a crucial factor for hospitals and patients, as prominently shown during the COVID-19 crisis. Different diagnostic methods have different focuses and different advantages - using a non-optimal diagnostic method may compromise the precision of the diagnosis result. Very specific, precise diagnosis methods can be used to not only identify diseases, but also to give the doctor reliable information about the effects of modifying, or weaning off, a specific medication during treatment. This is impossible with traditional simple diagnostic methods.

Many provincial procurement catalogues are not sufficiently specific, as they do not distinguish by method and technology, resulting in procurement of only the most simple and cheapest IVD products.

Recommendations

- Accelerate approval of new medical service items and simplify market access procedures.
- Include different diagnostics methods and technologies in provincial procurement catalogues.

6.2 Establish a Fast-track Market Approval Mechanism for Urgently Needed and Innovative IVDs

Concern

During the COVID-19 pandemic, Chinese hospitals could not use urgently needed imported IVDs because of long registration procedures.

Assessment

In 2019, the NMPA promulgated a regulation establishing a fast-track approval pathway for urgently needed medical devices, however this regulation does not specify the procedure or the required documents for application. At the same time, several local manufacturers' IVDs received fast-track approval at local MPAs, with some manufacturers not even submitting type test reports and clinical data.

Recommendation

 Publish more detailed regulations on how to apply for fast-track approval of urgently needed medical devices, and provide a level playing field for local and imported device manufacturers.

6.3 Re-classify IVD Reagents (1) 9

Concern

China assigns many diagnostic reagents to a higher risk class than other countries, leading to additional clinical trials and delayed market access.

Assessment

China is an active member of the Regulated Product Submission Working Group of the IMDRF. However, the former China Food and Drug Administration (CFDA) assigned a substantial number of IVD reagents into a higher risk class than the classification rules of the IMDRF specify. This higher risk classification leads to rising product development costs and expensive clinical trials without providing additional patient safety, ultimately hindering the development of the IVD industry.

In February 2017, the CFDA published the *Amendment* to the Provisions on IVD Product Registration.¹⁹ This updated regulation states that "the CFDA may adjust the classification rules according to the changing risk of IVD reagents". The official interpretation of this amendment states "in the future, the CFDA will ... adjust classification rules and classification catalogues

¹⁹ Amendment to the Provisions on IVD Product Registration, NMPA, 8th February 2017, viewed 24th April 2020, <http://www.nmpa.gov.cn/WS04/CL2186/300690. html>

based on the risk of IVD reagents."20

In December 2017, the *Notice on Re-classification of Several IVD Reagents* came into force.²¹ However, this notice covers only a small fraction of IVD products. The working group welcomes the start of the re-classification process and recommends that additional IVD reagents be re-classified soon.

Recommendation

 Refer to international rules of classification and continue to reclassify low-to-moderate risk IVD products into Class I or II.

6.4 Shorten the Time for Modification of Registrations of IVD-reagents (3) 4

Concern

The modification of valid registrations for IVD-reagents requires an excessively long time, endangering the quality and supply of reagents, with the change of manufacturing sites in particular being much more complicated for imported products compared to local ones.

Assessment

According to *Order No. 5*, released on 1st October 2014,²² the NMPA requires the same amount of time for the modification of a registration of IVD-reagents as for a new registration. The typical timeframe for the technical evaluation is seven to nine months for Class II, and nine to 11 months for Class III reagents.

IVD-reagents differ from medical devices in that there is no pathway for notifying the authorities of modifications to the instructions for use (IFU). Each update to the IFU requires a modification of the registration. The typical life cycle of IVD reagents from market approval in the CoO to discontinuation is four to five years. Within one year, about 20–30 per cent of all IFUs are updated. Therefore, the system for handling modifications at the NMPA would not be able keep pace with the rapid development of these types of products.

According to Article 58 of *Order No. 5*, "If one of the following points of the registration certificate and its annexes have changed, the applicant shall apply for modification of the registration: ... (7) the site of manufacture of imported IVD-reagents." However, changing a manufacturing site for domestic products is a much easier notification procedure. Modification of the registration of imported IVD-reagents includes chemical tests of three consecutive batches, resulting in an approval procedure that takes about a year longer than for domestic products.

Recommendations

- Establish a notification pathway for some simple, noncritical modifications, such as modified packaging and changes to the IFU.
- Establish a unified procedure for domestic and imported IVD-reagents to allow change of site of manufacture through a notification to the responsible MPA.
- Establish a simple fast-track procedure for evaluating and approving modifications.

Abbreviations

| AHWP | Asia Harmonization Working Party |
|----------|--------------------------------------|
| CDMD | Consumable and Disposable Medical |
| | Devices |
| CDR | Centre for Drug Re-evaluation |
| CFDA | China Food and Drug Administration |
| CMDE | Centre for Medical Device Evaluation |
| CNY | Chinese Yuan |
| COCIR | European Coordination Committee |
| | of the Radiological, Electromedical |
| | and Healthcare Information |
| | Technology Industry |
| CoO | Country of Origin |
| COVID-19 | Coronavirus Disease 2019 |
| DRG | Diagnostic-related Groups |
| EU | European Union |
| FDA | Food and Drug Administration |
| FIE | Foreign-invested Enterprise |
| GAC | General Administration of Customs |
| GDP | Gross Domestic Product |
| HTA | Health-Technology Assessment |
| HSA | Health Security Administration |
| IEC | International Electrotechnical |
| | Commission |
| | |

²⁰ Interpretation of the Amendment to the Provisions on IVD Product Registration, CFDA, 8th February 2017, viewed 24th April 2020, http://www.nmpa.gov.cn/WS04/CL2201/325767.html >

²¹ Notice on Adjustment of Attributes and Categories of Allergen-based Invitro Diagnostic Reagents, In-vitro Diagnostic Reagents for Flow Cytometry, Immunohistochemistry and In Situ Hybridization In-vitro Diagnostic Reagents, NMPA, 29th December 2017, viewed 24th April 2020, <http://www.nmpa.gov.cn/ WS04/CL2093/300476.html>

²² Provisions on IVD Registration, CFDA, 30th July 2014, viewed 24th April 2020, http://www.nmpa.gov.cn/WS04/CL2186/300661.html



| Instructions For Use |
|---|
| International Medical Device Regulators |
| Forum |
| In-vitro Diagnostics |
| Ministry of Finance |
| Ministry of Commerce |
| Medical Products Administration |
| National Healthcare Security Administration |
| National Medical Products Administration |
| Original Equipment Manufacturer |
| Unique Device Identifier |
| United States |
| |



Petrochemicals, Chemicals and Refining Working Group

Key Recommendations

- 1. Sustainability and Green Chemistry
- 1.1 Ensure the Effective and Well-communicated Implementation of Sustainability Policies for China's Chemical Industry (1)7
 - Strengthen cooperation between the government and international businesses and encourage China's central authorities to involve these companies as key stakeholders in policy development.
 - Implement the emissions trading system (ETS) and take further steps to enhance its legal foundation, transparency and mechanism-building.
 - Extend preferential economic and tax policies from the COVID-19 pandemic control period for chemical manufacturers to allow them to maintain focus on energy saving and carbon dioxide (CO₂) reductions despite the massive economic and logistic disturbances.
- 1.2 Promote Sustainability through Best Practice Sharing and Innovation on Safety Management and Environmentally Friendly Practices (3)4
 - Encourage scientific and risk-based approach to formulating safety and environmental policies for chemical enterprises' operations.
 - Recognise that there are different levels of maturity of operational practices in the chemical industry, and avoid 'one-size-fits-all' solutions when enforcing compliance.
 - Recognise the chemical industry as an essential enabler for green development and thus set up appropriate rules in the upcoming Yangtze River Protection Law to proportionately regulate the operation of downstream industries and the use of chemical-based materials.
 - Establish regular, formal communication channels and cooperation mechanisms between chemical companies and government officials to share experiences, ensure that the voices of chemical companies are reflected in policy-making and help local governments to effectively implement chemical safety and environmentally-friendly policies.
 - Create platforms to share and leverage Responsible Care principles and promote best practices and innovation in green development, and improve collaboration between domestic and international businesses.
 - Define differentiated management methods based on enterprises' maturity and commitment, to save resources for authorities and support sustainability of chemical 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 sustainability of materials' whole lifecycle.
- 1.3 Improve Policies for Promotion of the Circular Economy Within the Chemical Industry
 - Create a national platform to promote the implementation of circular economy principles, e.g. re-use of chemical waste as a raw material and energy co-generation.
 - Extend preferential economic policies to producers of strategic new emerging chemicals.
 - Promote public education on the high potential of recycled plastics to dispel impressions that they are inherently low-quality materials.
 - Foster local plastic recycling systems that match the maturity of those in Europe.



2. Investment and Manufacturing Costs

- 2.1 Guarantee Fair and Reasonable Treatment by Local Authorities with Respect to Relocations and Temporary Closures of Enterprises (3)4
 - 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.
 - Inform international businesses in advance of relocation criteria and pollution control plans to avoid disrupting chemical supply chains.
 - Reach mutual agreement with companies on relocation timelines and fair compensation to decrease associated costs for companies.
 - 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 the Retail Fuel Market <a>2
 - 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
 - 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.

3. Chemicals Management

3.1 Develop a Well-debated and Practical Legislation Framework for Chemical Risk Management 107

- Develop detailed criteria to determine substances for priority evaluation or control, with proportionate control options.
- Encourage enterprises to actively participate in risk assessment discussions with the government, working towards an agreement by which companies play a critical role in protecting intellectual property rights and economic benefits.
- Develop Risk Management Option Analysis (RMOA) guidance to guide regulators at all levels and supply chain players to select appropriate risk management measures for priority chemicals, and avoid sweeping bans or restrictions of certain substances through a risk-based approach that takes into account both hazards and exposure.
- Create low-volume exemptions for new chemical research and development (R&D) notification and hazardous chemical (HC) registration.
- Focus on chemicals with large volume and high environmental risk for information reporting, reduce the frequency of reporting and optimise the HC registration process to be more user-friendly and reduce the administrative burden on authority and enterprises.
- Formulate corresponding comprehensive laws and regulations for the new version of the HC registration management system.

Introduction to the Working Group

Chemicals are essential for manufacturing all kinds of products and are therefore indispensable to China's economy. 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 (SAMR), the Ministry of Industry and Information Technology (MIIT), the National Development and Reform Commission (NDRC), the National Health Commission (NHC), the European Chemicals Agency (ECHA), and senior European Commission officials. The working group greatly appreciates the constructive exchanges that have taken place between European industries and Chinese officials as well as the marketdriven 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). The AICM, the CPCIF and the working group 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 by 2025 it would have a sound environmental governance system with a level playing field for all enterprises and financial support for green development.¹ Chemical producers will play a key role in boosting green manufacturing, but the Coronavirus Disease 2019 (COVID-19) pandemic has brought unprecedented challenges to production supply chains. The MEE announced in March that environmental supervision would be modified to help companies resume production after the virus and fix environmental problems, adopting more high-tech, off-site supervision methods.² The central government has also updated its Pollution Discharge Permit (PDP) programme, which supervises emissions by requiring manufacturers to apply for permits before they begin discharging pollutants, in order to closely monitor emission levels. Last year, authorities carried out rectification pilot tests on this programme, after which the MEE issued several guidelines to broaden the number of included industries from 24 to 33. Enterprises should complete the certification and registration of PDPs before the end of September 2020.³ Although the working group welcomes the strengthened control of emissions, it is concerned that the PDP programme brings additional administrative burdens such as the inability to revise paperwork once submitted,⁴ which may hinder innovation in manufacturing processes, and the requirement to publicly disclose potentially sensitive proprietary information.

The development of a circular economy will prove necessary to promoting sustainability within the chemical industry, for example, the management of plastic waste through innovative manufacturing processes that use alternative materials or improved recycling processes. In January 2020, the NDRC released the *Opinions on Further Strengthening the Control of Plastic Pollution*,⁵ followed in April by the *Catalogue of Plastic Products Prohibited and Restricted from Production, Sale, and Use* for public comment.⁶ The working group welcomes these measures to boost the circular economy, and expects preferential policies for manufacturers of strategic new chemicals that contribute to the production of the alternative materials of which the measures seek to boost usage.

Investments and Manufacturing Costs

The Yancheng factory explosion in March 2019 in Jiangsu Province intensified a nationwide focus on plant

¹ China to Establish Modern Environmental Governance System, Xinhua, 3rd March 2020, viewed 21st April 2020, http://www.xinhuanet.com/english/2020-03/03/c_138840121.htm

² Xu, Muyu and Goh, Brenda, China to Modify Environmental Supervision of Firms to Boost Post-coronavirus Recovery, Reuters, 10th March 2020, viewed 21st April 2020, <https://www.reuters.com/article/us-health-coronavirus-china-environment/ china-to-modify-environmental-supervision-of-firms-to-boost-post-coronavirusrecovery-idUSKBN20X0AG>

³ Discharge Permit Expert Talk (1): What is the Cleanup and Rectification of Fixed Pollution Sources? How to do it, MEE, 24th March 2020, viewed 17th April 2020, http://www.mee.gov.cn/ywgz/pwxkgl/gldt/202003/t20200324_770381.shtml

⁴ Sung, Huang-Ming and Dai, Weiping, Environmental Program Changes Increase Burden for Doing Business in China, Trinity Consultants, 10th December 2018, viewed 13th April 2020, <https://www.trinityconsultants.com/news/federal/ environmental-program-changes-increase-burden-for-doing-business-in-china>

⁵ Opinions on Further Strengthening the Control of Plastic Pollution, NDRC, 16th January 2020, viewed 13th April 2020, <https://www.ndrc.gov.cn/xxgk/zcfb/ tz/202001/t20200119_1219275.html>

⁶ Announcement on the Public Solicitation of the Catalogue of Plastic Products Prohibited and Restricted from Production, Sale, and Use (Draft for Comments), NDRC, 10th April 2020, viewed 21st April 2020, https://hd.ndrc.gov.cn/yjzx/yjzx_add.jsp?Siteld=332>



safety and relocation,⁷ accompanied by provincial-level plans to shut down non-compliant companies. Although the working group welcomes an increased emphasis on safety, excessive shutdown measures may also disrupt compliant chemical supply chains. Local governments should therefore avoid a one-size-fits-all approach to closures, and offer transparent and fair criteria for relocation.

The deregulation of China's oil market has progressed over the past year. As of 1st May 2020, foreign enterprises with a total asset value of at least Chinese yuan (CNY) 300 million will be able to participate in oil and gas exploration and production.⁸ The launch of a national oil and gas company, which will merge the pipeline assets of China's state-owned enterprise (SOE) giants while separating transmission and sales businesses, will allow for more market competition for third parties.⁹

Chemicals Management

In January 2019, the MEE released the draft *Regulation* on Environmental Risk Assessment and Control of Chemicals (ERAC),¹⁰ a milestone in Chinese chemical management. The working group recommends the relevant authorities to adopt science-based approaches, in line with European Union (EU) standards such as Risk Management Option Analysis (RMOA),¹¹ to further analyse the intrinsic properties of these diverse groups of chemical and accurately identify which substances deserve control or prohibition. The working group also welcomes the MEE's May 2020 release of Environmental Management Registration Measures for New Chemical Substances (Order 12),¹² which eases new substance reporting requirements compared to its predecessor Order 7. However, the working group hopes that exemptions from notification can be made for lowquantity chemicals used for research and development (R&D) purposes.

1. Sustainability and Green Chemistry

1.1 Ensure the Effective and Well-communicated Implementation of Sustainability Policies for China's Chemical Industry (1)7

Concern

A focus on sustainable practices within the chemical industry is hindered by delays in the rollout of a national emissions trading system (ETS), as well as recent economic and supply chain disturbances.

Assessment

In December 2017, the NDRC launched China's national ETS,¹³ which is expected to become the largest carbon emissions trading programme in the world. It will cover 30 per cent of China's national emissions,¹⁴ deeply transforming the petrochemical and chemical industries. This system represents a major effort to cap carbon dioxide (CO₂) emissions in China. The ETS pilots that currently exist will gradually be integrated into the national system once the latter is finalised.¹⁵

Although the market was expected to enter a trial period in 2019, it has been delayed without adequate notice and explanation. Draft rules were released for public consultation in April 2019—the first official document for ETS trading parameters—nearly one and a half years after the project's announcement.^{16&17} The working group understands the need for a gradual phase-in to ensure proper infrastructure and date accuracy,¹⁸ but

⁷ State Council Security Committee: Comprehensively Carry out Centralised Investigation and Rectification of Dangerous Chemicals Safety Hazards, Xinhua, 25th March 2019, viewed 13th April 2020, <http://www.gov.cn/xinwen/2019-03/25/ content_5376596.htm>

⁸ China Opens Up Oil and Gas Exploration, Production for Foreign, Domestic Firms, Reuters, 9th January 2020, viewed 13th April 2020, https://www.reuters.com/ article/us-china-oil-mining/china-opens-up-oil-and-gas-exploration-production-toforeign-firms-idUSKBN1Z806Q>

⁹ China Announces Plan to Form National Oil & Gas Pipeline Company, Bloomberg, 5th March 2019, viewed 3rd May 2020, <https://www.bloomberg.com/news/ articles/2019-03-05/china-announces-plan-to-form-national-oil-gas-pipelinecompany>

¹⁰ Notice of Public Consultation on the Regulation on Environmental Risk Assessment and Control of Chemicals (Draft for Comments), MEE, 8th January 2019, viewed 13th April 2020, http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/201901/t20190111 689258.html>

¹¹ RMOA, ECHA, viewed 13th April 2020, <https://echa.europa.eu/understandngrmoa>

¹² Environmental Management Measures for New Chemicals (Order 12), MEE, 29th April 2020, viewed 9th May 2020, http://www.mee.gov.cn/xxgk2018/xxgk/xxgk02/202005/t2020057_777913.html

¹³ Chinese National Carbon Trading Scheme (Power Generation Industry), NDRC, 18th December 2017, viewed 21st April 2020, https://www.ndrc.gov.cn/xxgk/zcfb/ghxwj/201712/t20171220_960930.html

¹⁴ Emissions Trading Systems Cover 8 pct of Global Greenhouse Gas Emissions: Report, Xinhua, 20th March 2019, viewed 21st April 2020, <http://www.xinhuanet. com/english/2019-03/20/c_137908045.htm>

¹⁵ Emissions Trading Worldwide: International Carbon Action Partnership (ICAP) – Status Report 2019, ICAP, 2019, viewed 21st April 2020, https://icapcarbonaction.com/en/?option=com_attach&task=download&id=625

¹⁶ China Finally Issues Draft Rules for Carbon Emissions Trading Scheme, South China Morning Post, 4th April 2019, viewed 21st April 2020,

¹⁷ Notice on Public Consultation on the Opinions on the Interim Regulations on the Management of Carbon Emissions Trading (Draft for Comments), MEE, 3rd April 2019, viewed 13th April 2020, <http://www.mee.gov.cn/hdjl/yjzj/wqzj_1/201904/ t20190403_698483.shtml>

¹⁸ China Admits it Still has Work to do Before Carbon Trading Scheme Gets up and Running, South China Morning Post, 26th November 2018, viewed 21st April 2020, https://www.scmp.com/news/china/politics/article/2174999/china-admits-it-still-has-work-do-carbon-trading-scheme-gets-and>

expects a significant lead time for implementation and to make any necessary changes to maximise stakeholder engagement.

In January 2020, an MEE official announced that China would achieve a "breakthrough in progress" before the end of the year.¹⁹ In light of the COVID-19 outbreak, the launch of the national system may be delayed. The working group hopes for more clarification in this regard.

In the long-run, environmental regulation and enforcement will continue to tighten as China builds a "modern environmental governance system".²⁰ However, the working group hopes that these policies will be synchronised with the economic recovery of the chemical sector following the COVID-19 pandemic. Recent financial pressures and serious supply chain disturbances from the virus may threaten the ability of enterprises to carry out their energy saving and CO₂ reduction strategies, which rely on heavy investment and personnel availability for realisation.

National and regional authorities have implemented economic incentives to help affected enterprises recover; the extension of these policies throughout the chemical industry and for a longer period of time will help manufacturers feel stable in their commitment to more resource-intensive sustainability processes. For example, the extension of carryover periods for tax losses incurred in 2020 and carried over from the previous five years (i.e. from 2015 through 2019), from five to eight years, as provided to some industries,²¹ would be of great benefit to petrochemical companies that have suffered from the plunge in international oil prices and imbalance of supply and demand as a result of COVID-19.

Recommendations

- Strengthen cooperation between the government and international businesses and encourage China's central authorities to involve these companies as key stakeholders in policy development.
- Implement the ETS and take further steps to enhance

its legal foundation, transparency and mechanismbuilding.

- Extend preferential economic and tax policies from the COVID-19 pandemic control period for chemical manufacturers to allow them to maintain focus on energy saving and CO₂ reductions despite the massive economic and logistic disturbances.
- 1.2 Promote Sustainability through Best Practice Sharing and Innovation on Safety Management and Environmentally Friendly Practices () 4

Concern

Recent government policies reinforced negative views concerning the state of the chemical industry in China and ignored its significant contributions to promoting a responsible, green and innovative economy.

Assessment

The chemical industry is a key stakeholder in the development of an urgently needed, clear and comprehensive strategy on creating a sustainable green industry. 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 since the 2015 Tianjin incident.²²

National and regional governments have become extremely sensitive towards chemical safety issues.²³ Their concern is legitimate, 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. Yet international chemical companies and large SOEs usually implement comprehensive and sound policies based on Environmental Health and Safety (EHS) Assistant systems. In addition, international firms deploy Responsible Care practices,²⁴ an initiative developed by the International Council of Chemical Associations (ICCA), which China joined in 2014.

¹⁹ China to Make National Carbon Trading 'Breakthrough' by Year-end: official, Reuters, 14th January 2020, viewed 21st April 2020 https://www.reuters.com/ article/us-china-carbon/china-to-make-national-carbon-trading-breakthrough-byyear-end-official-idUSKBN1ZD05N>

²⁰ China to Establish Modern Environmental Governance System, Xinhua, 3rd March 2020, viewed 16th June 2020, http://www.xinhuanet.com/english/2020-03/03/c_138840121.htm

²¹ Announcement on Tax Policies Supporting the Prevention and Control of Pneumonia in New Coronavirus Infections, State Administration of Taxation, 6th February 2020, viewed 10th May 2020, http://www.chinatax.gov.cn/chinatax/n810341/n810755/ c5143465/content.html>

²² Hernandez, Javier C., Tianjin Explosions Were Result of Mismanagement, China Finds, The New York Times, 5th February 2016, viewed 30th June 2020, https://www.nytimes.com/2016/02/06/world/asia/tianjin-explosions-were-result-of-mismanagement-china-finds.html>

²³ State Council Security Committee: Comprehensively Carry out Centralised Investigation and Rectification of Dangerous Chemicals Safety Hazards, Xinhua, 25th March 2019, viewed 15th April 2020, <http://www.gov.cn/xinwen/2019-03/25/ content_5376596.htm>

²⁴ 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, n.d., viewed 15th May 2020, <https://www.icca-chem.org/responsible-care/



Many accidents stem from a lack of risk awareness and knowledge about best practices. The key differences between multinational corporations and domestic companies with respect to their maturity on EHS matters are not being recognised by the authorities, who still insist on a 'one-size-fits-all' approach to the chemical industry.²⁵ To avoid these problems, a formal channel of communication and cooperation between chemical companies and government officials is needed to promote the implementation of responsible and sustainable practices, and improve measures for the prevention of potential incidents. This collaboration should include chemical parks or associations such as the AICM or CPCIF. Practical tips like providing English-language versions of policies and more opportunities for comments and discussion could facilitate communication.

Although the authorities have ambitious plans for greening the economy, promoting innovation and increasing digitisation, these initiatives lack the appropriate mechanisms for facilitating cooperation among companies and institutions. The government should also establish sound and practical communication platforms for encouraging industries to cooperate on reducing their impact on the environment and fully utilising existing resources in an innovative manner, for example, in hazardous waste management.

According to AICM's 2019 Sustainability Report, 82 per cent of surveyed CEOs of European chemical companies operating in China believe it is difficult to implement Responsible Care there, mainly due to the public's lack of science-based understanding of the chemical industry and negative media perceptions that focus on accidents rather than sustainable development achievements.²⁶

Misconceptions about the chemical industry are also reflected in key legislations. In December 2019, the National People's Congress (NPC) released a draft of the Yangtze River Protection Law for public comment.²⁷ The draft labels some chemical sectors and chemical-based products of critical socio-economic importance such as cement, metals and plastic as high pollutants, proposing extreme regulatory measures including

substitution in some applications. If this draft passes without modification, unrealistic obligations will be imposed on backbone industries that actually enable green development. Regulators should avoid baseless bias against specific materials, and ensure they fairly and properly enforce the established EHS standards in the manufacturing process. China already has a full set of comprehensive and effective legislations and standards in place, which if enforced, should be sufficient to ensure that materials are produced in a sustainable manner.

Recommendations

- Encourage scientific and risk-based approaches to formulating safety and environmental policies for chemical enterprises' operations.
- Recognise that there are different levels of maturity of operational practices in the chemical industry, and avoid 'one-size-fits-all' solutions when enforcing compliance.
- Recognise the chemical industry as an essential enabler for green development and thus set up appropriate rules in the upcoming Yangtze River Protection Law to proportionately regulate the operation of downstream industries and the use of chemicalbased materials.
- Establish regular, formal communication channels and cooperation mechanisms between chemical companies and government officials to share experiences, ensure that the voices of chemical companies are reflected in policy-making and help local governments to effectively implement chemical safety and environmentally-friendly policies.
- Create platforms to share and leverage Responsible
 Care principles and promote best practices and innovation in green development, and improve collaboration between domestic and international businesses.
- Define differentiated management methods based on enterprises' maturity and commitment, to save resources for authorities and support sustainability of chemical 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 sustainability of materials' whole lifecycle.

²⁵ AICM Points Out Barriers to Responsible Care in China, Chemical Watch, 28th July 2016, viewed 27th April 2020, <https://chemicalwatch.com/48853/aicmpointsoutharriers-to-responsible-care-in-china>

^{26 2019} AICM Sustainable Development Report, AICM, 4th June 2019, viewed 21st April 2020, <http://aicm.cn/upload/files/20190604/1559634731364010712.pdf>

²⁷ Draft of the Yangtze River Protection Law Begins Public Consultation, NPC, 28th December 2019, viewed 21st April 2020, <http://www.npc.gov.cn/npc/c30834/2019 12/51db1bc6656a4b298e1618781c94eb8f.shtml>

1.3 Improve Policies for Promotion of the Circular Economy Within the Chemical Industry

Concern

China needs stronger institutional management to promote circular innovation within the chemical industry.

Assessment

Around half of global CO₂ emissions come from the extraction and processing of materials that underpin a 'take-make-dispose' economy.²⁸ In its essence, the 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.²⁹ In July 2018, China and the EU signed a joint Memorandum of Understanding on Circular Economy Cooperation, to mutually realise the economic and environmental potential of a transition to a circular economy and implement best practice sharing.³⁰

The circular economy is an emerging model and thus still faces economic challenges, including the need for huge investment in R&D, the development 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. Chinese institutional arrangements on the circular economy so far lack a holistic strategy or management system to efficiently advance on this issue. The success of the circular economy in China necessitates a centrallycoordinated strategy with a clearly defined midand long-term legislation framework, including targets and roadmaps, as well as the involvement of Chinese and EU 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.³¹ The chemical industry is eager

to minimise the environmental footprint of its activities, in particular by making use of the waste generated by its production processes. One example is the use of cogeneration for energy supply optimisation, i.e. the utilisation of co-products as material by other industries, or the transformation of waste into recognised valuable materials.

For example, plastics play a crucial part in sustainable product development,³² but also contribute heavily to pollution and waste if not kept within the circular economy via a mature and efficient domestic recycling system – one which China can now improve in the aftermath of its ban on imported plastic waste in 2018. Many chemical manufacturers, including members of the working group, contribute to global initiatives like the Alliance to End Plastic Waste,³³ and are developing innovative methods such as chemical recycling to turn plastic waste into feedstock for creating new products without using virgin fossil resources.³⁴

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,³⁵ as well as on developing new products that are recyclable by design as the end of their lifespan. This approach will complement the Chinese Government's recent announcement of its policy to drastically reduce the amount of plastic waste, with phased steps to ban the production and sale of disposable, non-degradable plastic products. The policy seeks to promote the use of alternative materials that can be easily recycled, promising fiscal and tax incentives for green products.³⁶ Implementation of these measures should make sure that such preferential policies are applied to manufacturers of strategic new chemicals that contribute to the production of degradable or reusable plastics, and more broadly to sustainable and recyclable products in general.

²⁸ Circular Economy and Material Value Chains, World Economic Forum, n.d., viewed 13th April 2020, https://www.weforum.org/projects/circular-economy/

²⁹ Several Opinions of the State Council on Accelerating the Development of Circular Economy, State Council, 2005, viewed 14th April 2020, http://www.gov.cn/zwgk/2005-09/08/content-30305.htm

³⁰ China-EU Agreement Paves Way for Global Adoption of Circular Economy, Ellen MacArthur Foundation, 16th July 2018, viewed 13th April 2020, <https://www. ellenmacarthurfoundation.org/news/china-eu-agreement-paves-way-for-globaladoption-of-circular-economy>

^{31 2019} AICM Sustainable Development Report, AICM, 4th June 2019, viewed 21st April 2020, <http://aicm.cn/upload/files/20190604/1559634731364010712.pdf>

³² Fitterling, Jim, *Our Indispensable Problem: The Paradox of Modern Plastics*, World Economic Forum, 15th January 2020, viewed 13th April 2020, https://www.weforum.org/agenda/2020/01/the-paradox-of-modern-plastics/

³³ Members, Alliance to End Plastic Waste, n.d., viewed 13th April 2020, <https:// endplasticwaste.org/members/>

³⁴ Chemical Recycling of Plastic Waste, BASF, n.d., viewed 13th April 2020, <https:// www.basf.com/global/en/who-we-are/sustainability/we-drive-sustainable-solutions/ circular-economy/mass-balance-approach/chemcycling.html>

^{35 2019} AICM Sustainable Development Report, AICM, 4th June 2019, viewed 21st April 2020, <http://aicm.cn/upload/files/20190604/1559634731364010712.pdf>

³⁶ Opinions on Further Strengthening the Control of Plastic Pollution, NDRC, 16th January 2020, viewed 13th April 2020, <https://www.ndrc.gov.cn/xxgk/zcfb/ tz/202001/t20200119_1219275.html>



Recommendations

- Create a national platform to promote the implementation of circular economy principles, e.g. re-use of chemical waste as a raw material and energy co-generation.
- Extend preferential economic policies to producers of strategic new emerging chemicals.
- Promote public education on the high potential of recycled plastics to dispel impressions that they are inherently low-quality materials.
- Foster local plastic recycling systems that match the maturity of those in Europe.

2. Investment and Manufacturing Costs

2.1 Guarantee Fair and Reasonable Treatment by Local Authorities with Respect to Relocations and Temporary Closures of Enterprises () 4

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

After the March 2019 explosion in Jiangsu, provincial authorities announced a rapid shutdown plan of Yancheng's Xiangshui Chemical Industrial Park. Following the accident, state media announced that 80 per cent of hazardous chemical production would be relocated to specialised industrial parks by the end of 2020.³⁷ Since then, nearly 1,000 chemical producers have been forced to shut down in Jiangsu and Shandong provinces.³⁸ These unexpected shutdowns can cause large ripples that disrupt raw material supply chains.

Meanwhile, the Yangtze River Protection Law forbids chemical plants from building or expanding within one kilometre of the river. This one-size-fits-all approach will prevent existing plants from carrying out necessary upgrades to high-end or green manufacturing, therefore rendering them uncompetitive in the market. Legislation should ensure that manufacturers meeting EHS standards are treated accordingly.

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)³⁹ air quality control, or major events nearby.⁴⁰

The working group fully understands the pressure over safety and environmental risks; however, this kind of sudden-stop policy focusses on quotas rather than performance,⁴¹ which can damage the chemical supply chain and have negative industrial repercussions. These shutdowns pose not only challenges to a plant's daily operations but also potential safety risks; some plants use carbon monoxide as upstream feedstock, so significant production reduction or plant shutdowns can cause a huge amount of carbon monoxide to burn in flare and be released, ironically resulting in increased carbon emissions.

The State Council's *Circular* [2017] No. 77 on the *Relocation of Hazardous Chemicals Production Enterprises from Urban Populated Areas (Circular* 77)⁴² was a positive step towards making relocation criteria more transparent. The central government's cross-ministry dialogue reflects coordinated efforts to address this relocation issue,⁴³ but such initiatives should involve foreign companies and be replicated within provinces as well. The working group hopes international businesses

³⁷ China Aims to Relocate 80% of Toxic Chemical Producers After Blast: Report, Reuters, 24th May 2019, viewed 17th April 2020, <https://in.reuters.com/article/ china-chemicals/china-aims-to-relocate-80-of-toxic-chemical-producers-afterblast-report-idINKCN1SU0CL?il=0>

³⁸ Wei, Cang, 2 Eastern Provinces Clamp Down on Chemical Plants, China Daily, 9th May 2019, viewed 17th April 2020, http://www.chinadaily.com.cn/a/201905/09/WS5cd37fb3a3104842260baa77.html

³⁹ Hu, Yongqi, Three-year Action Plan Aims for Blue Skies, China Daily, 19th June 2018, viewed 15th April 2020, http://www.chinadaily.com.cn/a/201806/19/WS5b287383a310010f8f59d939.html

⁴⁰ Zhou, Viola, Beijing Under Pressure to Deliver Blue Sky for Party Congress as Smog Arrives Early, South China Morning Post, 4th September 2017, viewed 15th April 2020, <https://www.scmp.com/news/china/society/article/2109652/beijingunder-pressure-deliver-blue-sky-party-congress-smog>

⁴¹ AICM's Suggestion on the 'Emergency Notice on Soliciting Opinions on the Regulation and Improvement Plan for Jiangsu Chemical Industry (Draft for Public Comment)', AICM, 26th April 2019, viewed 15th May 2020, <http://aicm.cn/ download/newsletter>

⁴² Circular on the Relocation of Hazardous Chemicals Production Enterprises from Urban Populated Areas, State Council, 27th August 2017, viewed 15th April 2020, http://www.gov.cn/zhengce/content/2017-09/04/content_5222566.htm

⁴³ The First Meeting of 2019 of the Special Working Group for the Promotion of the Relocation and Transformation of Dangerous Chemical Production Enterprises in Urban Densely-Populated Areas Held in Beijing, MIIT, 12th April 2019, viewed 15th April 2020, <http://www.miit.gov.cn/n1146285/n1146352/n3054355/n3057569/ n3057576/c6786920/content.html>

requested to relocate are treated equally to local companies, receive clear information and relocation criteria, are able to discuss relocation timelines with local authorities to decrease the associated costs, and receive fair compensation after relocating.

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.
- Inform international businesses in advance of relocation criteria and pollution control plans to avoid disrupting chemical supply chains.
- Reach mutual agreement with companies on relocation timelines and fair compensation to decrease associated costs for companies.
- 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 the retail fuel market (1)2

Concern

Despite an increasingly open oil market and signals of opening up the retail fuel sector, regulations and price ceilings continue to hinder foreign investment and the progress towards a competitive retail market.

Assessment

The deregulation of China's oil market has progressed in the past few years. Restrictions limiting foreign investment in petrol stations were lifted,^{44&45} and Shell was the first international oil company (IOC) to be awarded a licence to independently trade in China's wholesale market.⁴⁶ Prices are currently regulated through a system of price caps by the central government and only tenuously linked to international oil prices.⁴⁷ There have been several positive signals in recent years that suggest the government intends to deregulate the retail fuel sector. The *Several Opinions on Deepening Oil and Gas Sector Reform (Opinions)*, released by the State Council in May 2017,⁴⁸ advocated a central role for the market in guiding oil prices. However, the actions encouraged by the *Opinions* have not been forthcoming.⁴⁹

Deregulating oil prices and removing price ceilings would deliver a competitive retail market in China, with several key benefits. The first would be to support 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.⁵⁰ 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.⁵¹ Meanwhile, the low oil prices as a result of the COVID-19 epidemic and the oil price war⁵² provide a favourable window to launch deregulation measures.

Recommendations

 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.

48 Six Aspects of the 'Opinions on Deepening the Reform of the Oil and Gas System', China Law Info, 22nd May 2017, viewed 15th April 2020, http://www.chinalawinfo.com/News/NewsFullText.aspx?NewsId=85728>

49 Lelyveld, Michael, China's Oil Industry Reform Falls Short, Radio Free Asia, 12th June 2017, viewed 15th April 2020, https://www.rfa.org/english/commentaries/ energy_watch/chinas-oil-industry-reform-falls-short-06122017105651.html>

51 Zheng, Xin, BP to Invest More in Outlets, China Daily, 13th August 2018, viewed 15th April 2020, http://www.chinadaily.com.cn/a/201808/13/WS5b70dfcba310add14f385598.html>

⁴⁴ Zheng, Xin, Shell to Expand Nationwide Gas Station Network, China Daily, 23rd August 2018, viewed 15th April 2020, http://www.chinadaily.com.cn/a/201808/23/WS5b7e0a04a310add14f387447.html

⁴⁵ China Removes Limits on Foreign Ownership of Gas Stations, Caixin, 30th June 2018, viewed 30th June 2020, <https://www.caixinglobal.com/2018-06-30/chinaremoves-limits-on-foreign-ownership-of-gas-stations-101288799.html>

⁴⁶ Zeng, Lingke and Han, Wei, Shell Unit Gets Nod to Tap China's Wholesale Oil Market, Caixin, 3rd January 2019, viewed 15th April 2020, https://www.caixinglobal.com/2019-01-03/shell-unit-gets-nod-to-tap-chinas-wholesale-oil-market-101365787.html>

⁴⁷ China Sets Floor for Retail Fuel Pricing, State Council, 13th January 2016, viewed 15th April 2020, <http://english.gov.cn/news/top_news/2016/01/13/ content_281475271410529.htm>

⁵⁰ China Gasoline Retailing Development Trends Report 2019, Deloitte, May 2019, viewed 15th April 2020, https://www2.deloitte.com/content/dam/Deloitte/cn/Documents/energy-resources/deloitte-cn-er-china-gasoline-retailing-development-trends-report-en-190527.pdf>

⁵² Brower, Derek, Raval, Anjli, Seppard, David and Meyer, Gregory, *Eight Days That Shook the Oil Market — and the World, Financial Times*, 13th March 2020, viewed 8th June 2020, <https://www.ft.com/content/c9c3f8ac-64a4-11ea-a6cddf28cc3c6a68>



Assessment

LPG is one example of government regulation preventing market competition. The biggest proportion of LPG usage in China 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 CNY 25 to cover labour, cylinder, production and transportation costs, as well as depreciation, safety management fee, sales and management costs, tax, among other external expenses.⁵³

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 mid-April Shanghai's⁵⁴ price per cylinder was CNY 83, compared to CNY 148 in Nanjing,⁵⁵ CNY 110 in Hangzhou,⁵⁶ and between CNY 90–120 in Huzhou depending on the marketplace.⁵⁷ This price regulation prevents LPG retail companies from being profitable.

Recommendations

 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.

3. Chemicals Management

3.1 Develop a Well-debated and Practical Legislation Framework for Chemical Risk Management (1)7

54 Notice of Shanghai Municipal Development and Reform Commission on Adjusting the Maximum Retail Price of Cylinder LPG for Civil Use, Shanghai DRC, 10th April 2020, viewed 10th April 2020, <http://fgw.sh.gov.cn/jgl/20200410/ 5eb419793dd243cebc82ec1d9d410425.html>

Concern

The MEE's *ERAC* has proposed several lists of substances for priority assessment or control, but a lack of further guidance for determining risk management measures limits predictability within the chemical industry.

Assessment

China's top legislative bodies and major chemical regulators have long been aware of the urgent need for a comprehensive and well-coordinated legislative framework for chemical management. The State Council released the *Regulation on Safety Management of Hazardous Chemicals* in 2002,⁵⁸ which was updated in 2011.⁵⁹ In 2015, the MEM adopted the *Catalogue of Hazardous Chemicals* to manage 2,828 chemicals with significant toxic, explosive, corrosive and/or flammable properties.⁶⁰

In January 2019, the MEE released its draft *ERAC*,⁶¹ the first Chinese chemical management legislation to encompass both new and existing chemicals. Besides reconfirming the already established *Inventory of Existing Chemical Substances in China*, the *List of Strictly-restricted Chemicals*, the *List of Prohibited Chemicals* and the new chemical registration procedure, the draft also mandates 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.

Substances on these lists are subject to special regulatory controls. Prohibited chemicals cannot be manufactured, processed, used, imported or exported. Strictly-restricted chemicals are only allowed for authorised applications and their import-export is subject to both Chinese Government permission and

⁵³ 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, 9th May 2017, viewed 10th April 2020, <http://pkulaw.cn/fulltext_ form.aspx?Gid=18052366&Db=lar>

⁵⁵ Price confirmed by Nanjing Baijiang Liquefied Gas Co Ltd. hotline 95007, 13th April 2020

⁵⁶ Price confirmed by Hangzhou Xiaoran Gas Distribution Service Co Ltd. WeChat page, 13th April 2020

⁵⁷ April 7, 2020 Retail Price Monitoring Table for Consumer Goods of Some Residents in Counties and Districts, Development and Reform Commission of Huzhou Municipality, 7th April 2020, viewed 16th April 2020, <http://fgw.huzhou. gov.cn/2018-fzgggz/jgzc/jcyj/20200407/i2659854.html>

⁵⁸ Hazardous Chemicals Safety Management Regulations, State Council, 26th January 2002, viewed 15th April 2020, <http://www.gov.cn/gongbao/content/2002/ content_61929.htm>

⁵⁹ Hazardous Chemicals Safety Management Regulations (Order No. 591 of the State Council), State Council, 2nd March 2011, viewed 15th April 2020, http:// www.gov.cn/flfg/2011-03/11/content_1822902.htm>

⁶⁰ Catalogue of Hazardous Chemicals, Chemical Inspection and Regulation Service, 9th March 2015, viewed 15th April 2020, http://www.cirs-reach.com/pdf/ Catalog_of_Hazardous_Chemical_2015_CN.pdf

⁶¹ Notice of Public Consultation on the Regulation on Environmental Risk Assessment and Control of Chemicals (Draft for Comments), MEE, 8th January 2020, viewed 15th April 2019, <http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/201901/ t20190111_689258.html>

international Prior Informed Consent (PIC).⁶² The control options for *Chemicals with Priority Control* are more complicated, including mandatory clean production review, application authorisation/restrictions, and concentration restrictions in end products. Discharging substances that are defined as toxic or harmful contaminants requires a PDP and complete self-monitoring records.

Within chemical management, legislation and enforcement should be science-based and proportionate to avoid stigmatisation of certain elements, as well as to share scientific knowledge with the public. 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. The working group welcomes the MEE and NHC's recent joint release of the Framework Guidance for the Technical Approaches of Chemical Risk Assessment, 63 which adopts science-based approaches and recognises the specificities of some substances, like metals. The EU's RMOA could likewise indicate the appropriate risk management measures. Chemicals listed for priority assessment should not be automatically subject to priority control without additional analysis and a process for public consultation, as best operational practices can prevent risks more effectively. The working group encourages the MEE to work with chemical industry stakeholders to update the List of Chemicals for Priority Control and develop RMOA guidance for effective chemical prioritisation and selection of risk management measures.

In May 2020, the MEE released the *Environmental Management Registration Measures for New Chemical Substances (Order 12)*⁶⁴ to replace its 2010 predecessor Order 7.⁶⁵ New substances produced or imported in quantities under one tonne per year and polymers of low concern are now only subject to record-filing notification. The new measures simplify the reporting procedure, which could reduce compliance costs if chemical authorities at all levels enforce the measures properly. The working group expects that some new chemical and hazardous chemicals (HC) can be exempted after reasonable risk assessment; for example, exemption from the notification process for new chemical substances under 0.1 metric tonnes (100 kgs) per year for R&D purposes, as was included in draft revisions but removed from the final text. Reducing the notification requirements for new chemicals and waiving HC registration for low volumes for research purposes in the laboratory would encourage scientific research and innovation within the industry.

The working group awaits official release of the text for a recent law proposed by the MEM to strengthen the management of HC, which would lead to more obligations for industry players.⁶⁶ The working group encourages simplified administrative procedures and delegated powers throughout all levels of government to reduce repeated data input and the administrative burden on authority and enterprises. The National Registration Centre for Chemicals (NRCC) recently expanded its system to include registration for enterprises that use hazardous chemicals in their operations.⁶⁷ However, there are still no clear legal provisions for the new version of the system; for example, on how enterprises that both produce/import and operate hazardous chemicals should register. A clearer explanation on the terms of use would be more conducive to enterprise compliance, reasonable business development and behaviour standardisation.

Recommendations

- Develop detailed criteria to determine substances for priority evaluation or control, with proportionate control options.
- Encourage enterprises to actively participate in risk assessment discussions with the government, working towards an agreement by which companies play a critical role in protecting intellectual property rights and economic benefits.
- Develop RMOA guidance to guide regulators at all levels and supply chain players to select appropriate risk management measures for priority chemicals, and avoid sweeping bans or restrictions of certain

⁶² Understanding PIC, ECHA, n.d., viewed 5th June 2020, <https://echa.europa.eu/ regulations/prior-informed-consent/understanding-pic>

⁶³ Notice regarding the issuance of the "Framework Guidelines for Technical Methods of Environmental Risk Assessment of Chemical Substances (Trial)", NHC, 16th September 2019, viewed 20th March 2020, <http://www.nhc.gov.cn/jkj/ s5878/201909/f52216d8dc7d434d84c54038acab6ce2.shtml>

⁶⁴ Environmental Management Measures for New Chemicals (Order 12), MEE, 29th April 2020, viewed 9th May 2020, http://www.mee.gov.cn/xxgk2018/xxgk/xxgk02/202005/t20200507_777913.html

⁶⁵ Measures for Environmental Administration of New Chemical Substances (Order 7), MEE, 19th January 2010, viewed 11th June 2020, <http://www.gov.cn/ gongbao/content/2010/content_1671246.htm>

⁶⁶ Daliday, Ellen, China Consults Government on Draft Law to Replace Decree 591, Chemical Watch, 23rd January 2020, viewed 20th March 2020, https://chemicalwatch.com/89857/china-consults-government-on-draft-law-to-replace-decree-591>

⁶⁷ Hazardous Chemicals Registration Information System, NRCC, n.d., viewed 26th April 2020, <http://register-mhi.nrcc.com.cn/report/images/illustrate.pdf>



substances through a risk-based approach that takes into account both hazards and exposure.

- Create low-volume exemptions for new chemical R&D notification and HC registration.
- Focus on chemicals with large volumes and high environmental risk for information reporting, reduce the frequency of reporting and optimise the HC registration process to be more user-friendly and reduce the administrative burden on authorities and enterprises.
- Formulate corresponding comprehensive laws and regulations for the new version of the HC registration management system.

Abbreviations

| AICM | Association of International Chemical |
|-----------------|---|
| | Manufacturers |
| CNY | Chinese Yuan |
| CO ₂ | Carbon Dioxide |
| COVID-19 | Coronavirus Disease 2019 |
| CPCIF | China Petroleum and Chemical Industry |
| | Federation |
| ECHA | European Chemicals Agency |
| EHS | Environment, Health and Safety |
| ERAC | Regulation on Environmental Risk |
| | Assessment and Control of Chemicals |
| ETS | Emissions Trading System |
| EU | European Union |
| HC | Hazardous Chemicals |
| ICAP | International Carbon Action Partnership |
| ICCA | International Council of Chemical |
| | Associations |
| IOC | International Oil Company |
| Kg | Kilograms |
| LPG | Liquefied Petroleum Gas |
| MEE | Ministry of Ecology and Environment |
| MEM | Ministry of Emergency Management |
| MIIT | Ministry of Industry and Information |
| | Technology |
| NDRC | National Development and Reform |
| | Commission |
| NHC | National Health Commission |
| NPC | National People's Congress |
| NRCC | National Registration Centre for |
| | Chemicals |
| PCR | Petrochemicals, Chemicals and |
| | Refining |
| | |

| PDP | Pollution Discharge Permit |
|------|---------------------------------|
| PIC | Prior Informed Consent |
| R&D | Research and Development |
| RMOA | Risk Management Option Analysis |
| SAMR | State Administration for Market |
| | Regulation |
| SOE | State-owned Enterprise |

Pharmaceutical Working Group

Key Recommendations

- 1. Further Advance Regulatory Harmonisation and Convergence with International Standards (1)
 - Apply National Medical Products Administration's (NMPA's) experience in the International Conference on Harmonization of Technical Requirements for Registration of Pharmaceuticals for Human Use (ICH) Management Committee to join Pharmaceutical Inspection Cooperation Scheme (PIC/S) as a formal member in order to further advance China's regulatory harmonisation and convergence with international standards in its overseas Good Manufacturing Practices (GMP) audits and inspections.
 - Establish a clear roadmap to adopt international harmonised standards in drug traceability for the supply chain integrity and efficiency.
 - 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.

2. Coordinate Different Measures for Intellectual Property (IP) Protection and Ensure Their Adequate Implementation (3)

- Immediately implement the six-year Regulatory Data Protection (RDP) rule under the existing *Implementation Regulation of the Drug Administration Law*.
- Set up a clear timetable to launch implementation rules for RDP and Patent Term Extension (PTE).
- Give more room to the pharmaceutical industry to participate in the policy-making process and contribute to the formulation and successful implementation of IP protection laws and regulations.
- Establish an implementation timeline for the introduction of the mechanism for early resolution of patent disputes specified in the US-China Phase One Trade Agreement.
- Address the protection and enforcement of IPR for the pharmaceutical industry in the European Union (EU)-China Comprehensive Agreement on Investment (CAI) with a clear implementation timeline, especially regarding patent rights and RDP.
- Ease the criteria for submission of post-filing data in patent prosecution and invalidation laid out in the *Patent Examination Guidelines*.

3. Continuously Improve Rare Disease Policy to Ensure Patients' Access to Medicines

- Establish a central office responsible for rare diseases management in order to improve and strengthen inter-ministerial communication and coordination.
- Clarify the criteria for inclusion of rare diseases and take the industry feedback into account in order to expand the National Drug Reimbursement List (NRDL).
- Include more rare disease drugs in the coming NRDL adjustment or establish a special national fund to aid rare disease patient treatment in order to improve the affordability of their drugs.
- Establish national and provincial rare diseases special funds with a reimbursement framework based on patients' economic status to solve out-of-pocket expenditure.
- Integrate relevant social resources, such as charity funds, in the funding of orphan drugs.
- Set up related commercial insurance with government support for ultra-rare-diseases drugs.



4. Maintain Regular Listing and Promote Negotiation Listing in the NRDL Dynamic Updates to Promote Medical Insurance System Reform

- 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 before specified NRDL update kick-off dates.
- Establish communication channels with the industry to allow pharmaceutical companies throughout the process 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.
- Accelerate the inclusion of the single pill combination (SPC) in the NRDL to improve chronic disease management, especially hypertension and diabetes.
- 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 <a>2
 - Set up a drug selection mechanism to ensure the scope of the national VBP drug list be limited to drugs that have passed the Generic Quality Consistency Evaluation (GQCE) and that the numbers and capacity of GQCE manufacturers fully meet clinical needs.
 - Ensure that all biomedicines in the VBP meet strong and specific scientific, clinical and quality standards, considering the high risks of treatment replacement for patients.
 - Steadily promote the implementation of the second round of VBP and suspend any new round of VBP until Coronavirus Disease 2019 (COVID-19) is fully under control.
 - Reasonably determine the purchase quantity of the drugs in the VBP list and allow more than two winning companies in hospital alliances to ensure drug supply.
 - Respect the opinions of doctors, patients and hospitals, improve the decision-making mechanism for procurement volumes, and clarify that hospitals can purchase and use other products through online procurement of drugs.
 - Retain a reasonable amount of surplus products, rather than simply controlling or limiting proportions
 of use, in light of the specificities of different diseases as well as the maturity and growth levels of
 different product markets.
 - Apply fair competition principles to unselected products that participated in the VBP bidding instead
 of gradual price reductions or setting price limits, and avoid compulsive or disguised reduction of
 unselected products by administrative measures.
 - Clarify rules for substituting disqualified drugs, stringently assess the quality of the selected drugs and formulate relevant measures to closely monitor their use, in order to protect patients.
 - Closely monitor the clinical safety, effectiveness, compliance and patients' self-evaluation of changing from the original drugs to the VBP-winning drugs.



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- Develop evaluation indicators to provide a comprehensive assessment of the effectiveness of the VBP and invite all relevant stakeholders including medical institutions, medical personnel, patients, drug manufacturers and distributors to provide feedback in order to improve practice in the future.
- 6. Build a Favourable and Effective Regulatory Environment for Accelerating the Accessibility of Innovative Vaccines in China <a>2
 - Reform China's procurement criteria and process to include all NMPA-approved vaccines, imported and locally manufactured, for its National Immunisation Programmes (NIPs), to enable access for more innovative vaccines and build a more sufficient and sustainable supply to address public health needs.
 - Build a favourable and effective regulatory environment for innovative vaccines, including but not limited to International Multi-centres Clinic Trial (IMCT) and Oversea Marketing Authorisation (OMA), in order to reduce current delays of six years in addressing public health demands with new innovative vaccines.
 - Promote the harmonisation of the Chinese Pharmacopeia (ChP) with international standards.

Introduction to the Working Group

The Pharmaceutical Working Group represents approximately 35 international pharmaceutical manufacturing companies operating in China. 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

In 2019, China continued to deepen its healthcare reform and introduced a series of policies and measures to encourage cost-control integration and innovation. Costcontrol integration policies have further promoted generic quality consistency evaluation (GQCE), expanded nationwide volume-based procurement (VBP) to cover more provinces, updated the National Reimbursement Drug List (NRDL), and launched a diagnosis related groups (DRG) pilot. In addition, with encouraged innovation, the Marketing Authorisation Holder system was established in the newly-revised Drug Administration Law, and the registration and approval process of new anti-cancer drugs was accelerated.

The conclusion of the United States (US)-China 'Phase One' Trade Agreement in January 2020 was also welcomed by the foreign pharmaceutical companies.¹ Specifically, China committed under the agreement to implement intellectual property (IP) provisions such as patent term extension (PTE) for certain innovative drugs, an issue that the European pharmaceutical industry has been advocating for many years.

With the outbreak of the Coronavirus Disease 2019 (COVID-19), the healthcare industry is once again at the centre of the public gaze. With the pandemic being the foremost global humanitarian challenge, governments and industry are working hand-in-hand to better understand and address this unprecedented health crisis. On 14th February 2020, Chinese President Xi Jinping called for major improvements of the national public health emergency management system, through the revision of laws and regulations in the public health sector, to protect the safety and health of

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¹ Economic and Trade Agreement Between the Government of the United States of America and the Government of the People's Republic of China, 15th January 2020, viewed 10th April 2020, <https://ustr.gov/sites/default/files/files/files/agreements/ phase%20one%20agreement/Economic_And_Trade_Agreement_Between_ The_United_States_And_China_Text.pdf>



the people.² According to a survey conducted in mid-February 2020 among 104 China-based domestic and foreign pharmaceutical top executives and investors, the healthcare sector is anticipated to be a key area of emphasis in the upcoming 14th Five-year Plan, especially with regards to healthcare services, hospitals and the approach to disease prevention and education of the population as a whole. Expectations are also that there will be resources allocated to research and development (R&D), enabling pharmaceutical companies to engage and deploy the necessary programmes covering China's key health and disease areas.³ In the short-term, vaccines, anti-virus drugs, infectious disease research and online medical diagnosis will become hot spots in the market.

The working group is impressed by the achievements of the Chinese authorities in dealing with this unprecedented public health emergency and containing the further spread of COVID-19 in China.

The European pharmaceutical industry is fully committed to combating this unprecedented health crisis. By 3rd February 2020, the members of the Pharmaceutical Working Group had donated a total of Chinese yuan (CNY) 659 million (euro (EUR) 81 million) in cash and medical supplies to the Chinese efforts to combat the spread of the virus.

At present, the working group's main contribution to combat the public health crisis is to ensure the continuity of manufacture and supply of essential drugs and vaccines to Chinese patients. The industry is also actively engaged in the research of innovative therapies and vaccines to combat the pandemic.

To achieve the goal of further improving public health and preventing future healthcare crisis, the working group is committed to cooperate with the Chinese health authorities and support the development of regulations to improve the supply continuity of medicinal products, and accelerate the accessibility of innovative products for Chinese patients. Several important regulations and documents issued since the second half of 2019 are worth noting:

- The issuance of the Opinions on the Implementation of Expanding Pilot Areas of State-organised Centralised Drug Procurement and Usage by nine ministries, including the National Healthcare Security Administration (NHSA) and National Health Commission (NHC) on 25th September 2019.⁴
- The issuance of the DRG Payment National Pilot Technical Specification and Grouping Scheme by the NHSA in October 2019.⁵
- The inclusion of drugs negotiated in Category B of the NRDL under the Basic Medical Insurance (BMI), Occupational Injury Insurance and Maternity Insurance Programmes by the NHSA in November 2019.⁶
- The launch of the revised Drug Administration Law by the National People's Congress (NPC) on 26th August 2019. The Law took effect on 1st December 2019.⁷
- The issuance of the Notice on Building the Vaccine Information Traceability System jointly by the NMPA and the NHC on 13th December 2019.⁸
- The issuance of the Notice on the Release of Guidelines for Real World Evidence in Support of Drug Research and Development and Review (Trial) (No.1 2020) by the NMPA on 7th January 2020.⁹
- The call for public consultation on the Interim Measures on Healthcare Insurance Management of Retail Pharmacies (draft) by the NHSA on 22nd January 2020.¹⁰



² General Secretary Xi Jinping Chairs 12th Meeting of Central Commission for Comprehensively Deepening Reform, Ministry of Foreign Affairs, 14th February 2020, viewed 21st July 2020, <https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/ t1745270.shtml>

³ Snapshot Survey of COVID-19 Impact on China Pharma Industry, Deloitte, February 2020, viewed 10th April 2020, <https://www2.deloitte.com/cn/en/pages/ life-sciences-and-healthcare/articles/pharma-industry-survey-results-2019-ncov. html>

⁴ Opinions on the Implementation of Expanding Pilot Areas of State-organised Centralised Drug Procurement and Usage by Nine Ministries including NHSA, NHSA, 30th September 2019, viewed 10th April 2020, <http://www.nhsa.gov.cn/ art/2019/9/30/art_37_1817.html>

⁵ Issuance of the DRG Payment National Pilot Technical Specification and Grouping Scheme, NHSA, 24th October 2019, viewed 10th April 2020, <http:// www.nhsa.gov.cn/art/2019/10/24/art_14_1874.html>

⁶ Notice on the Inclusion of Drugs Negotiated in the Category B of NRDL under the BMI, Occupational Injury Insurance and Maternity Insurance Programs, NHSA, 28th November 2019, viewed 10th April 2020, <http://www.nhsa.gov.cn/ art/2019/11/28/art_37_2050.html>

⁷ Drug Administration Law of the People's Republic of China, NPC, 26th August 2019, viewed 10th April 2020, http://www.npc.gov.cn/npc/c30834/201908/26a6b28dd83546d79d17f90c62e59461.shtml>

⁸ Notice of NMPA and NHC on Building Vaccine Information Traceability System, State Council, 13th December 2019, viewed 10th April 2020, <http://www.gov.cn/ fuwu/2019-12/13/content_5460805.htm>

⁹ Notice on the Release of Guidelines for Real World Evidence in Support of Drug Research and Development and Review (Trial) (No. 1 of 2020), China Center for Food and Drug International Exchange (CCFDIE), 7th January 2020, viewed 10th April 2020, http://www.ccpie.org/cn/yjxx/yphzp/webin fo/2020/01/1573207428041366.htm>

¹⁰ Call for Comments on the Interim Measures for the Management of Medical Security in Medical Institutions (draft) the Interim Measures on Healthcare Insurance Management of Retail Pharmacies (draft), NHSA, 22rd January 2020, viewed 10th April 2020, <http://www.nhsa.gov.cn/art/2020/1/22/art_48_2283.html>

- The publication of Opinions on Deepening the Reform of Healthcare Security System by the State Council on 25th February 2020.¹¹
- The issuance of the Administrative Measures of Drug Production and Supervision, and Administrative Measures of Drug Registration by the NMPA on 30th March 2020.¹²⁸¹³

The 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 continue improving access to innovative drugs for the whole population.

Key Recommendations

1. Further Advance Regulatory Harmonisation and Convergence with International Standards

Concern

Although China has made significant progress in fulfilling its commitment as a member of the International Conference on Harmonisation of Technical Requirements for Registration of Pharmaceuticals for Human Use (ICH), and will benefit from implementing the ICH guidelines in the long run, 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 joining the ICH Management Committee, the NMPA released a roadmap specifying the timelines for implementing the ICH guidelines. This roadmap included targets for making it mandatory to submit adverse events according to the ICH E2B (R3) standard for electronic data transmission. For example, pharmaceutical companies have been required to submit serious adverse events reported from clinical trials in an interim system since May 2018, and submit post-approval reports into a system to be developed by July 2022.¹⁴ The draft of the *E2B (R3) Implementation Guide* customised for China (describing differences with *E2B (R3) Core Elements*) was released for public comments in May 2019 and finalised in November 2019.^{15&16} This shows a significant improvement in China actively fulfilling its commitment to the ICH. China will eventually benefit from the implementation of the ICH guidelines in drug innovation and registration, speeding up reviews and approvals, and strengthening the life-cycle management of drugs.

In addition, 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, the lack of adoption of internationally recognised standards in its overseas GMP audits and inspections is a major concern for the industry, as it may put European pharmaceutical companies in a disadvantaged position, and ultimately limit patients' and doctors' access to high guality drugs. Therefore, the industry recommends the NMPA draws on its experience in the ICH and join a globally recognised inspection organization such as the Pharmaceutical Inspection Cooperation Scheme (PIC/S). The mission of the PIC/S is to lead the international development, implementation and maintenance of harmonised GMP standards and quality systems of inspectorates in the field of medicinal products.¹⁷ As of June 2020, PIC/S has 53 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 (USFDA), Australian Therapeutic Goods Administration, British Medicines and Healthcare Products Regulatory Agency, and Japanese Pharmaceuticals and Medical Devices Agency.¹⁸ By joining the PIC/S, China will

¹¹ State Council Opinions on Deepening the Reform of Healthcare Security System, State Council, 5th March 2020, viewed 10th April 2020, http://www.gov.cn/zhenace/2020-03/05/content-5487407.htm

¹² Administrative Measures of Drug Production and Supervision, State Administration for Market Regulation (SAMR), 30th March 2020, viewed 10th April 2020, <http://gkml.samr.gov.cn/nsjg/fgs/202003/t20200330_313672.html>

¹³ Administrative Measures of Drug Registration, SAMR, 30th March 2020, viewed 10th April 2020, <http://gkml.samr.gov.cn/nsjg/fgs/202003/t20200330_313670. html>

¹⁴ CFDA Announcement on the ICH Level II Guideline, China-Japan Pharmaceutical Information, 29th January 2018, viewed 3rd August 2020, http://www.cjpi.org.cn/ zryyxxw/yaop/cfdatz/webinfo/2018/01/1515087120886527.htm>

¹⁵ NMPA's Notice on Public Consultation on the Post-Market Individual Case Safety Reports (ICSRs) E2B (R3) Implementation Guide (Draft for Comment), CCFDIE, 31st May 2019, 3rd August 2020, http://www.ccpie.org/cn/yjxx/yphzp/webinfo/2019/05/1560671808241787.http://www.ccpie.org/cn/yjxx/yphzp/

¹⁶ Notice on Publishing the Post-Market Individual Case Safety Reports (ICSRs) E2B (R3) Implementation Guide, NMPA's Center for Drug Reevaluation, 22nd November 2019, 3rd August 2020, http://www.cdr-adr.org.cn/drug_1/ICHzd_1/ICH E2B/201911/t20191122 46834.html>

¹⁷ Mission, Vision and Values, PIC/S website, viewed 10th April 2020, <https://www. picscheme.org/en/mission-vision-and-values>

¹⁸ Introduction of PIC/S, PIC/S website, viewed 10th April 2020, <https://www.picscheme.org>



benefit from participating in the development and harmonisation of international GMP guides and guidelines, networking and sharing information with other regulatory inspectors, as well as receiving timely notifications regarding quality defects of batches of medicinal products that have been distributed from the PIC/S Rapid Alert and Recall System.¹⁹

In the context of COVID-19, using international standards on the traceability of drugs and vaccines has become increasingly important. The United Nations International Children's Emergency Fund (UNICEF) and the World Health Organization (WHO) have recognised the benefits of the use of harmonised global or international identification and serialisation standards on vaccines to improve visibility and traceability.

Since 2015, UNICEF has recommended the use of Global Standards 1 (GS1) on secondary packaging of vaccines. The Global Alliance for Vaccines and Immunisation (GAVI) also requires GS1 data and barcode standards on secondary packaging to improve product identification, labelling, and data exchange within the immunisation supply chain.

From 1st October 2019, vaccine tenders backed by GAVI financing issued by UNICEF are required to have GS1 barcoding on secondary packaging by 31st December 2021.²⁰

Since August 2019, the NMPA has published ten guidance documents on building a traceability system for drugs and vaccines, accepting multiple coding standards including international ones. Compared with the previous national e-coding system, this is certainly a positive development.

However, since there are only six months available from the release of the documents to their full implementation, it is extremely challenging for the drug and vaccine manufacturers, as well as all parties involved in the supply chain, to have enough time to upgrade their software and hardware and conduct verification of the new systems, not to mention find funding—in the current epidemic situation—to adjust the old national e-coding systems. The operational complexity is amplified further due to multiple codes in the downstream, especially hospitals and pharmacies which are critical for patients' safety.

Therefore, the working group recommends establishing a clear roadmap to adopt international harmonised standards in drug and vaccine traceability to ensure supply chain integrity and efficiency, and provide enough time for manufacturers and all parties involved in the supply chain to switch to international standards, starting from imported/exported drugs.

Recommendations

- Apply NMPA's experience in the ICH Management Committee to join PIC/S as a formal member in order to further advance China's regulatory harmonisation and convergence with international standards in its overseas GMP audits and inspections.
- Establish a clear roadmap to adopt international harmonised standards in drug traceability for the supply chain integrity and efficiency.
- 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.
- 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 and the provisions laid out in the US-China Phase One Trade Agreement, the detailed rules, which are key for any policy's successful implementation, have yet to be decided.

Assessment

China has recently been actively encouraging basic research, drug discovery and clinical development in the life science industry. Since July 2015, the former China Food and Drug Administration (CFDA) (now the NMPA) has issued a series of policies and regulations that optimise review and approval procedures of new pharmaceutical products. China is at a critical stage, as it moves towards its ultimate goal of evolving from the role of a generic producer to that of a pharmaceutical



¹⁹ Benefits, PIC/S website, viewed 10th April 2020, <https://www.picscheme.org/en/ benefits>

²⁰ GAVI Announcement: Vaccine Manufacturer GS1 Compliance, UNICEF, 10th September 2019, viewed 10th April 2020, <https://www.unicef.org/supply/stories/ gavi-announcement-vaccine-manufacturer-gs1-compliance>

innovator. High risk, large investment and long periods of time are characteristic of the R&D of new drugs, but the results, i.e., the new drug, are easily copied. Therefore, IP protection is the backbone for an innovation-driven pharmaceutical industry.

In the past three years, the Chinese Government has published several policies to strengthen drug IP protection. In May 2017, the former CFDA published the draft document Encourage Innovation of Drugs and Medical Devices, Rights of Innovators (Document No. 55).²¹ In October 2017, the Central Committee of the Communist Party of China and the State Council jointly published the document Opinions on Deepening the Reform of Evaluation and Approval to Encourage Innovation of Drugs and Medical Devices (Opinions).²² On 13th April 2018, the State Council called for extending patent protections by a maximum of five years if a manufacturer applies for parallel registration for its innovative drugs in China and abroad. On 25th April 2018, the NMPA published the draft Regulations on Protection of Drug Study Data for public consultation.²³ On 4th January 2019, the NPC released draft amendments to the Patent Law-which includes PTE for invention patents of innovative drugs-for public comment.²⁴ In particular, both effective patent protection and regulatory data protection (RDP) play essential roles in incentivising and fostering sustainable pharmaceutical innovation by rewarding drug innovators with a specified period of market exclusivity.

On 15th January 2020, China signed the US-China Phase One Trade Agreement, which contains several provisions to reinforce IP protection for the pharmaceutical industry in China. These commitments include the establishment of an effective patent linkage mechanism, the admissibility of post-filing data submitted during patent prosecution and invalidation to demonstrate patentability and validity, the granting of PTE for pharmaceutical products, and the removal of licensing or administrative procedures that may require technology transfers from foreign to Chinese entities.²⁵

The working group is encouraged by the recent policies and the proposed amendments to the Patent Law to encourage innovation and strengthen IP protection. The working group believes that establishing a multilevel protection mechanism, which includes patents and RDP, will help China become a medical power and a major pharmaceutical innovator.

Despite these encouraging legal and policy developments, recently, 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. Over ten generic drugs were approved by the NMPA in 2019 even though the originators' compound patents were still in force. Meanwhile, it seems still guite challenging for drug originators to obtain a timely preliminary injunction from the courts before an infringing generic product is launched in the market. It was also noted in 2019-only two to four years after some originator drugs were approved in China-that some generic competitors were approved by the NMPA, regardless of the six-year RDP drug originators are entitled to under the Implementation Regulations of the Drug Administration Law.

The working group is convinced that the respect and protection of drug originator's IP rights, including both patent and RDP rights laid out by the existing laws and regulations, is paramount to foster pharmaceutical innovation, which ultimately benefits patients. In addition, the industry strongly recommends setting up a clearer timetable regarding the publication of PTE and RDP implementation rules, as well as the mechanism for early resolution of patent disputes. It is of utmost importance that China creates a predictable regulatory environment so that companies can plan their research and launch efforts accordingly. In the process of forming a multi-level protection mechanism, the working group also wants to have greater opportunities for making suggestions and contributing to the formulation and successful implementation of IP protection rules and regulations.

²¹ Encourage Innovation of Drugs and Medical Devices, Rights of Innovators, State Council, 12th May 2017, viewed 10th April 2020, <http://www.gov.cn/ xinwen/2017-05/12/content_5193269.htm>

²² Opinions on Deepening the Reform of Evaluation and Approval to Encourage Innovation of Drugs and Medical Devices, State Council, 8th October 2017, viewed 10th April 2020, <http://www.gov.cn/xinwen/2017-10/08/content_5230105. htm>

²³ NMPA Call-for-Comments on the Measures for the Implementation of Drug Test Data Protection (Provisional), China Pharmaceutical Information, 27th April 2018, viewed 10th April 2020, <http://www.cpi.ac.cn/publish/default/foradivce/ content/2018042713045718739.htm>

²⁴ Call for Comments on Amendment of Patent Law (draft), NPC, 4th January 2019, viewed 10th April 2020, <http://www.npc.gov.cn/npc/c35674/zlfxzaca.shtml>

²⁵ United States and China Reach Phase One Trade Agreement, Office of the US Trade Representative, 13th December 2019, viewed 10th April 2020, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/december/united-states-and-china-reach



Lastly, the working group highly recommends that the European Union (EU)-China Comprehensive Agreement on Investment (CAI) also addresses the protection and enforcement of intellectual property rights (IPR) for the pharmaceutical industry, which will ultimately yield innovation and encourage European investment in China.

Recommendations

- Immediately implement the six-year RDP rule under the existing *Implementation Regulation of the Drug Administration Law*.
- Set up a clear timetable to launch implementation rules for RDP and PTE.
- Give more room to the pharmaceutical industry to participate in the policy-making process and contribute to the formulation and successful implementation of IP protection laws and regulations.
- Establish an implementation timeline for the introduction of the mechanism for early resolution of patent disputes specified in the US-China Phase One Trade Agreement.
- Address the protection and enforcement of IPR for the pharmaceutical industry in the CAI with a clear implementation timeline, especially regarding patent and regulatory data protection.
- Ease the criteria for submission of post-filing data in patent prosecution and invalidation laid out in the Patent Examination Guidelines.

3. Continuously Improve Rare Disease Policy to Ensure Patients' Access to Medicines

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 rare disease and innovative drugs, the NMPA's Centre for Drug Evaluation (CDE) in 2018 published the *First List of Clinically Urgently Needed Drugs Launched Abroad*, which includes 40 drugs.²⁶ In 2019, a second list of 26 drugs was released, which includes 17 rare disease drugs.²⁷ As a result of

being included on these lists, 15 out of the 66 drugs received regulatory approval in less than 10 months, of which four are rare disease drugs. In addition, according to the *Drug Registration Administrative Measures* issued on 30th March 2020 by the NMPA, innovative and rare disease drugs will be eligible for priority review and approval from 1st July 2020.²⁸ Such policies have significantly improved rare disease diagnosis and treatment, drug accessibility and reimbursement, while also raising public awareness on these conditions, which affect millions of people in China.

However, despite the overall improvement of the regulatory environment for rare disease drugs in 2019, since the first version of the *National Rare Disease List*—which includes 121 rare diseases—was issued by the NHC in 2018,²⁹ the list has not been updated or expanded. This will limit the formation of other regulations, such as capacity-building of rare disease diagnosis and treatment, recognition and reimbursement of rare disease drugs, and tax reduction on rare diseases drugs.

To allow greater access to treatment for rare diseases patients, the working group suggests the *National Rare Disease List* and the *List of Clinically Urgently Needed Drugs Launched Abroad* be expanded to include more diseases and innovative drugs. To do so, the regulators will have to clarify the criteria for selection for both lists, and take industry feedback into account.

Furthermore, on 28th November 2019, the NHSA issued the Notice on the Inclusion of 70 new Drugs in Category *B* of the NRDL under the BMI, Occupational Injury Insurance and Maternity Insurance Programmes. New listings resulting from the 2019 NRDL negotiation include seven rare disease drugs.

It is a positive move to improve the affordability of rare disease treatment, and, according to the *Notice*, new drugs shall continuously be added to the reimbursement list to further relieve patients' financial burden. However, the current reimbursement policy only covers 70 to 80 per cent of the drug expenses across China, and most patients cannot afford treatment, especially high-cost

²⁶ Notice on the Publication of the First List of Clinically Urgently Needed New Overseas Drugs, CDE, 1st November 2018, viewed 10th April 2020, http://www.cde.org.cn/news.do?method=largeInfo&id=c059310700b4b383

²⁷ Notice on the Publication of the Second List of Clinically Urgently Needed New Overseas Drugs, CDE, 29th May 2019, viewed 10th April 2020, http://www.cde.org.cn/news.do?method=largelnfo&id=8ed064bd7e51fe68>

²⁸ Administrative Measures of Drug Registration, SAMR, 30th March 2020, viewed 3rd August 2020, <http://gkml.samr.gov.cn/nsjg/fgs/202003/t20200330_313670. html>

²⁹ Notice on the Publication of the First National Rare Disease List, NHC, 8th June 2018, viewed 13th July 2020, http://www.nhc.gov.cn/yzygj/s7659/201806/393a9 a37f39c4b458d6e830f40a4bb99.shtml>

orphan drugs. This translates into high levels of out-ofpocket expenditure for rare diseases patients.

To alleviate rare diseases patients' out-of-pocket expenditure, the working group recommends establishing a multi-channel funding mechanism, in which national and provincial-level special funds could be developed to provide rare diseases patients with a reimbursement framework tailored to their economic status, and which could also leverage social resources such as 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, providing the foundation for corresponding market access and reimbursement policy measures.

Recommendations

- Establish a central office responsible for rare diseases management in order to improve and strengthen inter-ministerial communication and coordination.
- Clarify the criteria for inclusion of rare diseases and take the industry feedback into account in order to expand the NRDL.
- Include more rare disease drugs in the coming NRDL adjustment or establish a special national fund to aid rare disease patient treatment in order to improve the affordability of their drugs.
- Establish national and provincial rare diseases special funds with a reimbursement framework based on patients' economic status to solve out-of-pocket expenditure.
- Integrate relevant social resources, such as charity funds, in the funding of orphan drugs.
- Set up related commercial insurance with government support for ultra-rare-diseases drugs.

4. Maintain Regular Listing and Promote Negotiation Listing in the NRDL Dynamic Updates to Promote Medical Insurance System Reform

Concern

The disconnect between commercial health insurance and basic medical insurance does not meet patients' needs, especially for rare disease conditions, for which few drugs are registered, diagnostic capabilities are limited and public medical insurance are insufficient.

Assessment

On 5th March 2020, the State Council unveiled the *Opinions on Deepening Medical Insurance System Reform.*³⁰ The objective of the reform is to establish by 2030 a medical security system that centres on basic medical insurance and is underpinned by medical aid. It calls for efforts to improve the medical treatment insurance mechanism, establish mechanisms for financing medical insurance, medical insurance payment and fund monitoring, and promote supply-side reform on 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 once failed to be added to the NRDL now have the opportunity to be included the following year, 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.

The working group recommends building a clear, evidence-based reimbursement negotiation procedure for innovative drugs that will allow companies to apply for reimbursement negotiation. Likewise, the implementation of dynamic updates of the NRDL would highly benefit from the establishment of regular communication channels with the industry throughout the update process. Such dialogue would allow the industry to supplement relevant evidence and provide NHSA experts with further insights to address any questions and request further evaluation. Moreover, the working group recommends granting a one-year extension to the two-year price negotiation contract term, provided that there is no new indication or generic drugs 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.

³⁰ Opinions on Deepening Medical Insurance System Reform, State Council, 5th March 2020, viewed 10th April 2020, http://www.gov.cn/zhengce/2020-03/05/content_5487407.htm



In addition, accelerating the inclusion of single pill combination (SPC) therapies in the NRDL could further improve chronic disease management, and hence contribute to the goals of the Healthy China Initiative (2019–2030). SPC therapies contain at least two active ingredients and are widely used to treat chronic diseases, such as hypertension and diabetes. The SPC can provide patients with additional options, improved clinical outcomes and adherence.

The working group recommends including in the NRDL any SPCs with active ingredients already included in the list. The reimbursement payment standard (RPS) for these SPC therapies could then be based on the sum of the RPS of the active ingredients.

Lastly, with the increasing financial burden on public medical insurance funds, it is necessary to further promote the combination of commercial health insurance and the BMI. In this regard, China could align with international practices by fully leveraging the strength of commercial insurance and 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 is within the government policy's scope of selfpayment. In the future, the medical insurance system should allow patients to reimburse their personal BMI accounts by purchasing commercial insurance, thus securing patients' right to choose different medicines. The establishment of such commercial insurance with the support of the government would facilitate treatment access and affordability for patients, especially for 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 dates.
- Establish regular communication channels with the industry throughout the regular process to allow pharmaceutical companies 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.
- Accelerate the inclusion of the SPC in the NRDL to improve chronic disease management, especially hypertension and diabetes.
- 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 12

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

According to the report on the 2019 National Healthcare Security Development issued by the NHSA on 30th March 2020, the 25 selected drugs in the '4+7' VBP pilot areas had reached on average 183 per cent of the agreed procurement volume by the end of 2019. The selected drugs account for 78 per cent of the procurement volume of generic drugs.³¹

On 1st September 2019, China launched the second round of VBP, less than a year after the first round



³¹ Issuance of 2019 National Healthcare Security Development, Accumulated Balance of Medical Insurance Fund Reaches 2691.2 Billion Yuan, Economic Daily, 30th March 2020, viewed 10th April 2020, <http://health.ce.cn/ news/202003/30/t20200330_7227599.shtml>

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began. In addition to the 11 cities selected for the first round, the new round of VBP was expanded to cover additional 25 provinces.³² On 29th December 2019, the national tender results for 33 molecule names were announced.³³ According to the statistics published by each province, 32 of 33 drugs were successfully purchased. Prices dropped by as much as 93 per cent, with an average decrease of 53 per cent.³⁴

On 25th February 2020, the State Council issued *Opinions on Deepening the Reform of Healthcare Security System*, aiming to further reduce the burden of medical expenses on Chinese patients.³⁵ 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.

The industry fully supports the government's goal of reducing patients' financial burdens. However, the working group also notices many regional VBPs involve injections or generic drugs that have not passed the GQCE. The procured drugs are intended for use in the treatment of digestive tract diseases, diabetes, hypertension, anti-infection, cardiovascular disease and other conditions. Through official negotiations, limiting price by the government and competing with other market players, some regions chose the lowest priced drugs.

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, one tender-winning drug was later disqualified

for the second round of VBP due to quality issues. However, the rules for substituting disqualified drugs remain unclear to the industry. Therefore, the working group recommends that the relevant government authorities stringently assess the quality of the selected drugs and formulate relevant measures to closely monitor the use of the drugs in order to protect patients.

The COVID-19 outbreak has also significantly impacted the production, distribution and use of drugs. The industry urges the Chinese authorities to take a cautious approach, closely monitor and evaluate the results of the second round of VBP, and suspend the third round until the pandemic situation is fully under control.

Recommendations

- Set up a drug selection mechanism to ensure the scope of the national VBP drug list be limited to drugs that have passed the GQCE and that the numbers and capacity of GQCE manufacturers fully meet clinical needs.
- Ensure that all biomedicines in the VBP meet strong and specific scientific, clinical and quality standards, considering the high risks of treatment replacement for patients.
- Steadily promote the implementation of the second round of VBP and suspend any new round of VBP until COVID-19 is fully under control.
- Rationally determine the purchase quantity of the drugs in the VBP list and allow more than two winning companies in hospital alliances to ensure drug supply.
- Respect the opinions of doctors, patients and hospitals, improve the decision-making mechanism for procurement volumes, and clarify that hospitals can purchase and use other products through online procurement of drugs.
- Retain a reasonable amount of surplus products rather than simply controlling or limiting proportions of use, in light of the specificities of different diseases as well as the maturity and growth levels of different product markets.
- Apply fair competition principles to unselected products that participated in the VBP bidding instead of gradual price reductions or setting price limits, and avoid compulsive or disguised compulsive reduction of unselected products by administrative measures.
- Clarify rules for substituting disqualified drugs, stringently asses the quality of the selected drugs and formulate relevant measures to closely monitor

³² Centralized Drug Purchase Document of the Alliance Region, Sunshine Medical Procurement All-In-One, 1st September 2019, viewed 10th April 2020, <http:// www.smpaa.cn/gjsdcg/2019/09/01/8974.shtml>

³³ Joint Procurement Office for State-organised Centralised Procurement and Use of Drugs: Announcement on National Centralised Drug Purchase Document (gyyd2019-2), Sunshine Medical Procurement All-In-One, 29th December 2019, viewed 10th April 2019, http://www.smpaa.cn/gjsdcg/2019/12/29/9205.shtml>

³⁴ One Year of VBP Pilot, Drug Price Will Continue Go Down and the Transformation of the Pharmaceutical Company Is Imminent, Sina Finance, 1st April 2020, viewed 10th April 2020, <https://finance.sina.com.cn/roll/2020-04-01/dociimxxsth3143417.shtml?cre=tianyi&mod=pcpager_fintoutiao&loc=32&r=9&rfunc =59&tij=none&tr=9>

³⁵ 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>



the use of the drugs, in order to protect patients.

- Closely monitor the clinical safety, effectiveness, compliance and patients' self-evaluation of changing from the original drugs to the VBP-winning drugs.
- Develop evaluation indicators to provide a comprehensive assessment of the effectiveness of the VBP and invite all relevant stakeholders including medical institutions, medical personnel, patients, drug manufacturers, and distributors to provide feedback in order to improve practice in the future.

Build a Favourable and Effective Regulatory Environment for Accelerating the Accessibility of Innovative Vaccines in China 2

Concern

Foreign vaccine companies are facing a number of market access challenges in China, such as unequal opportunities to enter the National Immunisation Programme (NIP), cumbersome registration processes and the lack of alignment between the Chinese Pharmacopeia's (ChP) specificities and international standards.

Assessment

With COVID-19 having become a global health concern, governments and industry are working closely to address the pandemic and develop treatment and vaccine solutions. Vaccines are recognised as one of the most effective and economical prevention tools for infectious diseases. As vaccine R&D is one of the top priorities to combat COVID-19 and other infectious diseases, the working group believes that building a more favourable policy and regulatory environment for accelerating vaccine accessibility is more than ever a critical priority.

As President Xi Jinping indicated at the meeting of the Central Committee for Deepening Overall Reform on 14th February 2020, developing innovative control, prevention and emergency measures is of utmost importance at the institutional level.³⁶ China will assess the revision of laws and boost legal support for public health. China will also establish a national vaccine reserve system and prepare for the possibility of regular prevention and control work. The Vaccine Administration Law took effect on 1st December 2019,³⁷ with detailed measures to be released in 2020. The working group recommends that industry stakeholders, companies, and industry associations be invited to actively take part in the policy formulation process.

The working group believes that these announcements will benefit patient access to innovative vaccines and ultimately mitigate future pandemic risks.

Despite these developments, imported foreign vaccines are still subjected to stringent regulatory barriers. 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 for international pharmaceutical companies.

The long registration and approval process for vaccines is another challenge, which also influences the progress of simultaneous vaccine R&D globally. Permitting vaccines to go through international multi-centres clinic trial (IMCT) and be accepted for registration submission without overseas marketing authorisation (OMA) would accelerate access to innovative vaccines for the Chinese population. The Pharmaceuticals Working Group acknowledges the recent progress made by the NMPA in piloting the vaccine review and approval process. The working group also understands a similar regulatory reform for vaccines may soon be launched, in which these products could have up to six years' acceleration for registration in the China market. The working group appreciates the Chinese Government's efforts in this regard but hopes vaccines can explicitly benefit from more accelerated registration measures.

Due to the gap 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 Chinese products abroad.

³⁶ Xi Jinping Presides over the 12th Meeting of the Central Committee for Deepening Overall Reform and Emphasizes: Improve the Major Epidemic Prevention and Control Mechanism and System, as Well as Improve the National Public Health Emergency Management System, Xinhua, 14th February 2020, viewed 13th July 2020, <http://www.gov.cn/xinwen/2020-02/14/content_5478896.htm>

³⁷ The Vaccine Administration Law, NPA, 29th June 2019, 3rd August 2020, <http:// www.npc.gov.cn/npc/c30834/201907/11447c85e05840b9b12c62b5b645fe9d. shtml>

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Recommendations

- Reform China's procurement criteria and process to include all NMPA-approved vaccines, imported and locally manufactured, for its NIPs, to enable access for more innovative vaccines and build a more sufficient and sustainable supply to address public health needs.
- Build a favourable and effective regulatory environment for innovative vaccines, including but not limited to IMCT and OMA, in order to reduce current delays of six years in addressing public health demands with new innovative vaccines.
- Promote the harmonisation of the ChP with international standards.

Abbreviations

| BMI CCFDIE | Basic Medical Insurance China Center for Food and Drug |
|---------------|---|
| | International Exchange |
| CDE | Centre for Drug Evaluation |
| CFDA | China Food and Drug Administration |
| ChP | Chinese Pharmacopeia |
| CNY | Chinese Yuan |
| COVID-19 | Coronavirus Disease 2019 |
| EUR | Euro |
| FDA | Food and Drug Administration |
| GAVI | Global Alliance for Vaccines and |
| | Immunisation |
| GMP | Good Manufacturing Practices |
| GQCE | Generic Quality Consistency Evaluation |
| GS1 | Global Standards 1 |
| ICH | International Conference on |
| | Harmonization of Technical |
| | Requirements for Registration |
| | of Pharmaceuticals for Human Use |
| IMCT | International Multi-centres Clinic Trial |
| IPR | Intellectual Property Rights |
| 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 |
| OMA | Oversea Marketing Authorisation |
| OOP | Out-of-pocket |
| PTE | Patent Term Extension |
| | |

| PIC/S | Pharmaceutical Inspection |
|--------|---|
| | Cooperation Scheme |
| RDP | Regulatory Data Protection |
| RPS | Reimbursement Payment Standard |
| R&D | Research and Development |
| SAMR | State Administration for Market |
| | Regulation |
| SPC | Single Pill Combination |
| UNICEF | United Nations International Children's |
| | Emergency Fund |
| VAT | Value-added Tax |
| VBP | Volume-based Procurement |
| WHO | World Health Organization |
| | |



Shipbuilding Working Group

Key Recommendations

- 1. Build Effective Solutions to Restore Normal Competitive Conditions and a Level Playing Field in Shipbuilding <a>2
 - Intensify discussions on government-driven market distortions and other trade irritants affecting shipbuilding—with a particular focus on production and investment subsidies—in all relevant international and bilateral fora.
 - Enhance transparency on sectoral strategies, action plans and support programmes, through existing bilateral channels such as the European Union (EU)-China Shipbuilding Dialogue.
 - Boost all available EU tools to tackle distortions and unfair practices in shipbuilding, taking into account the limits of current international trade disciplines, while remaining open to engagement in developing effective international solutions.
 - Propose a plan and a roadmap towards a possible bilateral, sector-specific agreement that is mutually beneficially in the absence of a global agreement on shipbuilding.

2. Market Access Barriers

- 2.1 Facilitate Market Access for Maritime Equipment Manufacturers and Service Providers
 - Conclude a mutual recognition agreement between the EU and China on certification of maritime equipment.
 - Ensure that European shipyards and maritime equipment companies can operate on equal terms with domestic producers, as a necessary step towards fostering investment and long-term partnerships.
 - Ensure ambitious and comprehensive public procurement market opening to foreign shipbuilding and maritime equipment manufacturing companies on a reciprocal basis.
 - Exempt imported ship components from value-added tax (VAT) payments and equalise import taxes between China and the EU.

2.2 Ensure that European Suppliers have Equal Access to Policy Incentives

- Create a mechanism to facilitate a dialogue on potential cooperation between Chinese and European companies on specific topics regarding high-tech supply chains.
- Describe what specific incentive measures will be provided for encouraged industries in the *Catalogue on Encouraging Foreign Investment Industries (2019)*, and ensure that equal incentive measures will be given to foreign companies investing in these specific sectors.
- Utilise the EU coordination mechanism for screening foreign investment.
- Make incentive packages available to foreign suppliers entering China.

2.3 Advance the Opening-up of the Cruise Market in China

- Allow foreign-invested cruise operators to sell tickets directly to Chinese customers.
- · Allow foreign-flagged cruise vessels to enter a greater number of ports.



- 3. Expand Financing Opportunities for Foreign-invested Firms in the Shipbuilding Industry (1)2
 - · Expand financing opportunities for foreign-invested firms.
 - · Allow Chinese leasing houses to finance foreign-invested shipyards.
- 4. Expand Opportunities for Foreign-invested Firms in the Shipbuilding Industry to Access Research and Development (R&D) Funds <a>2
 - Compile a list of R&D pilot projects based on the industry segments listed in the current edition of the *Catalogue of Encouraged Industries for Foreign Investment*, as well as in the two 2019 Action Plans and the *China Manufacturing Development Plan (CM2025)*.
 - Clarify how foreign-invested firms can gain access to funds destined for R&D activities, and create a transparent platform that will enable them to do so.

Introduction to the Working Group

The Shipbuilding Working Group represents European companies that design, manufacture, maintain and repair ships, as well as maritime equipment manufacturers, classification societies,¹ service providers and cruise operators. Shipyards and manufacturers of ship components play an essential role in satisfying the increasing global demand for cleaner and safer transportation systems. European companies in the sector have a long track record of contributing to the environmental sustainability and increased energy efficiency of ships. The green and digital transformation of shipping and maritime operations present both challenges and opportunities for both European and Chinese maritime technology companies in terms of supplying new innovative solutions.

Within the goals of the 19th Communist Party of China (CPC) National Congress and the second and third plenary sessions of the 19th CPC Central Committee, it was stated that China will build "a manufacturing power and maritime power, centring on improving the quality, efficiency and the benefits of shipbuilding, focusing on comprehensively promoting digital shipbuilding", as well as to "promote innovation, improve weak links, strengthen the foundation and set good examples to promote the digital and networked integration of ship design, building, management and service."²

Recent Developments

The Coronavirus Disease 2019 (COVID-19) crisis hit at a time when the global trading environment, in which shipbuilders and maritime equipment companies operate, was already under considerable strain from subdued demand, low profitability, market imbalances and protectionism.³

These companies are very much dependent upon global macro-economic trends, trade volumes, and the evolution of tourism and mobility patterns, as well as customer confidence. It is expected that COVID-19 will have a particularly negative impact on the market for complex ship types, such as cruise vessels, platforms and equipment needed for the exploitation of resources at sea. The construction of offshore oil and gas platforms and related ships will furthermore suffer heavily from the current drop in oil prices.

From a cruise operator perspective, COVID-19 caused disruptions across the global industry, with sailings either being cancelled or re-routed, passengers being placed under quarantine and cruise ship operators being barred from docking. While changed schedules initially looked better than outright cancellations, changing a cruise ship's itinerary is a complicated process and highly dependent upon berth and port availability, with few global ports possessing the infrastructure to accommodate big cruise ships. Cruise operators will need to pay out substantial sums to passengers in refunds, compensation and

¹ A classification society is a non-governmental organisation that establishes and maintains technical standards for the construction and operation of ships and offshore structures.

² Intelligent Shipbuilding Promotion Action Plan for 2019–2021, China Association of the National Shipbuilding Industry (CANSI), 29th December 2018, viewed 12th May 2020, <http://www.cansi.org.cn/ifor/shownews.php?lang=cn&id=11357>

³ Trade Set to Plunge as COVID-19 Pandemic Upends Global Economy, World Trade Organization (WTO), 8th April 2020, viewed 14th May 2020, <https://www.wto.org/english/news_e/pres20_e/pr855_e.htm>



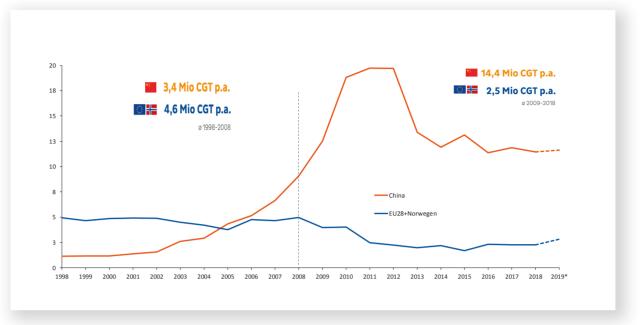


Figure 1: Completions (in million compensated gross tonnage (CGT)): China and Europe

Source: SEA Europe, based on IHS Fairplay data (2019: Extrapolation based on Q1 2019)

cancellation fees, meaning they may find themselves in a position whereby they are unable to service loan repayments and attend to cash flow problems. If demand decreases over a prolonged period of time, cruise operators might also consider laying-up their ships.⁴

Since China's accession to the World Trade Organization (WTO) in 2001, China's shipbuilding industry has undergone tremendous growth, which further intensified after 2006 when, in the 11th Five-Year Plan, Beijing recognised the industry as strategic, and a wide number of subsidies were deployed to support it.

China's growth as a shipbuilding nation over the last 15 years is illustrated in Figure 1. Despite declining after 2011, China's shipbuilding output (ships being completed and delivered) from 2009–2019 was still seven times higher than that of the European Union (EU). The main driver behind this decline after 2011 was the overcapacity in the standard ship segments (bulk, container and tankers), coupled with insufficient demand in the global market as a result of the 2008/2009 financial crisis. European shipbuilding was not as badly affected due to the fact that, for many years, it had engaged in almost no production of standard ship types. South Korea and Japan overtook these segments long before China did,

and nowadays European shipbuilders primarily engage in niche markets.

In recent years, China has been successful in attracting several newbuilt ferry orders, a niche segment in which European yards were world leaders.

China's ambition to reach a global leadership position in high-end shipbuilding and advanced maritime technology has been further translated into active policies with the Action Plan to Promote the Smart Transformation Shipyards and Shipbuilding (2019–2020) and the Intelligent Ship Development Action Plan for 2019–2021.^{5&6} More specifically, the two plans set tasks and ambitions to strengthen organisation and coordination within the industry, improve support for innovation and enhance financing mechanisms.⁷ In addition, the Guidelines on the Promotion of High-quality Development of the Maritime Industry (2020), issued jointly by the Ministry of Transportation (MOT) and three other ministries,⁸ stipulate that China will optimise the scale structure of its maritime fleet, upgrade the technical

⁴ COVID-19 Marine: Cruise Industry Impact From Coronavirus, Clyde & Co. 10th March 2020, viewed 7th April 2020, <https://www.clydeco.com/insight/article/ coronavirus-and-the-impact-on-the-cruise-industry>

⁵ Action Plan for Promoting Transformation to Intelligent Berth-assembling and Shipbuilding (2019–2021), MIIT, 30th December 2018, viewed 8th April 2020, http://www.miit.gov.cn/n1146285/n1146352/n3054355/n3057585/n3057594/ c6566590/content.htm>

⁶ Intelligent Shipbuilding Promotion Action Plan for 2019–2021, State Council, 30th December 2018, viewed 8th April 2020, http://www.gov.cn/xinwen/2018-12/30/content_5353550.htm

⁷ Ibid.

⁸ Ministry of Industry and Information Technology, Ministry of Commerce and General Administration of China Customs

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level of ship equipment and build a maritime fleet with adaptable scale, reasonable structure, advanced technology and green intelligence. Moreover, the guidelines stipulate that LNG ships⁹ and cruise fleets will be actively developed to enhance the international competitiveness of Chinese container, crude oil, dry bulk cargo and special transport fleets.¹⁰

On 2nd July 2019, listed units of the China State Shipbuilding Corp (CSSC) and of the China Shipbuilding Corp (CSIC) made several stock filings and revealed that they were in advanced talks over a strategic merger.¹¹ The two enterprises were previously a single company until 1999, when they were split in an effort to break up monopolies and boost competition. On 25th October 2019, the State Assets Supervision and Administration Commission of the State Council (SASAC) announced that the merger had received the necessary approvals and would begin to implement a 'joint restructuring' under the new proposed name, the China Industry Shipbuilding Corporation.¹² SASAC Chairman Hao Peng has opined that the merger is a way to "enhance the competitiveness of the domestic shipbuilding industry, promote the development of the national defence technology industry and reform state-owned enterprises".^{13&14} The merger was completed at the end of 2019, creating an industrial behemoth that is expected to control 20 per cent of the global market and have annual sales amounting to over Chinese yuan (CNY) 400 billion.¹⁵ In the eyes of the working group, this state-driven merger appears to be in line with the strategy outlined in the China Manufacturing 2025 (CM2025) development plan, which aims to make China a global technological leader and raises concerns over the effects subsidisation by Beijing could have on global competition.

- 9 A LNG carrier is a ship that is designed for the transport of liquefied natural gas in its chilled tanks.
- 10 Guidelines on the Promotion of High-Quality Development of the Maritime Industry, MOT, 3rd February 2020, viewed 8th April 2020, http://xxgk.mot.gov.cn/jigou/syj/202002/t20200203_3329054.html
- 11 Report: Beijing Gives Approval for CSSC-CSIC Merger, Maritime Executive, 3rd March 2019, viewed 7th April 2020, https://www.maritime-executive.com/ article/report-beijing-gives-approval-for-cssc-csic-merger>
- 12 China Approves Merger of Shipbuilding Giants, Jane's Defence Industry, 28th October 2019, viewed 7th April, 2020, https://www.janes.com/article/92183/ china-approves-merger-of-shipbuilding-giants>
- 13 Merger with CSSC Won't Create a Monopoly, says CSIC Chairman, Lloyd's List, 12th August 2019, viewed 7th April 2020, <https://lloydslist.maritimeintelligence. informa.com/LL1128733/Merger-with-CSSC-wont-create-a-monopoly-says-CSIC-chairman>
- 14 China: World's Largest Shipbuilder Established, World Maritime News, 26th November 2019, viewed 7th April 2020, https://worldmaritimenews.com/ archives/286979/china-worlds-largest-shipbuilder-established/>
- 15 Shipbuilding Giants Float Merger Plans, Caixin, 2nd July 2019, viewed on 8th April 2020, <https://www.caixinglobal.com/2019-07-02/shipbuilding-giantsfloatmerger-plans-101434449.html>

Maritime Equipment Industry

Ship-specific equipment-including power systems, electronic and electrical equipment, deck machinery and accommodations-accounts for 40 to 70 per cent of total ship value. China's existing production capacity is still very much dominated by low value-added ship types, whereby bulkers account for about 50 per cent of the total delivery, and mainstream cargo vessels-bulkers, tankers and containerships-together account for more than 90 per cent. By comparison, the share of equipment in high-tech ships is over 70 per cent, while for standard ship types, it is less than half of the total value.¹⁶ Coupled with sluggish demand caused by the cyclical downturn in the downstream shipping industry over the past few years, overcapacity is serious in low-end vessel production, especially for a large number of small and medium-sized private enterprises. In recent years, Chinese shipyards have therefore sought to increase their research and development (R&D) investment, strengthen management systems, and continuously optimise their product mix, targeting higher end, higher value ship types such as LNG, special engineering vessels, RoPax and luxury cruise vessels.^{17&18} Chinese shipyards are expected to build an average of three RoPax vessels per year until 2029,¹⁹ and six cruise ships per year until 2030.²⁰

In the field of power systems, domestic diesel engines have achieved technological breakthroughs and gained market recognition. However, in the eyes of the working group, the bottleneck of the ship equipment (supplier) industry is currently the largest barrier to China becoming a shipbuilding power. China's focus on developing selfsufficiency in the maritime industry means domestic manufacturers are favoured, and European suppliers find it difficult to increase their market share.

Cruise Industry

China has already overtaken Germany to become the world's second largest cruise market after the United States, and has seen a double-digit annual increase

17 RoPax vessels or Ro-Ro (roll on, roll off) ships are ships or ferries that can be used to transport both passenger and goods.

19 Ibid.

¹⁶ Research Report on China's Ship Accessory Equipment Industry 2020-2024, Business Wire, 28th January 2020, viewed 7th April 2020, ">https://www. businesswire.com/news/home/20200128005393/en/Research-Report-Chinas-Ship-Accessory-Equipment-Industry>

¹⁸ China Ship Equipment and Component Market, EURObiz, 3rd January 2019, viewed 7th April 2020, <https://www.eurobiz.com.cn/china-ship-equipment-andcomponent-market/>

²⁰ World Shipyard Monitor March 2019, Clarksons Research, viewed 12th May 2020, <https://www.clarksons.com/search/?q=World+Shipyard+Monitor+March +2019%2C>



Table 1: Cruise Market Overview

| China Cruise Market Structure | European Cruise Market Structure | Main differences |
|---|--|---|
| Coastal cruising and 'nowhere' cruising ²¹ are forbidden for international cruise lines. | Most EU countries have no restrictions on international cruise lines. | Cabotage policy mainly to protect the interests of local cruise lines. |
| International cruise lines are not allowed to sell shore excursions and onboard products; they can only sell tickets. | Most EU countries do not set any restrictions on the sale of products by cruise lines. | Such restrictions are to grant entitlement to local travel agencies as the only channel for outbound services. |

that may allow it to reach 10 million customers by 2026. Although this is still marginal compared with the penetration rate of cruises in the industry's traditional markets of Europe and North America, it is notable that, in the Asia market segment, Chinese tourists represent a majority of cruise passengers. However, cruise operators in China-both domestic and foreign-invested-face many challenges that negatively impact the sustainability of their business, they are not allowed to sell cruise tickets directly to customers, and instead have to go through travel agencies. As a result, cruise operators are not allowed access to their customers' data, and thus often struggle to adapt their offers to meet market demands. Furthermore, due to geopolitical tensions, as well as the strict regulations on the number of ports that ships flying a foreign flag can access in China, European cruise operators struggle to offer articulated routes and are limited to a small number of destinations.

Key Recommendations

1. Build Effective Solutions to Restore Normal Competitive Conditions and a Level Playing Field in Shipbuilding (2)

Concern

Government interventions and trade-distorting practices could potentially prolong the severity of the current overcapacity problem in shipbuilding, jeopardising the recovery path of the global market towards a healthier business environment and more profitability.

Assessment

The sentiment among European shipbuilding companies is that the Chinese State continues to play a strong role in the allocation of resources, through various forms of direct and indirect support measures to its domestic shipbuilding players, such as grants, capital injections through debt-for-equity-swaps,²² preferential access to finance,²³ or moves to encourage domestic state banks to support the domestic industry.²⁴

Government subsidies and other practices that distort the market can have a long-lasting, detrimental impact on the health and profitability prospects of both the shipbuilding and shipping industries. These trade-distorting government interventions should not be confused with financial support in the context of global emergencies, such as the COVID-19 crisis, when such support is on the contrary beneficial for industries, provided that it is targeted, limited in time and proportional.

The creation of effective mechanism to safeguard normal competitive conditions should be a shared interest for Europe and China to pursue through all relevant fora. Overcapacity in both the production and operation of ships indeed hinders the maritime industry's delivery on urgent challenges, including decarbonisation.

Moreover, enhanced transparency on corporate governance structures, support instruments and other forms of government-backed policies relevant to newlycreated entities would benefit all market players.

In the Action Plan to Promote the Smart Transformation of Shipyards and Shipbuilding (2019–2020) and the Intelligent Ship Development Action Plan for 2019–2021, the working group does not see structured consultation opportunities that may effectively enable European companies, together with domestic companies, to



²¹ Nowhere cruising is the activity of boarding a cruise ship for a short voyage into international waters before returning, without calling on any ports.

²² Shen, Cichen, CSSC to Buy Back Stakes in Four Subsidiary Yards From Investors, Lloyd's List, 26th February 2018, viewed 12th May 2020, https://lioydslist.maritimeintelligence.informa.com/LL1121561/CSSC-to-buy-back-stakes-in-four-subsidiary-yards-from-investors

²³ Shen, Cichen, Yard Talk: No End to State Subsidy Seen, Lloyd's List, 24th January 2020, viewed 12th May 2020, https://lloydslist.maritimeintelligence. informa.com/LL1130774/Yard-Talk--No-end-to-state-subsidy-seen>

²⁴ Shen, Cichen, No More Finance for Foreign-yard Newbuilds, China's Leasing Houses Told, Lloyd's List, 19th October 2017, viewed 12th May 2020, https://lioydslist.maritimeintelligence.informa.com/LL111954/No-more-finance-for-foreignyard-newbuilds-Chinas-leasing-houses-told>

contribute to the achievement of goals and tasks formulated in these two action plans. $^{\rm 25}$

Recommendations

- Intensify discussions on government-driven market distortions and other trade irritants affecting shipbuilding with a particular focus on production and investment subsidies— in all relevant international and bilateral fora.
- Enhance transparency on sectoral strategies, action plans and support programmes, through existing bilateral channels such as the EU-China Shipbuilding Dialogue.
- Boost all available EU tools to tackle distortions and unfair practices in shipbuilding, taking into account the limits of current international trade disciplines, while remaining open to engagement in developing effective international solutions.
- Propose a plan and a roadmap for a possible bilateral, sector-specific agreement that is mutually beneficially in the absence of a global agreement on shipbuilding.

2. Market Access Barriers

2.1 Facilitate Access for Maritime Equipment Manufacturers and Service Providers (3) 2

Concern

Despite the shipbuilding industry having been removed from the *Negative List for Foreign Investment*, European maritime manufacturers and service providers still face market access barriers due to hidden obstacles and discriminatory practices, while having to compete against state-owned enterprises (SOEs) that receive subsidies, tax benefits and other preferential treatment.

Assessment

China does not accept the Marine Equipment Directive (MED) certification procedure or the WheelMark for equipment, components or materials destined for China-flagged ship classes, although the China Classification Society (CCS) is authorised to perform MED certification. As a result, European component manufacturers are forced to obtain CCS certification, and this additional procedure often burdens them with extra costs.

Moreover, European maritime equipment manufacturers

are adversely impacted by China Compulsory Certificate (CCC) regulations on electronic equipment components.²⁶ If there are Chinese-made equivalents of products available, CCC certification is required, regardless of whether the products were manufactured in China or in the EU. Although complete integrated systems (electronic controls) seem not to be subject to import regulations, single components and assemblies delivered as loose components are.²⁷ This will result in extra work and administrative burdens, particularly as suppliers often source from their own company that adheres to international standards (International Standardization Organization (ISO) and International Electrotechnical Commission (IEC). While welcoming China's renewed efforts to join the WTO Government Procurement Agreement (WTO GPA), the working group encourages an ambitious and comprehensive market coverage of shipbuilding projects of shipbuilding projects at all levels of procurement (in particular at the subcentral and SOE levels), as a necessary prerequisite. Moreover, in contrast to international industry norms, Chinese shipbuilders that acquire and import ship components from outside China have to pay valueadded tax (VAT) on them.²⁸ This unfairly impacts the competitiveness of European maritime equipment manufacturers.

Finally, in May 2019, the China Marine Safety Administration (MSA) issued the *Notice of the Measures for the Administration of Ship Maintenance And Inspection Services [2019:172]*, requesting all service providers operating in China to be physically registered on the Mainland territory as legal companies.²⁹ Service providers must register online with the MSA. The working group is concerned that these new requirements will in practice exclude European manufacturers from providing their services if they do not have one (or several) companies registered in China.

²⁵ A detailed overview of each Action Plan, including goals and major tasks, can be found in the Shipbuilding Position Paper 2019/2020, European Business in China Position Paper 2019/2020, European Union Chamber of Commerce in China, September 2019, p. 267, https://www.europeanchamber.com.cn/en/ working-groups-forums-desks/77/shipbuilding>

²⁶ Electrical wires and cables, circuit switches, electric devices for protection or connection, information technology equipment, lighting apparatus and fighting equipment; without a CCC-mark, products may be denied import by Chinese customs.

²⁷ CCC Mandatory Products, MPR China Certification GmbH, viewed 19th May 2020, https://www.china-certification.com/en/list-of-ccc-mandatory-products/>

²⁸ According to international practice, additional VAT is not required given that imported components are assembled onboard a seagoing vessel if it is operated for at least 70 per cent navigation on the high seas and 100 per cent commercially. In: Application of VAT Zero Rate for Suppliers of and Services to Sea-going Vessels Changed, PwC, 26th November 2018, viewed 18th May 2020, <https://www.pwc.nl/en/insights-and-publications/tax-news/vat/application-vatzero-rate-seagoing-vessels.html>

²⁹ Notice of the Measures for the Administration of Ship Maintenance And Inspection Services [2019:172], Yueyang Municiple People's Government, 17th May 2019, viewed 11th May 2020, <http://www.yueyang.gov.cn/web/ xxgkml/2574/2629/4660/content_1549279.html>



Recommendations

- Conclude a mutual recognition agreement between the EU and China on certification of maritime equipment.
- Ensure that European shipyards and maritime equipment companies can operate on equal terms with domestic producers, as a necessary step towards fostering investment and long-term partnerships.
- Ensure ambitious and comprehensive public procurement market opening to foreign shipbuilding and maritime equipment manufacturing companies on a reciprocal basis.
- Exempt imported ship components from value-added tax (VAT) payments and equalise import taxes between China and the EU.

2.2 Ensure that European Suppliers have Equal Access to Policy Incentives

Concern

China's focus on developing self-sufficiency in the maritime industry is supported by subsidies to domestic manufacturers, making it difficult for European companies to compete on the Chinese market on fair terms.

Assessment

The draft *Catalogue on Encouraging Foreign Investment Industries*, published in 2019, is a clear example of how Beijing uses government policies to encourage forms of technology transfers aimed at advancing the competitiveness of the domestic industry.³⁰ The catalogue encourages foreign investments in activities related to designing and projecting ships and ships components, whereas production is openly excluded. Hence, it appears that the government's intent is to encourage foreign companies to share their know-how and best practices, while leaving to their Chinese counterparts the economic and industrial benefits related to selling and producing.

In the wake of the COVID-19 outbreak, and in order to preserve the technological sovereignty of the sector, the EU should consider shipbuilding and its supply chain as a strategic sector subject to the foreign investment screening mechanism by member states. There is strong motivation for Chinese shipbuilders to become independent of foreign technology. This poses both an opportunity and a threat for European companies. On one hand, given the due protections (such as intellectual property rights (IPR), trademark and patent protection) the working group believes this screening mechanism could foster innovation and healthy competition in the sector. On the other hand, the reality is that the crisis has created a vacuum in the high-tech supply chain in Europe and opened up opportunities for foreign counterparts to purchase high-tech marine equipment at discounted rates.

Recommendations

- Create a mechanism to facilitate a dialogue on potential cooperation between Chinese and European companies on specific topics regarding high-tech supply chains.
- Describe what specific incentive measures will be provided for encouraged industries in the *Catalogue on Encouraging Foreign Investment Industries (2019)*, and ensure that equal incentive measures will be given to foreign companies investing in these specific sectors.
- Utilise the EU coordination mechanism for screening foreign investment.
- Make incentive packages available to foreign suppliers entering China.

2.3 Advance the Opening Up of the Cruise Market in China

Concern

The cruise market in China is only partly open to foreigninvested cruise operators, which negatively impacts the sustainability of their business as restrictions continue to slow the growth of the market.

Assessment

Compared to European and American cruise markets, the Chinese cruise market remains partly closed to foreign-invested operators. Rules concerning cabotage,³¹ foreign-flagged vessels, and the fact that foreign-invested cruise operators are not allowed to sell cruise tickets directly to Chinese customers but are forced to sell via Chinese tour operators instead, are slowing down market growth. Advancing the opening up of the cruise market in China would benefit both foreign-invested and domestic shipbuilders and cruise operators in the long-term, and contribute to the recovery of the global cruise sector, which was hard hit as a result of the COVID-19 crisis.

³⁰ Catalogue of Encouraging Foreign Investment Industries Draft for Comments, MOFCOM & NDRC, 19th February 2019, viewed 14th May 2020, <http://wzs. ndrc.gov.cn/glwstzcyml20190201.pdf>

³¹ Cabotage is the right to operate sea, air, or other transport services within a particular territory. Maritime cabotage laws govern the transportation of goods and people between ports.

Recommendations

- Allow foreign-invested cruise operators to sell tickets directly to Chinese customers.
- Allow foreign-flagged cruise vessels to enter a greater number of ports.
- 3. Expand Financing Opportunities for Foreign-invested Firms in the Shipbuilding Industry (1)2

Concern

Foreign-funded companies engaged in the Chinese shipbuilding industry face restrictions when it comes to finding channels to finance their activities, which gives unfair advantages to domestic players and limits European companies' access to the market.

Assessment

Shipyards in China use three financing methods: loan financing, ship leasing and internal financing. 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. Furthermore, Chinese leasing houses have reportedly been asked by the MIIT not to finance newbuilding projects at foreign -owned shipyards,³²⁸³³ and the working group has seen no indication that this practice has changed. As a result, European shipbuilders operating in China can only finance their activities through internal funds.

Since it takes years to build a ship, and decisions have to be made well in advance, using internal funds to finance a ship that has been only partially paid for by a buyer that may be bankrupt when the building process is over is extremely risky. This high risk impacts the solvency of shipbuilding companies, which are forced to accumulate high volumes of assets to protect themselves. Thus, their operational capacity—their ability to use their assets to generate revenues—is negatively impacted. As a result, shipbuilding companies have to boost their profitability to finance themselves internally. However, Chinese SOEs can count on easy and less-costly financing methods and, since they also benefit from subsidies and grants, they can price their ships well below production costs. To compete with Chinese SOEs and to maintain their market shares, European companies have to lower their prices, which in turn lowers their profitability and their ability to finance internally.

Recommendations

- Expand financing opportunities for foreign-invested firms.
- Allow Chinese leasing houses to finance foreigninvested shipyards.

4. Expand Opportunities for Foreign-invested Firms in the Shipbuilding Industry to Access R&D Funds (2)

Concern

Due to unclear access mechanisms, foreign-funded companies engaged in the shipbuilding industry are restricted from obtaining R&D funds that the Chinese Government makes available to domestic companies.

Assessment

The Chinese Government has in recent years launched a wide range of policies and proposals, such as CM2025, the Action Plan to Promote the Smart Transformation of Shipyards and Shipbuilding (2019-2020) and the Intelligent Ship Development Action Plan for 2019-2021, all of which include a large volume of funds that companies can use for R&D purposes. Members of the working group report that they would be interested in setting up R&D departments in Mainland China. However, the current regulatory environment does not enable them to do so, due to a lack of transparent hard or soft platforms that would allow foreign-invested firms to access these funds. As a result, despite the absence of any law or regulation that explicitly excludes FIEs from accessing such funds, working group members are effectively unable to take advantage of such opportunities.

Recommendations

- Compile a list of R&D pilot projects based on the industry segments listed in the current edition of the Catalogue of Encouraged Industries for Foreign Investment, as well as in the two 2019 Action Plans and the China Manufacturing Development Plan (CM2025).
- Clarify how foreign-invested firms can gain access to funds destined for R&D activities, and create a transparent platform that will enable them to do so.

³² 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.

³³ Shen, Cichen, No More Finance for Foreign-yard Newbuilds, China's Leasing Houses Told, Lloyd's List, 17th October 2019, viewed 11th May 2020, https://lioydslist.maritimeintelligence.informa.com/LL111954/Nomore-finance-for-foreignyard-newbuilds-Chinas-leasing-houses-told>



Abbreviations

| CCC | China Compulsory Certificate |
|----------|---|
| CCS | China Classification Society |
| CGT | Compensated Gross Tonnage |
| COVID-19 | Coronavirus Disease 2019 |
| CNY | Chinese Yuan |
| CSIC | China's Shipbuilding Industry Corporation |
| CSSC | China State Shipbuilding Corporation |
| EU | European Union |
| FIE | Foreign-invested Enterprise |
| IEC | International Electrotechnical Commission |
| IPR | Intellectual Property Rights |
| ISO | International Organization for |
| | Standardization |
| LNG | Liquefied Natural Gas |
| MED | Marine Equipment Directive |
| MIIT | Ministry of Industry and Information |
| | Technology |
| MOT | Ministry of Transportation |
| MSA | China Marine Safety Administration |
| R&D | Research and Development |
| SASAC | State Assets Supervision and |
| | Administration Commission of the State |
| | Council |
| SOE | State-owned Enterprise |
| USD | United States Dollar |
| VAT | Value-added Tax |
| WTO | World Trade Organization |
| WTO GPA | WTO Government Procurement |
| | Agreement |
| | - |





Section Four Services



Services

The Services section of the *Position Paper* includes 4 working groups and 3 sub-working groups of the European Chamber:

- · Aviation and Aerospace
- Construction
 - Heating
- · Information and Communication Technology
 - Cybersecurity
- Logistics
 - International Liner Shipping

According to the National Bureau of Statistics (NBS), the total value of China's service industry in 2019 was Chinese yuan (CNY) 53.4 trillion, growing 6.9 per cent from 2018, and accounting for 59.4 per cent of gross domestic product (GDP).¹

However, the COVID-19 outbreak resulted in a 5.2 per cent year-on-year decrease in growth in the service industry for the first quarter of 2020.² To bring the outbreak under control, many provinces and cities in China imposed lockdown measures, such as travel restrictions, enforced quarantine and erecting physical roadblocks. This made the flow of goods and people almost impossible and led to a number of business operations having to shut down.

As COVID-19 spread globally, several countries, including China, closed their borders and imposed international travel restrictions. Together, these measures have had an extremely negative impact on the service sector, in particular the aviation, tourism, entertainment and logistics industries.

Several airlines decided to cancel international flights to China in early 2020, and then struggled to resume them.³ It is expected that 2020 will be the worst year in recent history for aviation,⁴ and the air passenger market is only expected to return to 2019 levels by 2023 or 2024.⁵⁸⁶ The Logistics Working Group reported that "intra-China and transborder transportation suffered their biggest impact in February 2020. The quarantine measures imposed on different Chinese cities led to a shortage of labour in both manufacturing and logistics. Ministry of Transport (MOT) statistics showed that the completed freight volume from January to April 2020 was 11.66 billion tonnes, a 13.7 per cent year-on-year decrease."⁷

To ensure the survival of these two sectors, Chinese authorities have issued supporting policies. For

7 For more information, please refer to the Logistic Working Group Position Paper on Page 345.

¹ Du Xishuang: the Quality and Efficiency of the Development of Service Sector Improved, National Statistics Bureau, 19th January 2020, viewed 6th July 2010, http://www.stats.gov.cn/tjsj/zxfb/202001/l20200119_1723779.html

² Du Xishuang: Significant Improvement in Service Sector in March, NBS, 19th April 2020, viewed 10th July 2020, http://www.stats.gov.cn/tjsj/zxfb/202004/t20200419_1739674.html

³ For more information, please refer to the Aviation and Aerospace Working Group Position Paper on Page 294.

⁴ Industry Losses to Top \$84 Billion in 2020, International Air Transport Association (IATA), 9th June 2020, viewed 10th July 2020, ">https://www.iata.org/en/pressroom/pr/2020-06-09-01/>

⁵ IATA: Demand in Global Air Passenger Market Might Recover in 2023-2024, IATA, published on 15th May 2020, viewed 6th July 2020, http://www.cata.org. cn/XWZX/HYYW/202005/t20200514_89992.html

⁶ For more information, please refer to the Aviation and Aerospace Working Group Position Paper on Page 294.

example, in support of the aviation industry, the Civil Aviation Administration of China (CAAC) introduced subsidies for airlines that continued to carry out flights, reduced or exempted airport fees and increased infrastructure investment related to emergency needs, resumption of work and safety of flights.⁸ However, foreign airlines may not benefit from all financial incentives due to the travel bans on international passengers and the resulting non-operation of flights.⁹

At the same time, necessary adjustments to people's lives and working practices as a result of the COVID-19 outbreak has led to new business opportunities. In the first quarter of 2020, China's mobile data traffic consumption increased 39.3 per cent from the same period in 2019. In March alone, the average household usage of mobile traffic reached 9.5 gigabytes, the highest level in the past 12 months, demonstrating the rapid growth of information consumption.¹⁰ The value created by data transmission, software, and information and communication technology (ICT) services enjoyed an increase of 13.2 per cent in the first quarter of 2020.¹¹ Such figures highlight both the increasingly important role and the potential of digital services.

Remote office platforms and conference call applications have allowed many companies to continue vital, daily communications and maintain normal business operations. With all enterprises increasingly reliant on the value-added telecommunications services (VATS) sector, the case for providing them with greater and improved internet/telecoms access has been strongly made, in the interests of keeping the economy running to the greatest extent possible.¹² However, as the VATS sector in China is still largely closed to European businesses, they are unable to operate on a level playing field and provide high-quality, competitive services to Chinese customers.¹³ Although two notices were recently released by the Ministry of Industry and Information Technology (MIIT) and the State Council,^{14&15} stating China's intention to liberalise the VATS sector in free trade zones for foreign-invested enterprises (FIEs), it will take time to assess implementation of the notices and whether they will actually lead to new business opportunities for FIEs.

Certain cybersecurity schemes have also resulted in a discriminatory environment for international businesses, restricting or even prohibiting FIEs from providing products and services to segments of the Chinese market. The lack of a clear definition of scope, as well as detailed procedures for such schemes, means that uncertainty continues and international businesses remain at an unfair disadvantage.¹⁶

Published in December 2019 by the Organisation for Economic Co-operation and Development (OECD), the *Services Trade Restrictiveness Index on China* shows minor improvement from the previous version. Architecture, rail freight transport and engineering services all attained better results compared with 2018 figures. However, FIEs in these three sectors are still unable to compete fairly with domestic Chinese companies.

⁸ CAAC's Notice on Policies to Actively Respond to the COVID-19, CAAC, 9th March 2020, viewed 2nd June 2020, http://www.caac.gov.cn/XXGK/XXGK/TZTG/202003/t20200309_201361.html

⁹ For more information, please refer to the Aviation and Aerospace Working Group Position Paper on Page 294.

¹⁰ MIIT: The Mobile Data Consumption per Household Peak at the Highest Level in the Past 12 Months, People's Daily, 25th April 2020, viewed 6th July 2020, http://it.people.com.cn/n1/2020/0425/c1009-31687659.html

¹¹ Du Xishuang: Significant Improvement in Service Sector in March, NBS, 19th April 2020, viewed 6th July 2020, http://www.stats.gov.cn/tjsj/zxfb/202004/t20200419_1739674.html

¹² For more information, please refer to the Information and Communication Technology Working Group Position Paper on Page 319.

¹³ Ibid.

¹⁴ Notification on the Preparation for the Relevant Value-Added Telecom Services Pilot Opening in Free Trade Zones, MIIT, 9th May 2020, viewed 1st June 2020, http://www.miit.gov.cn/newweb/n1146285/n1146352/n3057674/n3057693/n3057695/c7915545/content.html

¹⁵ State Council's Release on the General Construction Plan for the Hainan Free Trade Port, State Council, 1st June 2020, viewed 8th June 2020, http://www.gov.cn/zhengce/2020-06/01/content_5516608.htm

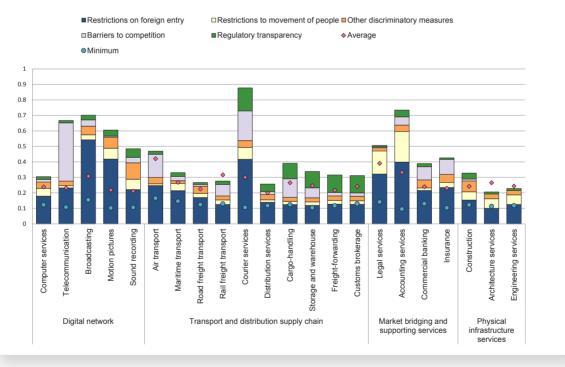
¹⁶ For more information, please refer to the Cybersecurity Sub-working Group Position Paper on Page 333.



For example, the rail freight transport sector is heavily controlled by state-owned enterprises, which makes it difficult for private business—including FIEs—to compete in a fair environment.¹⁷ In the civil engineering sector, National Bureau of Statistics data shows that the profit of wholly foreign-owned construction enterprises (WFOCEs) accounted for just 0.37 per cent, 0.27 per cent and 0.41 per cent of the total profit of all construction service providers (CSPs) in China in 2016, 2017 and 2018 respectively.¹⁸ In China, all CSPs are required to obtain qualification certification before they can participate in any construction projects.¹⁹ However, as European qualifications and experience outside China are largely not recognised in China, this leaves European CSPs unable to obtain local qualifications in some provinces. Furthermore, WFOCEs are only allowed to undertake four types of construction projects that fall under the scope permitted by their qualification grades, according to Decree 113 of the *Regulations on the Administration of Foreign-invested Construction Enterprises*.

In addition, Chinese construction authorities require European service providers to use a set of outdated standard contracts that were issued in 1999 by the former Ministry of Construction (MOC) and the former State Administration of Industry and Commerce (SAIC) for design, surveying, construction and construction supervision. Such contracts determine legal and compliance issues for European service providers that often prefer to use other types of contracts.²⁰ Similar to other sectors, although the supporting policies introduced by the State Council on 26th February 2020 to promote the resumption of work in the construction sector, it remains unclear how FIEs can benefit from this.²¹

STRI by sector and policy area (2019)



Source: OECD Services Trade Restrictiveness Index (STRI): The People's Republic of China²²

- 17 OECD Services Trade Restrictiveness Index (STRI): The People's Republic of China, OECD, December 2019, viewed 6th July 2020, https://www.oecd.org/trade/topics/services-trade/documents/oecd-stri-country-note-china.pdf
- 18 For more information, please refer to the Construction Working Group Position Paper on Page 303.
- 19 The Construction Law of the People's Republic of China, National People's Congress, 7th May 2019, viewed 10th July 2020. http://www.npc.gov.cn/npc/c30834/201905/0b21ae7bd82343dead2c5cdb2b65ea4f.shtml
- 20 For more information, please refer to the *Construction Working Group Position Paper* on Page 303.
- 21 Strengthening COVID-19 Epidemic Prevention and Control and Orderly Promotion of the Resumption of Work of Enterprises, State Council, 26th February 2020, viewed on 6th June 2020, https://www.gov.cn/zhengce/zhengceku/2020-03/02/content_5485626.htm
- 22 OECD Services Trade Restrictiveness Index (STRI): The People's Republic of China, OECD, December 2019, viewed 6th July 2020, https://www.oecd.org/

On 23rd June 2020, the National Development and Reform Commission (NDRC) and MOFCOM jointly released updated versions of China's Negative List for Foreign Investment and the Negative List for Foreign Investment for China's Free Trade Zones (FTZs).²³⁸²⁴ While both lists have been shortened and improvements have been made in certain manufacturing sectors and financial services, restrictions in aviation, ICT, international liner shipping and logistics remain almost the same.

The European Chamber's *Business Confidence Survey 2020* shows that most member companies remain committed to China despite the challenges they are facing.²⁵ However, this commitment should not be taken for granted, particularly given how badly companies have been impacted by COVID-19. The Chinese Government now has an opportunity to show its strength and leadership by following in the footsteps of the country's great reformers of the last forty years, and take full advantage of this crisis by further liberalising the market.²⁶



This icon represents the number of years the working group has been making this recommendation.

trade/topics/services-trade/documents/oecd-stri-country-note-china.pdf>

²³ Special Administrative Measures on Access to Foreign Investment (2020 Version), NDRC & MOFCOM, 23rd June 2020, viewed 6th July 2020, http://www.gov.cn/zhengce/zhengceku/2020-06/24/content_5521520.htm.

²⁴ Special Administrative Measures on Access to Foreign Investment in Free Trade Zones (2020 Version), NDRC & MOFCOM, 23rd June 2020, viewed 6th July 2020, http://www.gov.cn/zhengce/zhengceku/2020-06/24/content_5521523.htm

²⁵ European Chamber Business Confidence Survey 2020: Navigating In the Dark, European Chamber, 10th June 2020, <https://static.europeanchamber.com. cn/upload/documents/documents/BCS_EN2020_final[774].pdf>

²⁶ Ibid.



Aviation and Aerospace Working Group

Key Recommendations

1. Create a Stable Airworthiness Environment <a>2

- Make the airworthiness validation process more predictable and transparent, and ensure continuous dialogue and collaboration on airworthiness.
- Utilise the established trust between the Civil Aviation Administration of China (CAAC) and the European Aviation Safety Agency (EASA) to reduce duplicated certification/validation tasks, and reduce the burden on European original equipment manufacturers (OEMs) during product validation, regardless of whether the Bilateral Aviation Safety Agreement (BASA) and associated procedures are introduced or not.
- Improve the collaboration through the BASA on continued airworthiness issues by maximum reliance on the State of Design, supported by information sharing and defined communication mechanisms.
- Protect European OEM's intellectual property (IP) and respect their innovation and discovery during the product approval phase.

2. Increase the Efficiency of Airspace Use in China 14

- 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 European Union (EU) expertise to implement nationwide System Wide Information Management (SWIM) based on a data communication platform with a centralised data lake.
- Apply a data-driven approach to derive new applications and operational concepts to improve operational efficiency and relieve growing air traffic pressure.
- Study as early as possible the integration of Automatic Traffic Management (ATM) and Unmanned Traffic Management (UTM) to ensure fast and safe development of the Unmanned Aircraft System (UAS) market in China, and enhance exchanges with EU authorities and industry to enable harmonisation of Unmanned Aviation Vehicle (UAV) standards and regulations.
- Continue evaluating the possibility to let airlines freely choose the air route instead of registering only one or several routes for all kinds of operation and extend the current scope of the 'flexible entry and exit point' policy.
- Exchange idea with EU on how to integrate the civil and military airspace.

3. Enhance Dialogue Between Chinese Authorities and the European Industry 12

- Restore normal scheduled air services between the EU and China on the basis of air services agreements between China and EU Member States.
- Align all measures and decisions implemented at central and provincial administrative levels, and adopt international standards regarding COVID-19 testing.
- Return to normal practices by permitting the entry of EU citizens who need to travel to China for work and family reunion purposes.
- Create a joint EU-China commission to follow up on initiatives to create incentives and protective policies that can strengthen the resilience of airline companies and boost the aviation industry after the COVID-19 crisis.



- Launch a new phase of the EU-China Aviation Partnership Project (APP) .
- Abolish the Foreign Aviation Service Company (FASCO) monopoly position and allow foreign airlines to hire staff either directly or through various employment agencies.
- Grant computer reservation system services market access in a bilateral framework between the EU and China in aviation technology.
- 4. Develop a Regulatory Framework that Facilitates Sustainable Development of the Aviation Industry
 - Create a trusted and long-term communication channel between the EU and China to negotiate emissions targets in the frame of, but not limited to, the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA).
 - Facilitate strategic dialogue on potential cooperation on sustainable aviation technology development.
 - Create specific dialogues aimed at developing a certification strategy to ensure improved efficiency of aircraft in the future, including electrification or automation.

Introduction to the Working Group

The aviation industry significantly contributes to both the European Union (EU) and China in driving economic growth, creating jobs and facilitating mobility and trade. Today the European aviation industry represents 26 per cent of the world's market, contributing euro (EUR) 510 billion annually to the EU's gross domestic product, and supporting 9.3 million jobs.¹ China is the second largest aviation market today, and is predicted to be the world's largest by 2025.

The working group includes passenger and freight air carriers, as well as companies that manufacture a wide range of aerospace products, including civil aircraft, engines, helicopters, space systems and other products across the supply chain. It is also comprised of maintenance and service companies that carry out repairs, training, and other activities that support aviation and aerospace industries.

Recent Developments

In 2019, China celebrated the 70th anniversary of the foundation of the People's Republic of China. During those 70 years, the civil aviation industry in China has

undergone tremendous changes. Today there are 238 certified airports for civil aviation in China, including 39 airports with an annual passenger throughput of 10 million. Beijing Capital International Airport has become the world's second airport to have more than 100 million annual passenger throughputs in a year, after Atlanta Airport in the United States. Meanwhile, Beijing Daxing International Airport has commenced operations, with the aim of easing the pressure on Beijing Capital. In 2019, the total number of scheduled flight routes in China reached 5,521.²

China's civil aviation industry saw a total transportation turnover of 129.33 billion tonne-kilometres in 2019, a 7.2 per cent year-on-year increase. Passenger traffic volume stood at 660 million, up 7.9 per cent on 2018. The cargo and mail transportation volume reached 7.5 million tonnes, an increase of 2.0 per cent compared to 2018. Civil aviation annual passenger turnover accounted for 32.8 per cent of the national comprehensive transportation systems. The rate of flight dispatch reliability of the national fleet reached 81.65 per cent.³

¹ IATA North Asia Will Promote the Development of Chinese Civil Aviation, CAAC News, 5th June 2019, viewed 2nd June 2020, http://www.caacnews.com. cn/1/88/201906/t20190605_1275137.html>

² LI Xiaopeng, Press Conference of the State Council Information Office on September 24, 2019 "Building national strength in transportation", State Council, 24th September 2019, viewed 2rd June 2020, <http://www.gov.cn/xinwen/2019-09/24/ content_5432724.htm>

^{3 2020} National Civil Aviation Work Conference, CAAC, 6th January 2020, viewed 2nd June 2020, <http://www.caac.gov.cn/XWZX/MHYW/202001/t20200106_200171. html>



By the end of 2019, there were 62 air transport enterprises, 478 general aviation (GA) enterprises and 67,953 pilots with valid licences in China.

Chinese GA flights clocked up over a million hours in 2019, a 13.6 per cent year-on-year increase. The number of certified general airports grew to 246, exceeding the number of transport airports for the first time. There were over 392,000 drones registered in China in 2019, and 1.25 million drone commercial flight hours accumulated.⁴

The Aviation and Aerospace Working Group aims to monitor reforms of GA, state-owned companies and evaluating third parties. The working group is also concerned about administrative measures relating to the control of international air shipping rights, fostering the creation of standards on air electronic shipping business, supporting domestic aviation manufacturing, accelerating the airworthiness approval procedure and opening airline approval procedures, among others.

Regarding safety, based on the International Air Transport Association's (IATA's) *Air Transport Safety Report 2019*,⁵ the safety of worldwide airlines continues to improve on a yearly basis. The total accident rate (measured in accidents per one million flights) was 1.13, or equivalent to one accident for every 884,000 flights. This was down from 2018's rate of 1.36, as well as the average rate of the previous five years, 1.56 (2014–2018). However, 2019's rate was higher than 2017's record rate of 1.11. In 2020, due to the Coronavirus Disease 2019 (COVID-19) outbreak, the aviation industry is facing the most serious crisis in its history; however, ensuring the safety of aviation travel still remains its top priority.⁶

In 2019, the civil aviation industry achieved 12.31 million hours of safe flights, an increase of 6.7 per cent year-on-year. The accident rate was down 8.3 per cent from 2018 figures. China's aviation transportation industry set a new safety record of 112 months and 80.68 million hours of continuous safe flights, and at the same time achieved a record incident-free 17 years and

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seven months in the civil aviation security sector.7

Following the joint statement released during the EU-China Summit in March 2019, the EU and China signed a Bilateral Civil Aviation Safety Agreement (BASA) in May 2019, to strengthen aviation cooperation.⁸ It is hoped that this will serve to boost the competitiveness of the EU's aeronautical sector and enhance overall EU-China aviation relations. The BASA is expected to promote cooperation between the EU and China in their attempts to establish a high level of civil aviation safety and environmental compatibility. In addition to the BASA, the EU and China also signed a horizontal aviation agreement. With this horizontal aviation agreement, China also recognises the principle of EU designation.⁹ The BASA is undergoing the process of modification by EU Member States at time of writing, and both Brussels and Beijing are pushing for implementation of the agreement.

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, the reduction or exemption of airport fees, and increasing infrastructure investment related to emergency needs, and resumption of work and safety.¹⁰ However, foreign airlines may not benefit from all these financial incentives due to the 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' policy¹¹ and the *Notice of Adjustments to International Passenger Flights*¹² in March and June respectively, which specify that "one

^{4 2020} National Civil Aviation Work Conference, CAAC, 6th January 2020, viewed 2nd June 2020, http://www.caac.gov.cn/XWZX/MHYW/202001/t20200106_200171. html>

⁵ Air Transport Safety Report 2019, IATA, 6th April 2020, viewed 2nd June 2020, <https://www.iata.org/en/pressroom/pr/2020-04-06-01/>

⁶ International Air Transport Association Releases 2019 Air Transport Safety Report, IATA, 15th February 2020, viewed 2nd June 2020, https://www.iata.org/contentassets/6e5dc3af2fe246b8ae7ce8b8d0e16037/2020-04-06-01-cn.pdf

^{7 2020} National Civil Aviation Safety Conference, CAAC, 7th January 2020, viewed 2nd June 2020, http://www.caacnews.com.cn/1/1/202001/t20200107_1289670.html

⁸ Aviation Strategy for Europe: Aviation Agreements with China, European Commission, 20th May 2019, viewed 2nd June 2020, <https://ec.europa.eu/ commission/presscorner/detail/en/IP_19_2650>

EU-China Aviation Agreement, EUbusiness, 21st May 2019, viewed 2nd June 2020, https://www.eubusiness.com/topics/airlines/aviation-china

¹⁰ CAAC's Notice on Policies to Actively Respond to COVID-19, CAAC, 9th March 2020, viewed 2nd June 2020, http://www.caac.gov.cn/XXGK/TZTG/202003/t20200309_201361.html>

¹¹ CAAC: Notice on Further Reducing International Passenger Flights during the Epidemic Prevention and Control Period, 26th March 2020, viewed 16th March 2020 <http://www.caac.gov.cn/XXGK/XXGK/TZTG/202003/P020200326766958017420. pdf>

¹² CAAC: Notice on Adjustment of International Flights, 4th June 2020, viewed 16th June 2020, <http://www.caac.gov.cn/XXGK/XXGK/TZTG/202006/l20200604_202928.html>

weekly passenger flight operated by a foreign airline to China from an EU Member State is permitted". These measures further hinder the resumption of normal scheduled operations by EU airlines on routes between the EU and China.

Taking into account the substantial impact of this crisis on the aviation industry, the working group will closely follow the implementation of specific measures in China to sustain the industry, and ensure that European airlines and businesses in China receive equal and fair treatment to their Chinese counterparts.

Key Recommendations

1. Create a Stable Airworthiness Environment 1 2

Concern

The long, labour-intensive and unpredictable airworthiness certification processes needed when introducing products into the Chinese market are limiting possibilities for European airlines to develop, thereby dampening competition in China.

Assessment

Airworthiness is unequivocally considered to be a top priority for national aviation authorities. The BASA aims to align the airworthiness certification processes in the EU and China. This would enable companies from both sides to quickly accede to each other's market, and facilitate continued airworthiness management. The working group welcomed the signing of the BASA in May 2019, and expects the agreement to be ratified and implemented promptly. However, the COVID-19 outbreak might delay validation of the BASA. Unfortunately, an EASA-CAAC Safety Conference, intended to continuously develop BASAassociated procedures and scheduled for early 2020, was cancelled due to COVID-19. It is important that the BASA be implemented properly, in order to significantly reduce both the duplication of certification/validation and the burdens faced by OEMs.

Furthermore, the 'State of Design'-the State (country) having jurisdiction over the organisation responsible for the type design of an aircraft and its airworthinessis globally recognised as playing an important role in guaranteeing the continued airworthiness and competitiveness of OEMs. Deviation from that system

may impair OEMs' capability of reacting promptly if problems arise. The working group believes that the BASA, which has incorporated the State of Design principle, can encourage innovative design, improve intellectual property protection and strengthen bilateral cooperation on continued airworthiness.

Recommendations

- · Make the airworthiness validation process more predictable and transparent, and ensure continuous dialogue and collaboration on airworthiness.
- · Utilise the established trust between the CAAC and the EASA to reduce duplicated certification/validation tasks, and reduce the burden on European OEMs during product validation, regardless of whether the BASA and associated procedures are introduced or not.
- · Improve the collaboration through the BASA on continued airworthiness issues by maximum reliance on the State of Design, supported by informationsharing and defined communication mechanisms
- · Protect European OEMs' IP and respect their innovation and discovery during the product approval phase.

2. Increase the Efficiency of Airspace Use in China (1)4

Concern

The lack of a unified means of data-sharing is impeding the ability to benefit from the potential of data analytics to reduce airspace congestion issues and make air traffic management (ATM) more efficient in China, which results in additional costs, longer flying times and increased environmental damage for air carriers.

Assessment

China has been investing heavily in air traffic control (ATC) system expansions in order to support the rapid growth in air travel. To support many airports reaching their capacities, construction and expansion projects are being carried out at an accelerated pace throughout the country.

As a consequence, heterogeneous systems are being implemented, making it increasingly challenging to achieve seamless interoperability and data exchange between systems from different suppliers. Apart from the challenges of interfacing with multiple systems





with different standards, there is also an inability to centralise the ATM data or utilise big data concepts. This represents a significant missed opportunity to study ways to improve the efficiency of air traffic flow 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 up 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.

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 working-group level partnership between the safe air travel organisation EUROCONTROL and air traffic management bureaus (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, reduce carbon emissions by letting airlines choose the most effective routes in Chinese airspace.

The abrupt arrival of the unmanned aircraft systems (UAS) industry in China has exacerbated safety and security challenges. Public safety incidents and airspace conflicts between unmanned aircraft vehicles (UAVs) and civil transport aircrafts are starting to become commonplace. The working group recommends that the Chinese authorities improve air safety management while promoting UAS usage. From

an industry perspective, UAS traffic management (UTM) and the insertion of UAS into civil airspace should be the subjects of future research in order to optimise airspace efficiency while maintaining the current civil air-transport workload.

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 nationwide SWIM based on a data communication platform with a centralised data lake.
- Apply a data-driven approach to derive new applications and operational concepts to improve operational efficiency and relieve growing air traffic pressure.
- Study as early as possible the integration of ATM and UTM to ensure fast and safe development of the UAS market in China, and enhance exchanges with EU authorities and industry to enable harmonisation of UAV standards and regulations.
- Continue evaluating the possibility to let airlines freely choose air routes instead of registering only one or several routes for all kinds of operations, and extend the current scope of the 'flexible entry and exit point' policy.
- Exchange ideas with the EU on how to integrate civil and military airspace.

3. Enhance Dialogue Between Chinese Authorities and the European Industry (3)2

Concern

The COVID-19 crisis has shown that the channels for dialogue between China's aviation regulator and European enterprises are currently not sufficient, causing barriers to industrial players' development and risking their non-compliance, while also not observing international agreements regarding equal treatment toward foreign investors.

Assessment

Since the start of the COVID-19 global pandemic, the measures proposed by the CAAC for limiting international flights have been unilateral in nature, taken without consultation with EU Member States. This amounts to unilateral suspension of the air services



agreements between China and EU Member States, and severely impedes the resumption of flights by European air carriers between the EU and China. In fact, the government's 'Five-One' measures only permit one foreign carrier from one member state to operate one route to China, while more than one Chinese carrier can serve the same destination without restriction in the EU. This practice naturally produces an unfair imbalance.

Meanwhile, according to the *Notice of Adjustments to International Passenger Flights*, dual requirements for flight approval not only by the CAAC, but also by the local authorities of a destination for a 'certification letter', increase the administrative burden and costs for European air carriers.

'Circuit-breaker' measures specified in the Notice of Adjustments to International Passenger Flights set out penalties to be imposed on carriers that transport infected passengers. The measures propose that a carrier that unknowingly transports certain numbers of passengers who test positive for COVID-19 on arrival in China should have their traffic rights withdrawn for a defined period. The lack of clarity for implementing suspension of a route due to positive nucleic acid tests among arriving passengers numbering above certain thresholds, increases pressure and potential losses for airlines when dealing with subsequent flight planning and readjusting flights for affected passengers. This 'circuit breaker' contradicts the CAAC's policy on ticket sales (no CAAC confirmation, no sale of ticket), as the flight approval by CAAC is considered a provisional confirmation that can be withdrawn at any time after the tickets are sold. Meanwhile, passengers buy tickets without any guarantee that their flights will take off, and have very limited options for substitute flights after a cancellation.

Foreign airlines must also abide by the different standards and protocols of pandemic prevention for testing and quarantine at national and local levels in China, in addition to complying with the measures in their home countries. The frequently changing rules and policies in China make it difficult for airline companies to adapt.¹³

Due to the *Temporary Suspension of the Entry of Foreigners with Valid Chinese Visas and Residence Permits*,¹⁴ the inability to obtain entry permits is preventing a large number of foreign managers, technicians, visitors and personnel (such as teachers in international schools), and their family members, from returning to China. This seriously hampers the resumption of international exchanges, business and investment, and directly affects the recovery of work and the resumption of flights.

At the same time, the working group appreciates the series of incentives launched by the CAAC, the State Council and the Ministry of Finance for sustaining the industry, especially for supporting the European airline companies operating in China.

The State Council decided to exempt airlines from the fixed share of fees for the Civil Aviation Development Fund in 2020.¹⁵ Additionally, the implementation of a set of new supportive measures was announced, and the CAAC released a comprehensive set of packages.^{16&17} These included a moratorium on the 'use it or lose it' system for airport slots for domestic flights, an eight per cent reduction in fuel charges for domestic flights, the simplification of programme approval procedures, new investments via the Civil Aviation Development Fund, reductions in road and landing charges, and exemptions from ground service charges.¹⁸

Chinese Premier Li Keqiang, recognising that the capacity of international air cargo in China has been severely affected, announced a series of provisions for air operators (promoting increased links and new flexibilities for crew flight times), logisticians (offering 24hour clearance at all major airports) and infrastructure of airports (modernising cold chain or postal-sorting

¹³ Preventing Spread of Coronavirus Disease 2019 (COVID-19) Guideline for Airlines-5th Edition;Preventing Spread of Coronavirus Disease 2019 (COVID-19) Guideline for Airports - 5th Edition, CAAC, 18st March 2020, viewed 24th June 2020, http://www.caac.gov.cn/XXGK/TZTG/202006/t20200618_203183.html)

¹⁴ Ministry of Foreign Affairs and National Immigration Administration (NIA): Announcement by the MFA and the NIA on the Temporary Suspension of Entry by Foreign Nationals Holding Valid Chinese Visas or Residence Permits, NIA, 26th March 2020, viewed 24th June 2020, <https://www.nia.gov.cn/n741440/n741542/ c1267259/content.html>

¹⁵ State Council: Civil Aviation Enterprises are Exempted from Civil Aviation Development Fund, CANNews, 6th February 2020, viewed 2nd June 2020,<http://www.cannews.com.cn/2020/0206/208176.shtml>

¹⁶ Notice of MOF and CAAC on Funding Policy for Enterprises in Civil Aviation Transportation During COVID-19, CAAC, 4th March 2020, viewed 2rd June 2020, http://www.caac.gov.cn/XXGK/TZTG/202003/t20200304 201269.html>

¹⁷ CAAC Issue a Set of Policies and Measures to Promote the Stable Development of the Industry [Press Conference], CAAC, 9th March 2020, viewed 2nd June 2020, http://www.caac.gov.cn/XWZX/MHYW/202003/t20200309_201360.html

¹⁸ CAAC Introduce Safe Production and Operation of Civil Aviation in February, and the Relevant Supporting Policies of Civil Aviation in Response to the COVID-19, State Council, 12nd March 2020,viewed 2nd June 2020, ">http://www.gov.cn/xinwen/2020-03/12/content_5490607.htm#1>



systems).¹⁹ These measures were rapidly implemented by the CAAC, ensuring also transparency of fares with rigorous application by operators, as well as a commitment to quickly process and issue permits and authorisation.²⁰⁸²¹

The working group recommends the creation of a joint EU-China working group to monitor and follow up on the implementation of these initiatives, incentives and protective policies, and measure their contribution to Strengthen the resilience of airline companies, facilitate procedures for resumption of flights, and boost the aviation industry in China post-COVID-19.

Following a number of successful cooperation programmes, the EU-China Aviation Partnership Project (APP) was officially launched in 2016.²² The project allowed the EASA and the CAAC to directly implement activities together, in close cooperation with their industry partners. Aiming to strengthen the economic partnership between the EU and China in the civil aviation domain, the APP links technical cooperation with policy dialogue and focusses on activities of mutual interest.23 Co-financed by the EU and the Chinese Government, the APP had organised over 80 activities by end of June 2020. These brought together close to 5,000 European and Chinese aviation professionals to exchange information, experiences and best practices on a variety of aviation subjects. Topics covered included areas such as: regulatory dialogues on safety; GA, ATM and air navigation services (ANS) and airports; airworthiness; environmental protection; economic policy and regulation; aviation safety and security; and legislation and law enforcement.

This project contributed strongly to fostering a climate of exchange at the technical level. With the current EU-China APP scheduled to finish on 14th September 2020, the Aviation and Aerospace Working Group would like to highlight the important contribution this project has made to the improvement of ties between the EU and China aviation industries, and strongly supports the continuation of the project.

Moreover, equal treatment towards European foreign investors in China remains a strong concern, especially in the service sector. In Europe, a domestic or foreign airline is free to hire its employees through any means that best suits the company's practice. According to the principle of the equal treatment and reciprocity of the bilateral aviation agreements and the World Trade Organization (WTO) Service Agreement.²⁴ China must allow foreign airlines to hire employees as they see fit. However, In China, the obligation to recruit personnel using a special employment agency, such as FASCO, represents forced outsourcing. This directly affects airlines' performance in an industry where customer service satisfaction, and hence commercial success, is very much dependent upon the attitude and motivation of staff.

Reciprocal market access for computer reservation system (CRS) services should be granted to European service providers, given that the current Chinese regulations provide no meaningful market access. It would therefore not be sufficient to simplify or adjust the procedures in the CAAC 2012 interim CRS regulation CCAR315;²⁵ they would have to be repealed and replaced by a framework that offers EU CRS's the same market access in China as the EU offers Chinese players.

It would benefit the Chinese aviation sector and its passengers immensely if the European service providers were allowed to deliver its state-of-the art solutions in China. While there are no formal obstacles to this, the Chinese CRS services market remains closed. The Chinese Government is encouraged to take an active role in breaking the SOE monopoly in this arena.

Recommendations

 Restore normal scheduled air services between the EU and China on the basis of air services agreements between China and EU Member States.

¹⁹ CAAC: International Passenger Flights in Capital Airport Have Operated Generally Smoothly Since the First Entry Point Adjustment [Press Conference], CAAC, 24th March 2020, viewed 2nd June 2020, <http://www.caac.gov.cn/XWZX/ MHYW/202003/t20200324_201689.html>

²⁰ In the wake of these general guidelines, CAAC announced on 2nd April 2020 the detailed decisions supporting air cargo operations.

²¹ Notice published on 7th April to ensure transparency of fares in the context of rigorous application by operators with a processing commitment by the CAAC Department of Transportation to issue permits within 24 hours, seven days a week.

²² EU-China APP website, viewed 2nd June 2020, <https://www.eu-china-app.org>

²³ International Cooperation Explained, EASA, n.d.,viewed 2nd June 2020, <https:// www.easa.europa.eu/easa-and-you/international-cooperation/internationalcooperation-explained>

²⁴ General Agreement on Trade in Services, WTO, viewed 2nd June 2020, <https://www. wto.org/english/docs_e/legal_e/26-gats_01_e.htm>

²⁵ Interim Permit ManagementMeasures 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 9th July, 2020, http://www.caac.gov.cn/XXGK/XKGK/MHGZ/201605/t20160530_37632.htm)

- Align all measures and decisions implemented at central and provincial administrative levels, and adopt international standards regarding COVID-19 testing.
- Return to normal practices by permitting the entry of EU citizens who need to travel to China for work and family reunion purposes.
- Create a joint EU-China commission to follow up on initiatives to create incentives and protective policies that can strengthen the resilience of airline companies and boost the aviation industry after the COVID-19 crisis.
- Launch a new phase of the EU-China APP between the EU and China.
- Abolish the FASCO monopoly position and allow foreign airlines to hire staff either directly or through various employment agencies.
- Grant CRS services market access in a bilateral framework between the EU and China in aviation technology.

4. Develop a Regulatory Framework to Facilitate Sustainable Development of the Aviation Industry

Concern

While the aviation industry is developing technology to reach its reduced emission targets by 2050, the certification process is lagging behind, meaning that these new products cannot be fully deployed and adopted to deliver their environmental benefits.

Assessment

Chinese authorities have been vigorously debating the process for the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) initiative.²⁶ China calls for "promoting the establishment of a fair and equitable CORSIA implementation pathway featuring fairness and equity...through dialogue, consultation and negotiation", rather than the 'onesize-fits-all approach' most developed countries are opting for.²⁷ The European aviation industry played an important role in setting up the CORSIA, and will be a key player in ensuring the development of the different phases: (the pilot phase (2021–2023); the first phase (2024–2026); and the second phase (2027–2035). Strong coordination with China will be necessary to achieve full implementation.

From a technological point of view, China's leadership in eco-technologies is transforming the economics of our global energy system, with benefits that extend far beyond its borders. The government recognises that ramping up clean energy is crucial for meeting the country's own environmental, economic restructuring and energy security goals. Even if China is currently in the lead when it comes to creating these ecotechnologies, their application in the aerospace industry lags behind other countries. An alignment between the existing technologies in China and potential trends in aviation would permit the identification of benefits in their use for the future of the industry. Potential aspects to consider could include solar power, energy storage, fuel cells, sustainable fuel, carbon capture, material recycling and bio-materials. To ensure that these technologies can be integrated into the industry's portfolio, a strong link between the development of these technologies and the aviation authorities will be key.

Europe and China should support together the certification of new products and solutions for energy saving and emission reduction in the aviation industry to avoid long and complicated administrative approval procedure. Unification of standards and procedures for certification adopted by Europe and China may reduce 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 emissions targets within the framework of, but not limited to, the CORSIA.
- Facilitate strategic dialogue on potential cooperation on sustainable aviation technology development.
- Create specific dialogues aimed at developing a certification strategy to ensure improved efficiency of aircraft in the future, including electrification or automation.

²⁶ Carbon Offsetting and Reduction Scheme for International Aviation, CORSIA, April 2020, viewed 2rd June 2020, <https://www.icao.int/environmental-protection/CORSIA/Pages/default.aspx>

²⁷ Perspectives on the Fair and Equitable Corsia Implementation Pathway, ICAO, 2nd August 2019, viewed 2nd June 2020, https://www.icao.int/Meetings/A40/Documents/WP/wp_306_en.pdf



Abbreviations

| APP | Aviation Partnership Project |
|--------|---|
| ATC | Air Traffic Control |
| ATM | Air Traffic Management |
| ATFM | Air Traffic Flow Management |
| ANS | Air Navigation Services |
| BASA | Bilateral Civil Aviation Safety |
| | Agreement |
| CAAC | Civil Aviation Administration of China |
| CORSIA | Carbon Offsetting Scheme for |
| | International Aviation |
| CRS | Computer Reservation System |
| EASA | European Aviation Safety Agency |
| EU | European Union |
| FASCO | Foreign Aviation Service Company |
| FIR | Finite Impulse Response |
| GA | General Aviation |
| IATA | International Air Transport Association |
| ICAO | International Civil Aviation Organization |
| MRO | Maintenance, Repair and Operation |
| OEM | Original Equipment Manufacturer |
| SWIM | System Wide Information Management |
| UAS | Unmanned Aircraft System |
| UAV | Unmanned Aerial Vehicle |
| UTM | UAS Traffic Management |
| WTO | World Trade Organization |
| | |



Construction Working Group

Key Recommendations

- 1. Provide New Opportunities for Foreign Investment in Different Types of Cities and Towns, While Expanding and Building Responsive and Safe Infrastructure in Rural and Urban Areas, in Particular in Small and Mediumsized Cities (310)
 - Allow European companies to participate more widely in the process of China's urbanisation.
 - Expedite reforms that will allow European construction service providers to contribute more towards green buildings and sustainable cities as well as intelligent buildings, smart cities and smart communities in China.
 - Allow European companies to bid for and participate in projects such as in the national demonstration areas under the China Manufacturing 2025 initiative.
 - Remove market access barriers in the planning, architectural and design, construction and real estate sectors.
 - Allow European firms to contribute to the development of small and medium-sized cities and the improvement of urban utilities and infrastructure.
- 2. Allow European Companies Greater Access to Bid on Government Procurement Work
 - Allow European companies greater access to the bidding process on government procurement work in line with the World Trade Organization's Government Procurement Agreement.
- 3. Remove Market Access Barriers for European Planning, Architectural and Design, Construction, and Real Estate Service Providers to Enable Fair Competition and Facilitate Expertise-sharing (1)
 - Allow wholly foreign-owned construction enterprises to independently carry out local investment construction projects in China.
 - · Allow European service providers to bid for third party contracts in government projects.
 - Recognise international expertise and professional qualifications to facilitate knowledge-sharing and exchange of know-how across regions.
 - Remove strict requirements associated with using standard contracts issued by the former Ministry of Construction and the former State Administration of Industry and Commerce to file projects.
 - · Promote online filing for basic project and contract information only.
 - · Allow qualified foreign design firms to be an official third party in the registered contract.
- 4. Continue to Ensure a Fair, Balanced and Open Market Exists for Foreign Investment in the Real Estate Sector 10
 - Simplify application procedures, requirements and bureaucratic procedures for development projects.



European Heating Industry Key Recommendations

- 1. Update the Standard for Energy Efficiency of Domestic Gas Appliances and Introduce National Guidelines or Policies to Promote Full Condensing Wall-hung Boilers with Level 1 Energy Efficiency
- 1.1 Update the Energy Efficiency Standard, and Refine and Improve Requirements for Domestic Gas Appliances
 - Update and refine the energy efficiency standards for domestic gas appliances.
 - Refine and improve the efficiency requirement for domestic gas appliances.
- 1.3 Introduce Policy Guidelines for Promoting Energy-saving and Low-emission Boiler Technologies
 - 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 in the building.
 - Encourage research projects on full premixed condensing technology, about its application, energysaving and emission-reducing effects.
- 2. Establish Requirements for the Installation and Maintenance of Gas Appliances and Systems, and Educate Consumers on the Need for Regular Maintenance and Replacement (©2)
- 2.1 Establish Standards on the Installation of Gas Appliances and Training of Installation Workers, and Establish a Qualification System
 - Formulate and implement regulations for installation and maintenance of heating products.
 - · Improve training of installation personnel and establish a vocational certification system.
- 2.2 Strengthen Effective Supervision of Maintenance and Replacement of Gas Wall-hung Boilers
 - Strengthen effective supervision of regular maintenance and replacement of gas wall-hung boilers and educate consumers accordingly.
 - Issue gas wall-hung boiler maintenance regulations to ensure the safe and energy-efficient function of the appliance.
- 2.3 Cultivate Consumers' Awareness of the Need for Timely Removal and Replacement of Gasfired Water Boilers with High Energy Consumption and Emissions or Those at the End of Their Service Life
 - Cultivate consumers' awareness of the need for timely removal and replacement of gas-fired water boilers with high energy consumption and emissions or those at the end of their service life.
- 3. Review Original Local Market Access Testing Requirements for Domestic Gas Appliances and Previous Tests Related to the Product Licence Once Transferred to the CCC System and Help Importing Foreign Invested Enterprises (FIEs) Through the Transition
 - Clarify the market access requirements for gas appliances, unify the requirements of different regions and combine repetitive testing to reduce the burden on enterprises.
 - Issue detailed explanation and measures for CCC regulations and help importers to realise a stable transition to the CCC system.



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 Industry and Information Technology, the Ministry of Science and Technology, 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

New infrastructure projects in 2019

In 2019, China approved 26 infrastructure projects that will bring in investment worth a total of Chinese yuan (CNY) 981.7 billion. Planned projects include: the Chongqing-Kunming high-speed railway; further development of urban railway transit systems in Beijing, Chengdu, Xi'an and Zhengzhou; and the expansion of Xi'an's Xianyang International Airport. According to the NDRC, 2019's total approved investment saw a drop of 66 per cent from 2018's total of CNY 1.48 trillion for 27 infrastructure projects.¹

Impact of COVID-19 on the sector and government response

China was the first market to be affected by the

coronavirus disease 2019 (COVID-19), which led to unprecedented restrictions on mobility and lockdowns of major economic centres in order to combat the spread of the virus. The first quarter of 2020 saw postoutbreak China at the forefront of using high-tech digital platforms and innovation to adapt to the new challenges brought by the global pandemic. China has now moved towards investing considerably in new infrastructure as a strategy to combat economic pressure. For instance, the Standing Committee of the Political Bureau of the Communist Party of China Central Committee said that the country will focus on developing new infrastructure projects related to fifth generation (5G) technology networks and data centres. In their 2020 government work reports, 25 provincial-level regions mentioned new infrastructure projects, with 21 among them aiming to accelerate 5G network construction.² China's leading telecom operator, China Unicom, has decided to accelerate its planned construction of 250,000 5G base stations, now aiming to finish the project by the end of the third quarter of 2020.3

This comes as reduced business hours and restrictions on people's movements to prevent the spread of the virus have significantly disrupted businesses, particularly the retail sector.⁴ Meanwhile, data centres and logistics warehouses have been the most resilient in overcoming the difficulties caused by COVID-19, followed by public hospitals and clinics.⁵ As such, digitalisation is a crucial strategy to adapt to the new circumstances and transaction patterns.

2020 marks the first time infrastructure has been placed as a national priority due to data usage and online protocols, instead of more traditional needs for works such as roads or railways.⁶ While new infrastructure ranging from 5G networks, inter-city transit systems, industrial internet platforms, data centres, and electric car charging stations have seen a surge in investment amid the outbreak, the property sector did not rebound in the first quarter, despite efforts by the government from the end of February to encourage factories, construction companies and other sectors to return to

¹ China's Top 10 Infrastructure Projects for 2020 and Beyond Will Help Boost its Slowing Economy, South China Morning Post (SCMP), 28th January 2020, viewed on 11th May 2020, <https://www.scmp.com/economy/china-economy/ article/3047305/chinas-top-10-infrastructure-projects-2020-and-beyond-will>

² Economic Watch: China Speeds Up "New Infrastructure" Investment to Combat Economic Pressure, Xinhua, 5th March 2020, viewed 11th May 2020, <http://www. xinhuanet.com/english/2020-03/05/c_138846271.htm>

³ Ibid.

⁴ COVID-19: Insights & Opportunities for China's Real Estate Market, Colliers International, 1st May 2020, viewed 11th May 2020, https://www2.colliers.com/ en-CN/Research/Covid19-insights-opportunities-for-china-real-estate-market>

⁵ Ibid. 6 Ibid.



business as usual. In fact, China's *Beige Book* property index—which includes sales of homes and commercial property and is compiled through interviews with over 3,300 companies—indicated a deepening in the contraction of sales between February and March.⁷ A general contraction is expected in the sector in 2020 in comparison to the previous year.⁸

On 26th February 2020, the MOHURD published a *Notice on Strengthening COVID-19 Epidemic Prevention and Control and Orderly Promotion of the Resumption of Work of Enterprises.*⁹ The main aim of this policy is to establish special support mechanisms in response to the COVID-19 crisis (e.g. tax deductions, rent relief, training subsidies, return of social insurance premiums and other supportive policies).

In the first quarter of 2020, construction projects not considered crucial at a national level have been the most affected. The expansion of the China National Convention Centre, 10 kilometres (km) north of Tian'anmen Square, is one of several construction projects that were slowed down or brought to a standstill by official order. Furthermore, interior contractors for condominiums, usually carried out by small to mediumsized companies, have been severely affected as labourers find themselves unable to continue their work due to urban regulations and restrictions. For instance, as children stay at home and do their coursework online, there are reports of labourers being unable to obtain permits required to do their jobs because the noise of construction would affect children studying nearby.¹⁰ In addition, a substantial amount of labourers were not able to return to their places of work after the Chinese New Year as mobility was restricted, which intensified the impact on the sector.

According to the China Construction Industry Databook Series: Market Size & Forecast by Value and Volume, Opportunities in Top 10 Cities and Risk Assessment report released in January 2020, a continuous rise in residential construction is expected, with a particular focus by both the public and private sectors on providing affordable housing. Healthcare infrastructure is also expected to grow significantly in the coming years. Bearing in mind that the report was compiled slightly before the COVID-19 outbreak, it estimates that by the year 2024, the residential construction market in China will reach a compound annual growth rate of 7.5 per cent to reach CNY 9.4 trillion.¹¹

While virtually all sectors slowed down during the height of the outbreak in China, for construction, one reason may well be that investment dropped across the entire sector due to developers blocking cash flows. Property and construction sectors are currently challenged by a capital liquidity crunch. Commercial businesses have been particularly affected by the lack of consumption, which has led to decreased rental income. Companies are also moving offices to smaller, less expensive alternatives. Still, it seems that as long as China implements measures to help businesses jumpstart operations with ease, these challenges should only be short-term.¹²

China has indeed made efforts to make up for lost time: by mid-March 2020, Premier Li Keqiang ordered 11,000 projects to be resumed, many being stateled infrastructure development including 2022 Winter Olympic sites.¹³ As such, China is relying on the construction sector to return to full speed in order for the economy to regain growth rates halted during the first quarter of the year. However, from a global perspective, the outbreak is still severely damaging the economies of most countries. Even if China is able to adapt well in the coming months, a worst-case scenario of a global economic crisis may threaten any progress made.

Meanwhile, market access restrictions continue to have an impact on the development of European



⁷ China Property Sector Shows Signs of Deterioration, Financial Times, 24th 2020, viewed on 11th May 2020 <https://www.ft.com/content/2fb8a37a-6d7d-11ea-89df-41bea055720b>

⁸ Moody's Changes Outlook on China Property Sector to Negative; Refinancing Risk Remains Manageable for Most, Moody's, 16th April 2020, viewed 28th May 2020, <https://www.moodys.com/research/Moodys-changes-outlook-on-Chinaproperty-sector-to-negative-refinancing--PR_422904>

⁹ Strengthening COVID-19 Epidemic Prevention and Control and Orderly Promotion of the Resumption of Work of Enterprises, State Council, 26th February 2020, viewed on 8th May 2020, http://www.gov.cn/zhengce/zhengceku/2020-03/02/content_5485626.htm

¹⁰ China's Feeble Construction Sector Dims Outlook for GDP Rebound, Asia Nikkei, 18th April 2020, viewed on 11th May 2020, https://asia.nikkei.com/Economy/ China-s-feeble-construction-sector-dims-outlook-for-GDP-rebound>

¹¹ China Construction Industry Databook Series - Market Size & Forecast by Value and Volume, Opportunities in Top 10 Cities, and Risk Assessment, Research and Markets, January 2020, viewed 25th May 2020, <https://www.researchandmarkets.com/reports/5006032/china-construction-industry-databook-series?utm_source=dynamic&utm_medium=BW&utm_code=85fsp4&utm_campaign=1371407++2020+Insights+on+the+China+Construction+Industry+ +Market+Size+%26+Forecast+by+Value+and+Volume%2c+Opportunities+in+To p+10+Cities%2c+and+Risk+Assessment&utm_exe=jamu273bwd>

¹² The Impact of COVID-19 on Construction Industry in China, Arcadis, 18th April 2020, viewed 25th May 2020, https://www.arcadis.com/en/asia/our-perspectives/articles/the-impact-of-covid19-on-construction-industry-in-china/#>

¹³ China's Feeble Construction Sector Dims Outlook for GDP Rebound, Asia Nikkei, 18th April 2020, viewed 25th May 2020, https://asia.nikkei.com/Economy/China-s-feeble-construction-sector-dims-outlook-for-GDP-rebound>

businesses in China. The European Chamber's *Business Confidence Survey 2020* revealed that 44 per cent of respondents report having missed business opportunities due to market access restrictions.¹⁴ This situation will be further exacerbated by any economic downturn as a result of the COVID-19 pandemic.

Belt and Road Initiative (BRI) during COVID-19

China's largest infrastructure project, the BRI, has also been affected by the consequences of the outbreak. Several projects in countries along the BRI 'route', such as those in Nepal, Sri Lanka, Bangladesh and Indonesia, have been forced to put their development schedule on hold as labour and equipment supplies were cut during the peak of the outbreak in China.¹⁵

Yangtze River Delta Integration

The Yangtze River Delta (YRD) plan covers Shanghai and the three neighbouring provinces of Jiangsu, Zhejiang and Anhui, which together make up 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.¹⁶

The YRD plan was released on 1st December 2019, with the aim of creating a strong and active economic growth nucleus and a gateway for further opening up the economy. The expectation was that the resulting worldclass city cluster would foster new economic drivers in the nation and boost the integrated development of the delta region.¹⁷ The YRD's prospects are still to be defined more clearly.¹⁸

Real estate (RE) sector

When COVID-19 infection numbers dropped to single figures in China in April 2020, there was a gradual resumption in economic activity in certain sectors. The office RE sector saw rapid recovery since early to mid-March, with a return-to-office rate at the beginning of June 2020 ranging between 80-100 per cent in Shanghai and 75-80 per cent in Chengdu and Chongqing.¹⁹ The retail re-opening rate surpassed 90 per cent in Chengdu and hit 100 per cent in Shanghai. Additionally, retailers and landlords are now utilising digital platforms with a long-term view following their reliance on the medium during the crisis. Many are creating partnerships with online services to provide home delivery, and adopting social media channels such as WeChat to create communities, enhance sales and attract customers.²⁰ Warehouse parks are another RE sector which for the most part also resumed operations as traffic density and transportation systems returned to normal levels. This increased mobility has also led to hotels being able to gradually open as safety measures become less strict. In fact, according to a study by market research agency STR, an estimated 87 per cent of hotels in the country have resumed operations since March this year.21

China's property markets are set to benefit from a number of initiatives and policies put in place by local and national authorities with the aim of supporting recovery as the country begins to emerge from COVID-19 crisis mode. These include plans by regulators and the Shanghai Government on accelerating the city's development as an international financial centre; coordinated development plans for Beijing's Tongzhou district and three surrounding counties in Hebei Province; and moves in Guangzhou and Shenzhen to facilitate property transactions and ease cashflow pressures on developers.²²

The EU-China Partnership on Sustainable Urbanisation and EU-China cooperation

The EU-China Partnership on Sustainable Urbanisation celebrated its eighth anniversary in 2020. Since its launch, expectations of EU-China cooperation on urbanisation have been very high. Two projects have already been proven to be good mechanisms for city-to-city, city-to-industry and industry-to-industry cooperation: the EU-China Innovation Platform, linked to the Innovation Cooperation Dialogue (ICD); and

¹⁴ European Business in China Business Confidence Survey 2020, European Union Chamber of Commerce in China, 2020, p. 57, https://www.europeanchamber.com.cn/en/publications-business-confidence-survey

¹⁵ Coronavirus Slows China's Belt and Road Push, Reuters, 18th February 2020, viewed 11th May 2020, <https://www.reuters.com/article/us-china-health-silkroad/ coronavirus-slows-chinas-belt-and-road-push-idUSKBN20C0RF>

¹⁶ Big Plans for Yangtze River Delta as China Takes on the Wealth Gap and Pollution, SCMP, 2nd December 2019, viewed on 18th May 2020, https://www.scmp.com/news/china/politics/article/3040281/big-plans-yangtze-river-delta-china-takes-wealth-gap-and>

¹⁷ Ouyang, Shijia and Zhou, Wenting, Plan Unveiled for Yangtze River Delta's Integration, China Daily, 2nd December 2019, viewed on 18th May 2020, https://www.chinadaily.com.cn/a/201912/02/WS5de40ac3a310cf3e3557b30b.html

¹⁸ Big Plans for Yangtze River Delta as China Takes on the Wealth Gap and Pollution, SCMP, 2nd December 2019, viewed on 18th May 2020, https://www.scmp.com/news/china/politics/article/3040281/big-plans-yangtze-river-delta-china-takes-wealth-gap-and>

Are Green Shoots Emerging in China? COVID-19 Impact on Property Markets, JLL, 8th April 2020, viewed on 11th May 2020, <https://www.joneslanglasalle.com. cn/en/trends-and-insights/research/are-green-shoots-emerging-in-china>
 20 Ibid

²¹ Ibid

²² APAC Market Snapshot, Q1 2020, Capital Markets, Asia Pacific, Colliers International, 22nd April 2020, viewed 15th May 2020, < https://www2.colliers.com/ en-XA/Research/Asia-Pacific-Market-Snapshot-Q1-2020>



the International Urban Cooperation Project.^{23&24} The European Chamber has been actively engaged in these projects by organising industry workshops, and providing suggestions on how to innovate policies related to market access and public procurement, technical standards and regulations, and intellectual property rights.

Nonetheless, the achievements of the EU-China Partnership on Urbanisation have not always matched expectations. The Construction Working Group encourages all relevant stakeholders to make sure that the essential academic discussion that has characterised this partnership so far can be further cemented with practical results.

European businesses are looking forward to contributing to further reform efforts and being involved in more construction projects. The construction industry has been among the sectors most negatively affected by market access barriers—both explicit and implicit regulatory constraints and an uneven playing field. The sum of these elements has left little or no space for European companies that have made high-end services and products their trademark. European construction firms, service providers, suppliers, infrastructure providers and manufacturers—with the rich experience they have when it comes to providing the kind of highquality products and services that China is looking for could provide valuable expertise.

The travel ban

On 26th March 2020, the Ministry of Foreign Affairs and the National Immigration Administration issued a notice imposing entry restriction for foreigners to prevent imported cases of COVID-19. Prior to this, international travellers were allowed to enter on condition they undergo mandatory quarantine and strict self-reporting of medical conditions.

Travel bans caused by the pandemic could have a severe impact on many companies across the sector. The top management of many companies have been unable to return to China, thus jeopardising their ability to resume normal business operations in the country. This could not only put many companies at risk of

24 About ! UC Asia, International Urban Cooperation Asia, viewed 15th May 2020, <https://www.iuc-asia.eu/>

collapse in a worst-case scenario, but also have a negative impact on China across many different areas if it cannot rely on the services of these companies.

According to official statistics, the number of foreign residents represent a very small proportion approximately 10 per cent—of the total number of returnees.²⁵ For the majority of them, their desire to return is linked to resuming their jobs. These individuals are all duly registered in China, pay taxes and are part of the Chinese business community. Thus, the working group hopes to see an easing of restrictions that lets members fully resume their business operations in the country.

Key Recommendations

1. Provide New Opportunities for Foreign Investment in Different Types of Cities and Towns, While Expanding and Building Responsive and Safe Infrastructure in Rural and Urban Areas, in Particular in Small and Medium-sized Cities 10

Concern

Existing market access barriers in the construction sector are preventing European businesses from fully partnering with local companies and contributing to China's continued urbanisation.

Assessment

Despite several announcements of further opening up in the construction sector, the industry was still included in the Market Access Negative List issued by the NDRC on 23rd June 2020.²⁶ The list stipulates that, in order to operate, construction companies need to obtain a series of permits and to follow all legal procedures. Besides needing a general construction permit, construction companies also have to be approved as qualified construction enterprises, as well as needing further approval for their construction projects and anti-seismic plans, among other requirements.

These market access barriers are further exacerbated by the chronic difficulties that foreign-invested



²³ EU-China Innovation Platform on Sustainable Urbanisation, EU, 2017, viewed 15th May 2020, <https://www.urban-eu-china.eu/en/about/>

²⁵ Press Release of the Joint Prevention and Control Mechanism, The State Council of the People's Republic of China, 16th March 2020, viewed 26th May 2020, http://www.gov.cn/xinwen/gwylflkjz59/wzsl.htm>

²⁶ People's Republic of China National Development and Reform Commission and Ministry of Commerce Notice, State Council, 24th June 2020, accessed 3rd July 2020, http://www.gov.cn/zhengce/zhengceku/2020-06/24/content_5521520. htm>

companies face when it comes to public procurement. The working group expects European companies can in the future increase their involvement, especially in the two key areas where the contributions of Europeaninvested companies can add a great deal of value: green construction projects and public infrastructure.

Recommendations

- Allow European companies to participate more widely in the process of China's urbanisation.
- Expedite reforms that will allow European CSPs to contribute more towards green buildings and sustainable cities as well as intelligent buildings, smart cities and smart communities in China.
- Allow European companies to bid for and participate in projects such as in the national demonstration areas under the China Manufacturing 2025 initiative.
- Remove market access barriers in the planning, architectural and design, construction and real estate sectors.
- Allow European firms to contribute 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).²⁷⁸²⁸

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 possible', and currently has observer status.²⁹⁸³⁰ On 21st October 2019, China submitted its seventh offer (sixth revised offer) for accession to the agreement.³¹ 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.³²

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. This is also in line with the Foreign Investment Law (FIL)³³ that came into effect at the beginning of 2020. So far, the GPL "is much more closely aligned with GPA requirements than the TBL".³⁴

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".³⁵ These 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

²⁷ Broadly speaking, the GPL covers central and sub-central government purchases. See *The Government Procurement Law of the People's Republic of China*, Standing Committee of the National People's Congress (NPC), 29th June 2002, viewed 18th May 2020, http://www.ccgp.gov.cn/zcfg/gjfg/201310/ t20131029_3587339.htm>

²⁸ 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 *The Bidding Law of the People's Republic of China, China.org.cn*, 30th August 1999, viewed 18th May 2020, <http://www.china.org.cn/china/LegislationsForm2001-2010/2011-02/12/ content_21908808.htm>

²⁹ The GPA is a plurilateral agreement between 48 WTO member countries who 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 shall 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 18th May 2020, <https://www.wto.org/english/tratop_e/gproc_e/gp_apa_e.htm>

³⁰ 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 13th May 2020, <https://academic.oup.com/jiel/article-abstract/12/3/663/817776>

³¹ China Submits Revised Offer for Joining Government Procurement Pact, WTO, 23rd October 2019, viewed 18th May 2020, <https://www.wto.org/english/news_e/ news19_e/gpro_23oct19_e.htm>

³² Jean Heilman Grier, China: Revising Tendering and Bidding Law, Perspectives on Trade. Perspectives and Observations, 13th April 2020, viewed 18th May 2020, https://trade.djaghe.com/?tag=china-gpa-accession

³³ Foreign Investment Law of the People's Republic of China, Invest in China, 19th March 2019, viewed 18th May 2020, http://www.fdi.gov.cn/1800000121_39_4872_0_7. html>

³⁴ Jean Heilman Grier, China: Revising Tendering and Bidding Law, Perspectives on Trade. Perspectives and Observations, 13th April 2020, viewed 18th May 2020, https://trade.djaghe.com/?tag=china-gpa-accession

³⁵ Ibid.



more likely it is to end up in the crosshairs of the EU's proposed International Procurement Instrument.³⁶

The European Chamber's *BCS 2020* registered that 44 per cent of companies reported missing business opportunities due to market access restrictions, such as barriers to government procurement processes.³⁷ This data serves to illustrate the widespread nature of the problem for European business.

Recommendation

- Allow European companies greater access to the bidding process on government procurement work in line with the WTO's GPA.
- 3. Remove Market Access Barriers for Foreign Planning, Architectural and Design, Construction, and Real Estate Service Providers to Enable Fair Competition and Facilitate Expertise Sharing

Concern

European CSPs—including architects, quantity surveyors, project managers and contractors—face legal barriers to enter the Chinese market, preventing them from sharing their world-class expertise and cutting-edge technology with Chinese CSPs.

Assessment

Construction is one of the key drivers of a country's economy, especially for a large country like China in the midst of rapid urbanisation. The healthy development of the construction industry is of paramount importance to ensuring the effective use of resources and providing optimum living standards and environmental protection. For instance, good city planning can: optimise land use and ensure the long-standing quality of construction; positively influence peoples' moods by providing visually attractive architecture; ensure the overall quality of a city's construction by utilising advanced technology and 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 service providers are not allowed to bid for third-parties contracts in Chinese Government projects. Frequently, European firms cannot be recognised in China as a party in government projects and can only participate as sub-contractors of local design institutes. This is because European qualifications are at large not recognised in China, leaving European CSPs unable to obtain local qualifications in some provinces. 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.

To provide services in the fields of planning, design, engineering, construction, surveying and construction supervision, European service providers are required to obtain various Chinese industry qualifications, which entail a declaration of the company's registered capital, personnel, place of business and track record. This framework ignores the fact that many European service providers already hold top qualifications in their home countries.

European service providers continue to face legal and compliance issues because they are required by many construction authorities to use standard contracts for filing. Chinese construction authorities require European service providers to use a set of standard contracts, issued in 1999 by the former Ministry of Construction (MOC) and the former State Administration of Industry and Commerce (SAIC) for design, surveying, construction and construction supervision. Such contracts, besides being outdated, determine legal and compliance issues for European service providers that often prefer to use other types of contracts. This situation could be improved by facilitating online filing for basic project and contract information.

Foreign construction companies have been permitted to establish wholly foreign-owned construction enterprises (WFOCEs) in China for more than 15 years. However, the local construction market is still not completely open to WFOCEs. They are only allowed to undertake four types of construction projects that fall under the scope permitted by their qualification grades, according to Decree 113 of the *Regulations on the Administration of Foreign-invested Construction Enterprises*. These types include the following:



³⁶ 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 18th May 2020, https://www.europarl.europa. eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harnessglobalisation/file-international-procurement-instrument-(ipi)

³⁷ Outlook on Chinese Business Environment – Regulation, Business Confidence Survey 2020, p. 57.

- Construction projects solely funded by foreign investment, foreign donations or foreign investment and donations;
- Construction projects financed by international financial institutions and awarded through international bid invitations based on the terms and conditions of the loans;
- Chinese-foreign, jointly-operated construction projects with foreign investment accounting for at least 50 per cent of the total investment, or Chineseforeign, jointly-operated construction projects with foreign investment accounting for less than 50 per cent of the total investment (which are not possible for Chinese construction enterprises to implement independently due to technological difficulties), and approved by the administrative department in charge of construction at the provincial level, autonomous region or municipality directly under the central government; and
- Construction projects funded by Chinese investment (which are not possible for Chinese construction enterprises to implement independently due to technological difficulties), which may be jointly undertaken by Chinese and foreign construction enterprises subject to the approval of the administrative department in charge of construction at the provincial level, autonomous region or municipality directly under the central government.³⁸

Out of these four types of projects, in reality only 50 per cent are funded by wholly foreign-invested projects or Chinese-foreign joint venture projects. This is a niche market and the project scales are relatively small compared to most local investment projects. WFOCEs often face intense competition with small and medium-sized Chinese contractors. Under such circumstances, most WFOCEs are not successful and some have to downsize or even leave the market. Many European contractors have no motivation to expand their business in China, despite the large construction market. National Bureau of Statistics data shows the profit of WFOCEs accounted for 0.37%, 0.27% and 0.41% of the total profit of all CSPs in China in 2016, 2017 and 2018 respectively.³⁹

Recommendations

- Allow WFOCEs to independently carry out local investment construction projects in China.
- Allow European service providers to bid for third party contracts in government projects.
- Recognise international expertise and professional qualifications to facilitate knowledge-sharing and exchange of know-how across regions.
- Remove strict requirements associated with using standard contracts issued by the former MOC and the former SAIC to file projects.
- Promote online filing for basic project and contract information.
- Allow qualified foreign design firms to be an official third party in the registered contract.

4. Continue to Ensure a Fair, Balanced and Open Market Exists for Foreign Investment in the Real Estate Sector 10

Concern

In China's RE sector, both foreign and domestic developers face huge hurdles in the form of strict requirements, and European land developers are still locked out due to stricter regulations and supervision.

Assessment

The RE field in China still has very stringent regulations that cause a lot of problems for both domestic and foreign enterprises. 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),⁴⁰ addresses a variety of measures for controlling the flow of foreign capital. Besides outlining the 50 per cent proportion between registered capital and investment, it lists two additional conditions affecting foreign-invested enterprises (FIEs): FIEs 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.⁴¹ This creates unfair competition between local and foreign companies, especially in relation to the different requirements for registering capital.

³⁸ Regulations on the Administration of Foreign-Invested Construction Enterprises, Ministry of Commerce (MOFCOM), 2002, viewed 18th May 2020, http://www.mofcom.gov.cn/article/bh/200301/20030100064300.shtml>

³⁹ Statistical Data for the Total Profit of Construction by Registration Status, National Bureau of Statistics, viewed 15th June, 2020, http://data.stats.gov.cn/english/ easyquery.htm?cn=C01>.

⁴⁰ Opinions Governing Market Access and the Administration of Foreign Investment in China's Real Estate Market, MOHURD, 11th July 2006, viewed 20th May 2019, http://www.mohurd.gov.cn/zcfg/jsbwj_0/jsbwjfdcy/200611/t20061101_157771. http://www.mohurd.gov.cn/zcfg/jsbwj_0/jsbwjfdcy/200611/t20061101_157771.

⁴¹ Regarding the realisation of total investment, the rate is also 35 per cent for domestic companies. See, *Guidance to Risk Management of Real Estate Loans for Commercial Banks*, State Council, 30th June 2006, [2004] 57, http://www.gov.cn/ztzl/2006-06/30/content_323806.htm>.



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.⁴²

The working group welcomes this improvement and recognises the positive steps being undertaken by the Chinese authorities to promote a more mature and international investment environment. However, the working group believes that currently outdated terms found in *Circular No. 171* need to be clarified.

The Notice on Further Strengthening and Regulating the Examination, Approval and Supervision of Foreign Direct Investment in the Real Estate Industry (Circular No. 50),⁴³ 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. While some of these stringent procedures have since been removed, many still remain.

Approval and regulatory restrictions such as those mentioned in this section limit the introduction of foreign investment and know-how that could help build a healthier market environment. For instance, *Circular No. 50* requires a filing in the Ministry of Commerce (MOFCOM) system, which adds additional time and procedures. This runs counter to the purpose of *Circular No. 122*, which encourages foreign companies to register foreign currency directly. Even if investment is encouraged or permitted, indirect restrictions are a disincentive for foreign enterprises.

Recommendation

• Simplify application procedures, requirements and bureaucratic procedures for development projects.

Abbreviations

| BRI | Belt and Road Initiative |
|----------|--------------------------------------|
| COVID-19 | Coronavirus Disease 2019 |
| CSP | Construction Service Provider |
| EU | European Union |
| FIE | Foreign-invested Enterprise |
| FIL | Foreign Investment Law |
| GPL | Government Procurement Law |
| ICD | Innovation Cooperation Dialogue |
| MOC | Ministry of Construction |
| MOFCOM | Ministry of Commerce |
| MOHURD | Ministry of Housing and Urban-Rural |
| | Development |
| NDRC | National Development and Reform |
| | Commission |
| NPC | National People's Congress |
| RE | Real Estate |
| SAIC | State Administration of Industry and |
| | Commerce |
| TBL | Tender and Bidding Law |
| WFOCE | Wholly Foreign-owned Construction |
| | Enterprise |
| WTO | World Trade Organisation |
| YRD | Yangtze River Delta |

⁴² Notice to Adjust Policies Regarding Market Access and Administration of Foreign Investment in China's Real Estate Market, MOHURD, 19th August 2015, viewed 18th May 2020, <http://www.mohurd.gov.cn/wjfb/201508/t20150828_224060. html>

⁴³ Notice on Further Strengthening and Regulating the Examination, Approval and Supervision of Foreign Direct Investment in the Real Estate Industry, MOFCOM, 23th May 2007, viewed 18th May 2020, http://www.mofcom.gov.cn/aarticle/b/g/200707/20070704900232.html

Heating Sub-working Group

Introduction to the Sub-working Group

Heating mitigates the negative impacts of cold weather, playing a vital role in providing comfortable and sustainable living conditions for human beings. Bringing heating to people in an energy-efficient and environmentally sound way is a key objective of the heating industry. The Heating Sub-working Group (or the Europe China Heating Initiative (ECHI)) seeks to promote European technologies that provide ecofriendly 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 transition programme is one of China's national strategies to fundamentally reduce particulate matter and nitrogen oxide (NOx) emissions,¹ as well as to achieve increased energy efficiency. European heating manufacturers can make significant contributions to the successful implementation of the coal-to-gas strategy^{2&3} while helping China to win the battle for blue skies.⁴ The recommendations in this Position Paper aim to provide Chinese stakeholders with useful industrial insights and experience, in the hope of improving the regulatory environment of the heating industry in China and benefitting the Chinese population.

The representation of the European Heating Industry in China was created in 2002. It currently consists of 11 European enterprises involved in the manufacturing of highly efficient and renewable-based heating technologies and heating components. They manufacture heating appliances (e.g. high-efficiency heating boilers), burners, water heaters, renewables (e.g. solar and heat pumps) and industrial components. In 2016, the Heating Working Group became a sub-working group of the Construction Working Group. Together with its parent group, it strives to promote advanced European heating technology and offers information on the latest trends and developments in the heating industry.

Recent Developments

In 2019, the market performance of gas-fired wallhung boilers was largely determined by the 'coal-to-gas' transition programme in northern China, and various enterprises actively participated in the programme, especially in Hebei and Shandong provinces. The total sales volume of gas-fired wall-hung boilers in the Chinese market in 2019 grew 25.6 percent to 4.02 million units. However, sales of gas-fired condensing wall-hung boilers fell 10.7 per cent year-on-year to 0.25 million units in 2019, accounting for 6.2 per cent of total sales. The biggest factor in the decline in sales of condensing gas-fired boilers is the completion of the 'coal-to-gas' transition in areas where condensing boilers are used for replacement.⁵ Moreover, the outbreak of COVID-19 and the lockdown measures in China that followed at the beginning of 2020 seriously hit the wall-hung boiler market; total sales dropped by 35.9 per cent in January and February compared with the same period in 2019.6

Moreover, full condensing technology is not yet widely used in China, which lags behind Europe in this regard. This technology increases energy efficiency and reduces operational costs and NOx emissions, but more importantly, benefits end users. Thus, by launching relevant policies to support full condensing technology applications in China, the government will eventually reap the benefits for the environment.

Regulatory Environment

The Chinese Government is currently following two global policy trends in the heating industry. The first is enacting product standardisation to promote the quality of consumer goods. The *National Standard for Gas-fired Heating and Hot Water Combi-boilers (GB 25034-2010)*,⁷ for example, is currently under such revision.

¹ 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 20th April 2020, http://www.mee.gov.cn/gkml/sthjbgw/sthjbwj/201809/t20180927_630570.htm>

² Coal-to-gas 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.

³ Notice on the Three-Year Action Plan for Winning the Blue Sky Defense War, State Council, 27th June 2019, viewed 20th April 2020, http://www.gov.cn/ zhengce/content/2018-07/03/content_5303158.htm>

⁴ Ibid.

⁵ Gas-Fired Heating and Hot Water Combi-Boiler 2019 Market Statistics, China Quality Supervising and Test Centre for Gas Appliances (CGAC), 17th March 2019, viewed 20th March 2020, <http://cgac.chinagas.com.cn/News/detail/ item/2354.html>

⁶ Market of Gas Wall-hung Boilers: Where are the Opportunities After the Accomplishment of "Coal to Gas"?, China Appliance, 11th May 2020, viewed 10th June 2020, <http://www.dianqizazhi.com/2020/05/11/31434.html>

⁷ Gas-fired Heating and Hot Water Combi-boilers (GB25034-2010), openstd.samr.gov. cn, 2nd September 2010, viewed 1st August 2020, <http://openstd.samr.gov.cn/bzgk/ gb/newGbInfo?hcno=01F2B0E2C2D9C0770B9249A052C07545>



On 5th July 2019, the State Administration of Market Regulation (SAMR) issued the *Notice on Implementation Measures for Moving Explosionproof Electrical and other Products from the Production Licence to China Compulsory Certification Management*,⁸ moving household gas appliances production licence management under the responsibility of China Compulsory Certification (CCC), allowing a one-year transition period.

Entering into force on 1st October 2020, the adoption of the CCC system simplifies the approval procedure for industrial products and promotes their general safety level. The sub-working group welcomes the adoption of the CCC system and appreciates the government authorities' efforts to ease the difficulties importing enterprises may have encountered during the transition period. For instance, because of the outbreak of COVID-19, factory inspections in Europe could not be executed on time, which could delay enterprises operating in China in obtaining the CCC. The China Quality Supervising and Test Centre for Gas Appliances (CGAC) authorities quickly responded to the crisis by adopting flexible measures to facilitate the acquisition of CCC for imported products. The working group hopes that government authorities could further explain other CCC implementing measures for importing companies in order to realise a smooth transition.

The second global trend is the introduction and implementation of comprehensive regulatory policies to increase energy efficiency and reduce pollutant emission. As for energy efficiency, the National Standard on Quality Inspection and Grade Evaluation for Gas-Burning Appliances (GB/T 36503-2018), released by the SAMR and the SAC, rates and categorises gas appliances and components into levels A, B, or C.⁹ This Guobiao (GB) or national standard provides an understanding of how energy efficient the appliances are, and limits toxic substances and the emission of carbon dioxide (CO₂) and NOx by gas-burning appliances. To further promote energy-saving concepts and select the most energy-efficient enterprises in various industries, the National Development and Reform Commission (NDRC) and six other ministries listed the most energy-efficient manufacturers in the *Energy Efficiency Leader Implementation Plan*, thereby setting a benchmark for other enterprises to follow.¹⁰

Regarding reducing pollutant emissions, the first national standard to set the maximum emission limit for boilers (<65 tonnes per hour (t/h))¹¹ was introduced by the MEE in 2014, with the publication of the *National Emission Standard of Air Pollutants for Boilers (GB 13271-2014)*. However, some local standards now have higher requirements than this national level standard.¹²

The Heating Sub-Working Group hopes that China's efforts to reduce environmental pollution will in turn boost the development of a market for energy-efficient boilers. The sub-working group is willing to share experiences during the policy-making processes to help the government achieve its goal, with the hope that relevant government departments will take enterprises' interests into account during drafting and implementation and ease their burden, in order to encourage coordinated and healthy development of the industry.

Key Recommendations

- Update the Standard for Energy Efficiency of Domestic Gas Appliances and Introduce National Guidelines or Policies to Promote Full Condensing Wall-hung Boilers with Level 1 Energy Efficiency
- 1.1 Update the Energy Efficiency Standard, and Refine and Improve Requirements for Domestic Gas Appliances

Concern

The current energy efficiency standard for gas-fired wall-hung boilers is out of date and lacks practical and referential value in comparison with the energy efficiency levels such appliances could actually achieve.

Assessment

On 1st June 2016, GB 20665-2015 Minimum Allowable

⁸ Notice on Implementation Measures for Moving Explosion-proof Electrical and other Products from the Production License to China Compulsory Certification Management, SAMR, 9th July 2019, viewed 13th May 2020, <http://gkml.samr. gov.cn/nsjg/rzjgs/201907/t20190709_303296.html>

⁹ National Standard on Quality Inspection and Grade Evaluation for Gas-fired Appliances (GB/T 36503-2018), CGAC, 16th July 2018, viewed 18th April 2020, http://cgac.chinagas.com.cn/News/detail/item/2342.html

¹⁰ Energy Efficiency Leader Implementation Plan, MIIT, 8th January 2015, viewed 20th April 2020, http://www.miit.gov.cn/n1146285/n1146352/n3054355/n3057542/n3057544/c3634683/content.html

¹¹ National Emission Standard of Air Pollutants for Boilers (GB 13271-2014), Ministry of Environmental Protection (now MEE), 16th May 2014, viewed 20th April 2020, <http://permit.mep.gov.cn/permitExt/outside/news_detail. jsp?pkid=f45dfebd-4c0f-439e-8e35-be195c90beaa&type=SSHYPFBZ>

¹² For example, Beijing banned the installation of water wall-hung boilers with NOx emission over 70mg/kwh, 25th June 2019, viewed 14th July 2020, http://www.gov.cn/xinwen/2019-06/25/content_5403068.htm



Values of Energy Efficiency and Energy Efficiency Grades for Domestic Gas Instantaneous Water Heater and Gas Fired Heating and Hot Water Combi-boilers¹³ officially replaced the original national standard GB 20665-2006. The new standard has played a role in promoting the structural upgrading of gas wallhung boilers, and implementing energy-saving and emission-reduction requirements for gas appliances. The standard divides energy efficiency into three levels: 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. However, only gas wall-hung boilers that reach 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 gas wall-hung boilers, Levels II and III becoming obsolete. The energy efficiency of the latest full premixed condensing wall-hung boilers could reach 108 per cent of the current standard,¹⁴ therefore updating the standard would help promote high energy efficiency products while weeding out low energy efficiency products.

In Europe, energy labels for household appliances display seven levels, which better categorise products with different energy efficiency.¹⁵ While European standards for energy efficiency of household appliances differ from Chinese, a more refined evaluation system in China would encourage producers to pursue higher energy efficiency.

Recommendations

- Update and refine the energy efficiency standards for domestic gas appliances.
- Refine and improve the efficiency requirement for domestic gas appliances.

1.3 Introduce Policy Guidelines for Promoting Energy-saving and Low-emission Boiler Technologies

Concern

The government does not sufficiently encourage energy efficient and low emission heating technologies, such as full premixed condensing technologies, while relevant application 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 wall-hung boiler: conventional and condensing. Condensing wall-hung boilers increase energy efficiency—up to 20 per cent more efficient than conventional ones—and reduce pollutant emissions. Moreover, a state-of-the-art condensing boiler reduces NOx emissions by up to 75 per cent compared with non-condensing models.¹⁶

In construction projects, where possible, it is better to promote the use of condensing boilers from the first installation or during the formulation of guidelines and policies on energy efficiency and pollution control. Doing so will eliminate the need to rearrange corresponding accessories and pipes in order to replace old conventional boilers, or during replacement 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 for 2018–2020, states clearly:

"Further reduce NOx emissions from gas-fired heating water heaters. The 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.* The use of gas water heaters with energy efficiency Level II or below, and those with NOx emissions meeting only the Level V of gas-fired water boiler national standard, are prohibited in new, renovation and expansion projects."¹⁷

¹³ GB 20665-2015 Minimum Allowable Values of Energy Efficiency and Energy Efficiency Grades for Domestic Gas Instantaneous Water Heater and Gas Fired Heating and Hot Water Combi-boilers, 15th May 2015, viewed 2^{td} July 2020, http://www.gb688.cn/bzgk/gb/newGbInfo?hcno=75D38814EF3EE95E56E53D C00CF759C6>

¹⁴ Gas Condensing Technology: Key for Efficiency and Clean Air in China, ECHI, 3rd June 2019, viewed 20th April 2020, <https://www.bdh-koeln.de/fileadmin/user_ upload/ISH2019/Broschueren/broschuere_februar_2019_gas_condensing_ technology_en.pdf>

¹⁵ About the Energy Label and Ecodesign, European Commission, viewed 11th June 2020, <https://ec.europa.eu/info/energy-climate-change-environment/ standards-tools-and-labels/products-labelling-rules-and-requirements/energylabel-and-ecodesign/about_en>

¹⁶ Gas Condensing Technology: Key for Efficiency and Clean Air in China, ECHI, 3rd June 2019, viewed 20th April 2020, https://www.bdh-koeln.de/fileadmin/user_ upload/ISH2019/Broschueren/broschuere_februar_2019_gas_condensing_technology_en.pdf>

¹⁷ Three-year Action Plan for Winning the Battle of Blue Sky Protection, Xinhua, 15th September 2019, viewed 20th April 2020, <http://www.xinhuanet.com/2018-09/15/c_1123433365.htm>



This guideline helps 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. Most studies in this regard are from companies and associations (for example, the Beijing Association of Building Energy Efficiency and Environmental Engineering). The number of universities with relevant departments or research projects is still relatively limited; Tongji University and Tianjin Chengjian University being the exceptions with research projects on condensing technology and full premixed combustion. The sub-working group recommends both industry stakeholders and government departments to dedicate more attention to and understand the benefits of full premixed condensing technology.

Recommendations

- Introduce policy guidelines for promoting energysaving 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 in the building.
- Encourage research projects on full premixed condensing technology, including its application, energy-saving and emission-reducing effects.
- Establish Requirements for the Installation and Maintenance of Gas Appliances and Systems, and Educate Consumers on the Need for Regular Maintenance and Replacement (2)
- 2.1 Establish Standards on the Installation of Gas Appliances and Training of Installation Workers, and Establish a Qualification System

Concern

As there is a lack of effective guidelines and standards on installation and maintenance of gas wall-hung boilers, sub-standard installations may hamper development of the heating market and pose safety problems.

Assessment

Gas-fired wall-hung boilers are complex products that

provide heating and hot water for apartments. Their operation involves the use of gas, water and electricity, as well as air intake and smoke exhaust devices. When installing a heating system, it is necessary to choose a highly efficient and safe heat source. The system also needs to be configured with reliable hydraulic and control devices. To ensure the safe use and long life of the boiler, it is better to install a complete set of corresponding flues from the boiler manufacturer.

The Chinese Government and authorities have issued national standards for gas-fired heating and water boilers and industry standards for product application. However, there is still a lack of effective monitoring and maintenance after installation. Though sophisticated full premixed wall-hung condensing boilers require installers to have a high level of technical qualifications to be able to carry out their work sufficiently, there are no rules or regulations supervising these workers.

European Union (EU) Member States have a rich experience of gas-fired heating and hot water combiboiler products usage for more than 50 years. More importantly, EU standards, products, applications and services are mature and comprehensive. Meanwhile, EU Member States also have well-regulated and mature methods and systems for certifying the qualifications of service engineers and providers. Enterprises represented by the ECHI entered the Chinese market quite early and therefore have much experience, from both China and Europe, to offer the Chinese Government on formulating relevant regulations If there is a training mechanism in place for gas-fired water boiler installers and a vocational threshold, it would promote the technical skills of gualified installers and ensure the safety of installation and subsequent usage.

Recommendations

- Formulate and implement regulations for installation and maintenance of heating products.
- Improve training of installation personnel and establish a vocational certification system.

2.2 Strengthen Effective Supervision of Maintenance and Replacement of Gas Wall-hung Boilers

Concern

Consumers do not have sufficient awareness that gas heating appliances need regular maintenance and must be replaced at the end of their life-cycle.

Assessment

In European countries where the technology and application of gas-fired water boilers are quite developed, the necessity of regular maintenance of domestic gas-fired water boilers has been accepted by the public. As a result, Europe has mature supervision measures, which could be an example for Chinese market regulators and consumers. However, cultivating consumers' consciousness of the need to maintain gas appliances depends on vigorous publicity and effective supervision by relevant government departments, along with appeals and calls from the industry.

Regular maintenance guarantees efficient operation of gas boilers, increases reliability, prolongs lifetime, reduces costs of ownership and effectively reduces risks of operation. 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 NOx), originally established for environmental protection but which also secures combustion performance and safety of the boiler.

Recommendations

- Strengthen effective supervision of regular maintenance and replacement of gas wall-hung boilers and educate consumers accordingly.
- Issue gas wall-hung boiler maintenance regulations to ensure the safe and energy-efficient function of the appliance.
- 2.3 Cultivate Consumers' Awareness of the Need for Timely Removal and Replacement of Gas-fired Water Boilers with High Energy Consumption and Emissions or Those at the End of Their Service Life

Concern

Chinese consumers are not accustomed to replacing gas-fired water boilers that have reached the end of service life or that do not meet relevant regulations.

Assessment

Replacement of appliances with high energy consumption and high emissions is not only conducive to improving environmental protection, but also to reducing the maintenance and costs for users. Gas-fired water 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 life span. If these old boilers are not replaced in line with relevant regulations, they may cause considerable safety risks. The working group is aware that, in the EU, several member states have started programmes to label previously installed heating appliances, showing how old and/or inefficient it is. This has raised awareness among consumers that some appliances need to be substituted and that energy and household expenses could be saved by doing so. In Beijing, new, renovation and expansion projects prohibit the use of gas-fired water boilers with energy efficiency Level II or below, and the replacement of about 780,000 low-efficiency and high-emission gas wall-hung boilers is going to start in the near future. This will help to improve the regional air quality and save energy. The sub-working group hopes that such replacement work can be adopted in more places.

Recommendation

- Cultivate consumers' awareness of the need for timely removal and replacement of gas-fired water boilers with high energy consumption and emissions or those at the end of their service life.
- 3. Review Original Local Market Access Testing Requirements for Domestic Gas Appliances and Previous Tests Related to the Product Licence Once Transferred to the CCC System and Help Importing Foreign Invested Enterprises (FIEs) Through the Transition

Concern

According to the SAMR's *Implementation Requirements* of the Management of Explosion-proof Electrical and other Products from Production License to China Compulsory Certification, domestic gas appliances will be managed by the CCC system, but the regulation does not clarify whether earlier type test results will still be recognised.

Assessment

Fundamental changes have taken place in the past two decades: the quality of natural gas has been rapidly improved and stabilised while the quality requirements for gas products have also been gradually improved. On 7th September 2011, the MOHURD abolished the



1997 *Measures for Urban Gas Management* stipulating gas compatibility test requirements.¹⁸

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. From the perspective of company product quality management, the notice contains high 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 Licenses for Industrial Products and Simplifying the Examination and Approval Procedures,¹⁹ the transition to the CCC system for products involving public health, safety and environmental protection is to "unify certification standard 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. However, the order from the central government and implementation at local levels lack coordination, leading to overlapping inspection at both national and local level. Type tests for domestic gas appliances under the previous production certification system and local tests on the compatibility of gas sources are not aligned in terms of testing items or standards, yet the tests still overlap with or exceed test items under the new CCC system. Therefore, to reduce the burden on enterprises, it is necessary to consolidate the various kinds of tests.

Moreover, the notice regulates how domestic companies holding production certificates could transition to the CCC system. However, for FIEs importing products from overseas that do not have a production certificate, it was not stipulated clearly whether their products imported before 1st October 2020 without a CCC logo could still be in the market. The working group recommends that the regulation concerning imported products also be taken into consideration during the transition period.

Recommendations

· Clarify the market access requirements for gas

¹⁸ Decision to Abolish the Provisions on Urban Gas Safety Management, Measures for Urban Gas Management and Regulations of the Ministry of Construction on the Conditions for 15 Administrative Regulations to be Incorporated Into the State Council Decision, MOHURD, 7th September 2019, viewed 19th April 2020, http://www.mohurd.gov.cn/fgjs/jsbgz/201109/t20110926_206399.html>

19 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 20th April 2020, <http://www.gov.cn/zhengce/content/2018-09/30/content_5327123.htm appliances, unify the requirements of different regions and combine repetitive testing to reduce the burden on enterprises.

 Issue detailed explanation and measures for CCC regulations and help importers to realise a stable transition to the CCC system.

Abbreviations

| AQSIQ | Administration of Quality Supervision, |
|-----------------|--|
| CGAC | Inspection and Quarantine |
| CGAC | China Quality Supervising and Test |
| | Centre for Gas Appliances |
| CGHC | China Gas Heating Speciality Committee |
| CO ₂ | Carbon Dioxide |
| ECHI | Europe China Heating Initiative (the |
| | Heating Sub-working Group) |
| EU | European Union |
| FIE | Foreign Invested Enterprise |
| MEE | Ministry of Ecology and Environment |
| MEP | Ministry of Environmental Protection |
| MIIT | Ministry of Industry and Information |
| | Technology |
| MOF | Ministry of Finance |
| MOHURD | Ministry of Housing and Urban-rural |
| | Development |
| NOx | Nitrogen Oxide |
| SAC | Standardisation Administration of |
| | China |
| SAMR | State Administration for Market Regulation |

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 1
 - Reduce 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 (IRC), internet protocol virtual private networks (IP-VPN), Internet access services and information services.
 - · Maintain international companies' full access to the Software as a Service (SaaS) market, without excessive government intervention or unnecessary licensing requirements.
 - · Maintain stable access to legitimate global internet resources that are critical for corporate business development, and ease restrictions on VPNs.
- 2. Develop an ICT Regulatory and Standardisation System that Benefits both the End-user and Industry Transformation as a Whole, in Support of a Global Market and Shared Digital Economy (1)
 - · Ensure openness and transparency in the standardisation process, as well as full and equal membership rights for international companies in all information and communication technology (ICT)-related standards development organisations (SDO) in China, including social organisations and industrial alliances.
 - · Encourage a non-discriminatory spectrum policy for various ICT technologies, such as mobile broadband and low-power wide-area network (LPWAN), to ensure that early and globallyharmonised 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 Agreement on Technical Barriers to Trade (WTO/TBT) for any standard that is applicable to mandatory conformity assessment and market access.
 - · Provide clear guidelines on the implementation of the Cybersecurity Law to create a regulatory environment that is conducive to digital business development.



3. Build a Commercial Cryptography Regulatory Framework with Rules that are Clear, Fair and Conducive to International Harmonisation

- Provide a narrow definition of the scope of commercial cryptographic products subject to conformity assessment by preserving the core function test.
- Allow adoption of international standards and practices related to commercial cryptography, and avoid mandating domestic standards.
- Ensure efficient and streamlined conformity assessment processes for commercial cryptography to minimise disruption to business operations, and that intellectual property (IP) and confidential information are protected during such processes.
- Preserve the core function test in defining the negative list for import licence and export control, ensuring the import list is no more, or even less, expansive than the current scope defined in 2013.
- 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 encryption functionality cannot be modified by the end user' in light of the established concept in global trade.
- Clarify the scope and processes for commercial cryptography application security assessments and national security reviews 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.

4. Ensure Equal Opportunities for International Companies in China under Chinese Industrial Policies (1)

- Establish fair competition by reforming market access conditions, enhancing post-market supervision and strengthening intellectual property rights (IPR) protection through concrete policy measures.
- Ensure China's guiding industrial policies are conducive to innovation and fair competition and are not used for the short-term promotion of domestic industry.
- Encourage greater reciprocity in ICT innovation and, 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 funding, R&D deductions and other policy incentives in support of China's industrial policies.
- Ensure that government guidance funds operate under market conditions.

Cybersecurity Sub-working Group Key Recommendations

- 1. Ensure that Cybersecurity Schemes Do Not Create Discriminatory Market Access Barriers 14
 - Differentiate national security from commercial security in a clear manner, and refrain from broadening the scope of relevant cybersecurity schemes.
 - Limit the applicability and influence of the various theoretically non-binding documents, e.g. national standards, in such a manner that it does not overcome binding legislation.

- Promote mutual recognition, adoption of and reliance on applicable international 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 (3)5

- 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 various government authorities involved.
- Reduce cybersecurity-related administrative burdens on companies, including due to duplicative or fragmented certification requirements.
- Remove inspection, system connection and penetration testing in cybersecurity managementrelated articles.
- 3. Ensure Transparency, Consistency, Non-discrimination and Proportionality in Cybersecurity Rule-making and Law Enforcement (3)4
 - Provide an open and transparent platform that allows European business to engage in cybersecurity rule-making in China 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 and standardisation bodies involved in cybersecurity rule-making.
 - Recognise international companies operating in China 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 developments that will benefit both the European Union (EU) and China if both sides are committed to cooperate further. European ICT companies are among the largest investors in China and contribute to China's development by transferring technology, creating jobs, contributing expertise, providing intellectual property (IP) and by training a new generation of Chinese engineers in the ICT field. A large percentage of European ICT companies have significant research and development (R&D) operations with well-established links to Chinese universities and research institutes that contribute significantly to ICT sectoral development in China.

Formed in 2001, the Information and Communication Technology Working Group consists of major European telecommunications vendors, service providers, digital content providers and other companies that meet on a regular basis to assess reforms that can affect the ICT industry. The working group also serves as a platform for information exchange on developments in the ICT industry, including but not limited to standardisation and conformity assessment, services, technical regulations,



research and innovation, interoperability and global harmonisation. The Information and Communication Technology Working Group contains the Cybersecurity Sub-working Group.

Recent Developments

Coronavirus

The Coronavirus Disease 2019 (COVID-19) outbreak has had a considerable impact on international commerce, with China reporting a 11.4 per cent decrease in exports (in Chinese yuan (CNY) terms) for the first quarter of 2020.¹ As China accounts for approximately 20 per cent of intermediate products for manufacturing, the outbreak has also had a considerable impact on global supply chains. One key concern of European ICT companies relates to critical electronic components. Production stoppage, first in China, and then subsequently in Europe, has created shortages of critical electronic components for some manufacturers.

The COVID-19 outbreak has highlighted the importance and value of digital services. The crisis has emphasised the vital role played by cloud, internet protocol virtual private networks (IP-VPNs), internet access and internet services. Remote office platforms and conference call applications have allowed many companies to continue vital, daily communications and maintain normal business operations. With all enterprises relying on the value-added telecoms services (VATS) sector, the case for providing them with greater and improved internet/telecoms access has been strongly made, in the interests of keeping the economy running to the greatest extent possible during the pandemic.

US-China Trade Agreement

The signing of the 'Phase One' United States (US)-China trade agreement (Phase One Agreement) was a significant milestone in China's evolving trade negotiations with the US. The Phase One Agreement marked significant progress on core commercial issues for foreign companies in China, including commitments on IP protection, ending forced technology transfers, increasing market access for emerging industries in the financial services space, and monetary policy. These commitments alongside the launch of the Foreign Investment Law and the anticipated National Intellectual Property Law represent a significant step forward in levelling the playing field for foreign enterprises. The working group calls for equal implementation of these measures for European and US companies. However, the deals omitted some key structural issues, including those related to cybersecurity and state subsidies for domestic enterprises. The working group therefore looks forward to engaging in future dialogue on these important topics.

At the core of the Phase One Agreement is the requirement for China to purchase US goods and services to the value of US dollar (USD) 200 billion over two years, based on 2017 levels. This includes large purchases of manufactured goods as well as services, including cloud. An important consideration is the potential damage that this deal could have on China's other trading partners, including the EU. The working group urges that companies be treated equally, regardless of their country of origin, in respect to the contents of the agreement, including negotiated purchases.

New Infrastructure

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'; a concept first announced in 2018 that encompasses fifth generation (5G) mobile networks, ultra-high-voltage power facilities, inter-city transport, electric vehicle charging stations, big data centres, artificial intelligence (AI) and industrial internet. Both the central government and many provincial-level regions have included New Infrastructure projects in their government work reports.² On 20th April 2020, the National Development and Reform Commission (NDRC) further clarified the concept and scope of the New Infrastructure initiative, 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 Al; and innovative infrastructures that support scientific

¹ Review of China's Foreign Trade in the First Quarter of 2020, General Administration of Customs, 15th April 2020, viewed 17th June 2020, <http:// english.customs.gov.cn/Statics/83de367c-d30f-4734-aba9-2046ab9b8a19. html>

² China Speeds Up 'New Infrastructure' Investment to Combat Economic Pressure, China Daily, 5th March 2020, viewed 28th April 2020, https://www.chinadaily.com.cn/a/202003/05/WS5e60b362a31012821727ca4b.html

research, technology and product development.^{3&4} It differentiates from 'traditional infrastructure' in that it focusses on the digital intelligent transformation of the economy to promote data-driven industries.

China originally expected to achieve 5G pre-commercialisation in 2019, and large-scale commercialisation in 2020, and now, through the 'new infrastructure' plans, this endeavour has been reaffirmed. The first batch of four commercial licences for 5G were issued to China Telecom, China Mobile, China Unicom and China Broadcasting Network in June 2019.⁵ Chinese telecom carriers have already confirmed their intention to build over 550,000 5G base stations in 2020, following a call from the Ministry of Industry and Information Technology (MIIT) in February 2020 for more effort toward the resumption of production in the telecommunication industry, even during the crisis.⁶ European ICT companies have been closely engaged with, actively invested in and contributed to such activities in order to support China's ambitious 5G roll-out and the construction of new infrastructure.

China's leadership sees AI as a key strategic issue for the country to seize opportunities in the next stage of technological revolution and industrial transformation.⁷ The central government is determined to leverage the country's growing technological capacity, abundant data resources and strong domestic demand to become a global AI champion. This ambition is documented in the Next Generation AI Development Plan (Plan), released by the State Council in July 2017.⁸ The Information and Communication Technology Working Group believes there is room for the European ICT industry to take part in China's AI development, if it is done in a fair, open, predictable and highly competitive market environment. For more information, please refer to Key Recommendation 4 of this paper.

Telecommunications (Telecoms)

On 23rd June 2020, China released a new Special Administrative Measures for Foreign Investment Access to Pilot Free Trade Zones (2020) (FTZ Negative List),⁹ with no additional changes to the 2019 version in regards to VATS. The 50 per cent foreign shareholding cap on domestic IP-VPN services has remained since the 2018 FTZ Negative List. On 22nd February 2019, the State Council released a response to the Comprehensive Pilot Work Plan for Promoting the Expansion and Opening Up of Beijing's Service *Industry*,¹⁰ permitting foreign participation in internet access services for trial in Beijing, a relaxation of the previously imposed restrictions on foreign telecoms companies operating in China. On 9th May 2020, the MIIT's Department of Information and Communication Development published a Notification on the Preparation for the Relevant VATS Pilot Opening in FTZs,¹¹ while on 1st June 2020, the State Council released the General Construction Plan for the Hainan Free Trade Port.¹² Both made clear China's intention to open up VATS services in the FTZs for foreign-invested enterprises (FIEs). The Special Management Measures for Foreign Investment Access (Negative List) (2020) released on 23rd June 2020, saw no updates from the year before in the telecoms section.¹³

Cryptography

On 26th October 2019, the 13th Standing Committee of the National People's Congress (NPC) approved the adoption of the Cryptography Law. Effective from 1st January 2020, it is the highest-level piece of legislation governing the cryptography field.¹⁴ It defines cryptography as "technology, products and services that adopt specific transformations to provide

³ NDRC: Speed Up the Introduction of A Package Of Macro-Policies To Ensure The Smooth Operation Of The Economy, State Council, 20th April, viewed 28th April, <http://www.gov.cn/xinwen/2020-04/20/content 5504535.htm>

⁴ Getting to Know China's New Infrastructure Projects, CGTN, 6th May 2020, viewed 2nd June 2020, <https://news.cgtn.com/news/2020-05-06/Getting-toknow-China-s-new-infrastructure-projects-QfIOLy9khq/index.html>

⁵ China Issues 5G Licenses Today, People.cn, 6th June 2019, viewed 6th June 2019, <http://en.people.cn/n3/2019/0606/c90000-9585248.html>

⁶ Ma Si, Telecom Carriers to Ramp Up Work on 5G Base Stations, China Daily, 3rd March 2020, viewed 28th April 2020, http://www.chinadaily.com.cn/a/202003/03/WS5e5d9852a31012821727bbcf.html

⁷ Xi Stresses Boosting Healthy Development of New-generation AI, Qiushi, 1st November 2018, viewed 4th May 2019, http://english.qstheory.cn/2018-11/01/c_1123647235.htm

⁸ New Generation AI Development Plan, State Council, 20th July 2017, viewed 4th May 2019, <http://www.gov.cn/zhengce/content/2017-07/20/content_5211996. htm>

⁹ Special Administrative Measures for Foreign Investment Access to Pilot FTZs (Negative List) (2020Version), NDRC, 23rd June 2020, viewed 9th July 2020, https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202006/t20200624_1231939.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 28th April 2020, http://www.gov.cn/ zhengce/content/2019-02/22/content_5367708.htm>

¹¹ Notification on the Preparation for the Relevant VATS Pilot Opening in FTZs, MIIT, 9th May 2020, viewed 1st June 2020, <http://www.miit.gov.cn/newweb/ n1146285/n1146352/n3054355/n3057674/n3057693/n3057695/c7915545/ content.html>

¹² State Council's Release on theGeneral Construction Plan for the Hainan Free Trade Port, State Council, 1st June 2020, viewed 8th June 2020, http://www.gov.cn/zhengce/2020-06/01/content_5516608.htm

¹³ Special Management Measures for Foreign Investment Access (Negative List) (2020), NDRC, 23rd June 2020, viewed 8th July 2020, https://www.ndrc.gov.cn/ xxgk/zcfb/fzggwl/202006/t20200624_1231938.html>

¹⁴ The Strong Legal Guarantee of the Crypto Work in the New Era, Office of the State Commercial Cryptography Administration (OSCCA), 27th October 2019, viewed 28th April 2020, <http://www.oscca.gov.cn/sca/xwdt/2019-10/29/ content_1057220.shtml>



information with encryption protection or security authentication", with divisions into 'core', 'common' and 'commercial' cryptography. The law states that commercial cryptography may be used by citizens, legal persons and other organisations to ensure network and information security in accordance with the law, as long as state secrets are not involved. It also states that commercial cryptography-related development, production, sales, service, import and export activities are to be carried out in adherence to relevant laws, administrative regulations, mandatory national standards and the technical specifications disclosed by companies.

A series of implementation rules of the Cryptography Law have been issued by relevant ministries, including:

- On 30th December 2019, the State Cryptography Administration (SCA), the General Administration of Customs of China (GACC) and the Ministry of Commerce (MOFCOM) issued Announcement No. 38 on the import licence and export control of commercial cryptography,¹⁵ while the SCA and the State Administration for Market Regulation (SAMR) issued Announcement No.39 on commercial cryptographic product certification.¹⁶
- On 31st March 2020, the SAMR and the SCA issued the Opinions on Implementing the Testing and Certification of Commercial Cryptography.¹⁷
- On 11th May 2020, the SAMR and the SCA issued the Catalogue of *Commercial Cryptographic Product Certification (First Batch)* and the rules of commercial cryptographic product certification.¹⁸

More implementation rules for the Cryptography Law are anticipated before the end of 2020, for example: commercial cryptographic product lists for import licence and export control, commercial cryptographic products involving national security, the national economy and people's livelihood, and public interests will be included in the Catalogue of Critical Network Equipment and Specialised Network Security Products.

Key Recommendations

 Open up China's Value-added Telecoms Services (VATS) Sector Further to International Investment, and Ease Internet Access (§11)

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

With the development of new technologies and business models, telecoms is increasingly relevant for all companies, even beyond the scope of the ICT industry. However, many long-standing restrictions still remain, mainly due to existing restrictions on the provision of VATS.

The COVID-19 outbreak clearly emphasised the need for better internet access, as well as a greater variety of VATS providers.

a. VATS

As China's market continues to develop, ICT revenues will increasingly be derived from the supply of services, applications and content. The convergence of telecoms, the Internet, consumer electronics and media industries 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 the market and encourage innovation. While European companies have played an important role in supplying ICT infrastructure, devices and services in China, thereby creating a significant source of employment, they have, by and large, been excluded from new opportunities in the country's ICT market.

According to China's long-standing, telecoms-related market access restrictions, generally only companies that are less than 49 per cent foreign-invested can apply for a Basic Telecoms Services licence. Only companies that are less than 50 per cent foreign-invested can apply for a VATS licence, with the exception of limited sections such as online data processing and transaction processing services (operating e-commerce), domestic

¹⁵ Announcement No. 38, SCA, 30th December 2019, viewed 19th May 2020, http://www.oscca.gov.cn/sca/xwdt/2019-12/30/content_1057371.shtml

¹⁶ Announcement on Adjusting Administration of Commercial Cryptographic Products, SCA, 30th December 2019, viewed 19th May 2020, http://www.oscca.gov.cn/sca/xwdt/2019-12/30/content_1057372.shtml

¹⁷ Opinions on Implementing the Testing and Certification of Commercial Cryptography, Certificate and Accreditation Administration, 31st March 2020, viewed 19th May 2020, <http://www.cnca.gov.cn/xxgk/zxtz/2020/202003/ t20200331_57991.shtml>

¹⁸ Announcement on Releasing the Commercial Cryptographic Products Certification Catalogue (First Batch) and the Commercial Cryptographic Products Certification Rules, SCA, 11th May 2020, viewed 19th May 2020, <http://www.oscca.gov.cn/sca/xwdt/2020-05/11/content_1060749.shtml>

Section Four: Services

multi-party communications services, store-and-forward services and call centre services.¹⁹ In order to better accommodate technological advancements, substantial changes are needed to open up the majority of VATS, which remain restricted.

Among the various VATS types under the *Telecoms Catalogue* revised in 2015,²⁰ Internet resources collaboration (IRC) is one of the services that foreign players wish to be able to provide the most. These services are 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 cloud service providers still find themselves confronted with insurmountable market access barriers in the form of licensing, technical cooperation and data localisation requirements.

International companies in China only enjoy limited access to domestic IP-VPN services. Reduced access to information will inevitably negatively impact businesses and innovation in China—especially as R&D relies on research and information exchange as well as cross-border transactions and ultimately investments, as they are all underpinned by the free access to, and flow of, information. Further openingup domestic IP-VPN services would help increase competition and bring more affordable solutions to SMEs.

The working group welcomes the new trial policy allowing foreign participation in internet access service announced by the Beijing government and the State Council in February 2019.²¹ 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, the lack of detailed information and implementation guidance causes confusion for foreign enterprises that want to apply for such a licence or trial gualification.

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Information services are another VATS of particular interest to international companies operating in China, but this area is also highly regulated, and applying for the relevant licences is difficult. As mobile Internet and Internet of Things (IoT) continue to develop, these kind of restrictions are an increasingly burdensome obstacle to European businesses that wish to bring their expertise to the Chinese market.

b. Internet access

Despite China's pursuit of innovation-driven growth, the European Chamber's *European Business in China Business Confidence Survey 2020* revealed that 50 per cent of respondents believe China's internet access restrictions have a negative economic impact on their business.²² These restrictions also negatively impact domestic and international enterprises' ability to undertake research, conduct e-commerce transactions or even divert business from online vendors, hampering the development of China's ICT sector, and more largely, its entire business ecosystem.

In the survey, European companies also state that unstable connections and access restrictions have severely impacted businesses in the following ways:

- 46 per cent report lower productivity in the office.
- 49 per cent also report difficulties in exchanging data and documents with their headquarters, partners and customers.
- 45 per cent highlight their inability to search for information and engage in research.
- 12 per cent report that it impacts their ability to attract and retain talent.
- 7 per cent say it has led to them deferring plans to establish R&D operations in China.

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 and information services.

¹⁹ Special Management Measures for Foreign Investment Access (Negative List) (2020), NDRC, 23rd June 2020, viewed 8th July 2020, https://www.ndrc.gov.cn/ xxgk/zcfb/fzggwl/202006/t20200624_1231938.html>

²⁰ Telecoms Catalogue, MIIT, 28th December 2015, viewed 8th June 2020, <http:// www.miit.gov.cn/n1146285/n1146352/n3054355/n3057709/n3057714/ c4564270/content.html>

²¹ 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 28th April 2020, <http://www.gov.cn/zhengce/ content/2019-02/22/content_5367708.htm>

²² European Business in China Business Confidence Survey 2020, European Union Chamberof Commerce in China, 10th June 2020, https://www.europeanchamber.com.cn/en/publications-business-confidence-survey



- 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 (1)

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, aiming to make 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 notice that TC260's Working Group 3 on Cryptographic Solutions has also opened up to international participation to a certain extent, though participation is 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 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-guality 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 globallyharmonised 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,²³ international companies are still not granted the necessary licences to implement them.

In the process of developing new standards, the mandating of specific technologies that only serve the interests of certain companies should also be avoided. Technology neutrality is a well-tested concept that not only guarantees the best quality experience for the end user but also avoids unnecessary economic burdens. It has been proved that the market can choose which technologies are competent enough to solve consumer issues. The working group therefore urges China to avoid mandates that favour certain companies, in order to create a stronger market. Enhancing dialogue with market players would be helpful to avoid setting forth requirements that are difficult to implement or that will jeopardise the business ecosystem.

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).

A

²³ 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.

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- Checking for black-listed technologies and configurations in a non-transparent process.
- Failing to file WTO/TBT notifications for changes in the conformity assessment criteria.

Providing clear, written requirements well in advance of the implementation date and notifying the WTO/TBT committee of conformity assessment criteria changes would ensure that the industry has sufficient time to ensure compliance, helping to avoid unnecessary technical barriers. Please see Key Recommendation 1 of the *Standards and Conformity Assessment Working Group Position Paper* for further discussion of this issue.

The working group would also like to underline that additional information unrelated to testing core product features—such as disclosure of source code and additional software or hardware information—should not be part of conformity assessment requirements, as these mainly relate to the exact implementation of standards and specific techniques. Understanding how each company implements standards does not add to test reliability, and instead requires companies to disclose sensitive commercial information.

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 700 MHz band for IMT services in China will promote healthy and sustainable market growth in the IMT industry.

From a long-term perspective, the 5G spectrum is now an important topic for the global preparation of 5G commercialisation. The International Telecommunication Union (ITU) World Radiocommunication Conference 2015 identified the potential new spectrum for 5G, including both below and above 6 gigahertz (GHz). China is an important stakeholder for global discussion and harmonisation of 5G technology, and close coordination with global and regional regulators is highly desired. Therefore, the working group urges China to implement an active plan of allocating more bandwidth to support IMT and 5G development, including the opening of incumbent bands (e.g. 700 MHz band) and studying new areas of the spectrum (e.g. bands above 6 GHz) to enhance China's leadership in 4G and 5G ecosystem development. The working group would like to actively facilitate the exchange and coordination between China and the EU regarding spectrum regulation. 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 3,300–3,600 MHz, 4,800–5,000 MHz 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.

Recommendations

- Ensure openness and transparency in the standardisation process, as well as full and equal membership rights for international companies in all ICT-related SDOs in China, including social organisations and industrial alliances.
- Encourage a non-discriminatory spectrum policy for various ICT technologies such as mobile broadband and low-power wide-area network (LPWAN), to ensure that early and globally-harmonised spectrum allocation contributes to social and economic transformation.
- Ensure that local standards or other technical requirements do not unfairly mandate specific technologies.
- Streamline the conformity assessment process in such a way that it:
 - clarifies how interested parties can implement it;
 - clarifies to what extent the complex and duplicative conformity assessment process for ICT products will become simple, transparent and unified; and
 - allows international testing, inspection and certification agencies to perform desired ICT product conformity assessment services in China.
- Provide clarification on conformity assessment requirements well in advance of the implementation date and provide notification under the WTO/TBT Agreement for any standard that is applicable to



mandatory conformity assessment and market access.

- Provide clear guidelines on the implementation of the Cybersecurity Law to create a regulatory environment that is conducive to digital business development.
- 3. Build a Commercial Cryptography Regulatory Framework with Rules that are Clear, Fair and Conducive to International Harmonisation

Concern

The promulgation of China's first-ever Cryptography Law is bringing profound changes to its commercial cryptography regulatory framework, an opportunity that has yet to be seized by the government to address a series of long-standing issues in the sector that prevent the creation of a level playing field.

Assessment

Cryptography allows for the protection of information and communications and is key to any robust information security system. While most geographies 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, due to the introduction of its Commercial Cryptography Regulation in 1999, and the vague regulatory requirements and strong control over the R&D, production, use, and import and export of commercial cryptography that resulted.²⁴ In this regard, the promulgation of the Cryptography Law in October 2019²⁵ has opened up opportunities for developing new rules that can be more aligned with international practices and thereby more conducive to healthy industry development.

Testing and certification

One of the Cryptography Law's chief innovations is the replacement of the previous administrative licensingbased market access system, with one that features mandatory and voluntary testing and certification. Under this new system, commercial cryptographic products involving national security, national economy and people's livelihood, and public interests will be included in the *Catalogue of Critical Network Equipment and Specialised Network Security Products*, and may not be sold or provided unless they pass the testing and certification by a qualified institution. Meanwhile, the SCA and the SAMR have established a state-promoted commercial cryptography certification system, including a first batch product catalogue and the corresponding certification rules.²⁶ The working group welcomes the fact that this certification system has been designed to be voluntary by nature, as a result of which under no circumstances should it be turned into a *de facto* market access requirement.²⁷

Moreover, many ICT products today can be characterised as including cryptographic functionality that is not their core function. To encourage suppliers to implement security into connected devices, rather than creating volumes of products requiring testing and certification that are impossible to sustain, as well as market failure in cases where tested or certified products are more expensive and customers are reluctant to pay a premium for the added security, the working group believes commercial cryptography-to the extent considered for testing and certification-needs to be limited to cases where encryption is the core function. A component in a product should not be considered the product's core function if cryptography is not the primary 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. Furthermore, extensive interpretations of "national security, national economy and people's livelihood, and public interests"²⁸ should be avoided to focus the scope of mandatory testing and certification on what is truly necessary.

Finally, the working group recommends the testing and certification system be based on established international standards and practices—to which China has also contributed—to the greatest extent possible, instead of mandating specific Chinese standards. The Cryptography Law is laudable in not requiring compliance with recommended national standards or

²⁴ Commercial Cryptography Regulation, SCA, 7th October 1999, viewed 7th April 2020, <http://www.oscca.gov.cn/sca/xxgk/1999-10/07/content_1002578.shtml>

²⁵ Cryptography Law, National People's Congress (NPC) Standing Committee, 27th October 2019, viewed 7th April 2020, http://www.oscca.gov.cn/sca/xxgk/2019-10/27/content_1057225.shtml

²⁶ Announcement on Releasing the Commercial Cryptographic Products Certification Catalogue (First Batch) and the Commercial Cryptographic Products Certification Rules, SCA, 11th May 2020, viewed 19th May 2020, <http://www.oscca.gov.cn/sca/xwdt/2020-05/11/content 1060749.shtml>

²⁷ For more on recommended standards used as market access requirements, see Key Recommendation 2 of the Standards and Conformity Assessment Working Group Position Paper.

²⁸ Description given in Article 31 in the Cybersecurity Law in regards to operations security to CII.

industry standards related to commercial cryptography, a legislative development that demands revision of incompatible regulations and standards. Commercial cryptographic products that meet international standards, have been proven secure and are commonly used in other global markets should be permitted to enter and be used in the China market.

Import licence and export control

The Cryptography Law requires the establishment of a negative list for commercial cryptography subject to import licence and export control, while commercial cryptography used in undefined 'mass consumer products' is exempted. The working group suggests the negative list be narrowly tailored and based on the Catalogue of Cryptographic Products and Equipment with Cryptographic Technology Subject to Import Administration, jointly released by the SCA and the GACC in 2013, which only covers commercial cryptographic products having encryption as the core function.²⁹ The negative list should also avoid a 'catchall' provision subjecting similar products not specifically enumerated to import licence or other requirements regulating commercial cryptography. In this way, the negative list would be in line with the World Semiconductor Council Encryption Principles³⁰ and the de-regulation trend worldwide.

While the working group applauds the exemption of 'mass consumer products', it further recommends that the government clarify the scope of such an exemption by adopting the established concept in global trade.³¹ The working group recommends that 'commercial cryptography in mass consumer products' refer to cryptography features as found in components and products openly available to the public that are either charged or free or charge, for personal or business use, and where the encryption functionality cannot be modified by the end user. The working group would like to respectfully underline that imposing uncertainties

regarding products potentially subject to import licence disadvantages China, because it makes the policy difficult to administer and limits the domestic ICT sector's access to imported products.

Interactions with cybersecurity schemes

Other elements of the Cryptography Law, such as Article 27, which is pertinent to application security assessments and national security reviews for commercial cryptography used in critical information infrastructure that are more closely linked to the Cybersecurity Law,³² are also of concern to the working group. The working group urges transparency to be applied to the design and implementation of the entire assessment and review processes, that these schemes to be narrowly tailored in scope, and that their disruptions to normal business activities to be minimised.

On the whole, the Information and Communications Working Group deems it necessary to develop a regulatory framework for commercial cryptography that contributes to security, minimises costs, protects IP and trade secrets, is technologically neutral and remains open to innovation. Referencing common international practices and subjecting relevant regulatory changes to public consultation and WTO/TBT notification would help ensure the fulfilment of these goals.

Recommendations

- Provide a narrow definition of the scope of commercial cryptographic products subject to conformity assessment by preserving the core function test.
- Allow adoption of international standards and practices related to commercial cryptography, and avoid mandates of domestic standards.
- Ensure efficient and streamlined conformity assessment processes for commercial cryptography minimising disruption to business operations, and that IP and confidential information are protected during such processes.
- Preserve the core function test in defining the negative list for import licence and export control, ensuring the import list is no more, or even less, expansive than the current scope defined in 2013.
- Define 'mass consumer products' as 'cryptography features as found in components and products

²⁹ Catalogue of Cryptographic Products and Equipment with Cryptographic Technology Subject to Import Administration, SCA, 31st December 2013, viewed 7th April 2020, <http://sca.gov.cn/sca/xwdt/2013-12/31/content_1002403.shtml>

³⁰ Encryption Principles, World Semiconductor Council, 23rd May 2013, viewed 15th July 2020, <http://www.semiconductorcouncil.org/wp-content/uploads/2016/04/ May-2013-WSC-WSC-Encryption-Principles-FINAL.doc>

³¹ On 22nd April, in the Cryptography Policy Q&A (no.87) released by the State Cryptography Administration (SCA), the description given on 'mass consuming product' alludes to personal use and does not specify whether it shall be charged or free, which diverges from international practice and understanding that 'mass consumer products' entails business use of cryptography products that can be either charged or free. For more information, please visit <htp:// www.sca.gov.cn/sca/xxgk/2020-04/02/content 1060694.shtml>

³² Cybersecurity Law, NPC Standing Committee, 7th November 2016, viewed 7th April 2020, <http://www.npc.gov.cn/wxzl/gongbao/2017-02/20/content_2007531. htm>



openly available to the public that can be either charged or free, for personal or business use, and where the encryption functionality cannot be modified by the end user' in light of the established concept in global trade.

- Clarify the scope and processes for commercial cryptography application security assessments and national security reviews 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.

4. Ensure Equal Opportunities for International Companies in China under Chinese Industrial Policies 11

Concern

China's ambitious industrial policies, as well as much of its private sector and economy at-large, have only provided limited benefits to international companies, as full play is not given to market forces, which may exacerbate the current trend of global decoupling of supply-chains and increase protectionism.

Assessment

China continues to press a wide variety of forwardlooking industrial policies. National plans and initiatives, including the *National Guidelines for the Development of the Integrated Circuit (IC) Industry*,³³ *the Industrial Internet* + 5G Plan,³⁴ the Next Generation *Al Development Plan*,³⁵ and the *Strategy for Innovation and Development of Intelligent Vehicles*,³⁶ underpin ambitions to master high-end technologies such as AI, robotics, semiconductor chips, IoT and big data analytics, among others.

Upgrading China's industrial base and pursuing the development of next-generation technologies is a necessary undertaking – for the sake of both China's environment and long-term economic sustainability. However, the working group cautions against preferential industrial policies and government funding, or market access restrictions on 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 play a supporting role in China's forward-looking national industrial plans and boost China's overall innovation capacity. Over the years, they have contributed to the local economy, participated in Chinese standardisation and R&D activities, and developed many patented technologies. Through investment and participation in the Chinese market, they have played a part in China's innovation strategies and goals. However, due to the emphasis on reducing reliance on international technology and imports, China's industrial plans disproportionately support domestic companies through state funding, R&D programmes and a series of other policy initiatives. The result is reduced international participation in crucial technology segments such as telecoms, cloud computing, IC, AI and IoT.

Regarding R&D participation, the working group welcomes China's progress in providing R&D funding to international companies operating 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.³⁷ However, FIEs are still restricted from making individual applications and are instead required to co-apply with a domestic partner. In addition, the process for applying for these funds is still overly burdensome and often requires the disclosure of private information and unnecessary documentation. This situation is further complicated by a lack of transparency in the application process and the opaque decision-making process of national key project planning. Furthermore, the policy that states intellectual property rights (IPR) ownership is a prerequisite for applying for R&D funds needs to be further clarified.

Restricting international involvement limits knowledgesharing that is crucial for China if it wants to achieve its technological goals. Such restrictions also run

³³ National Guidelines for the Development of the IC Industry, State Council, 24th June 2014, viewed 25th May 2020, http://www.gov.cn/xinwen/2014-06/24/content-2707281.htm

³⁴ Industrial Internet + 5G Plan, MIIT, 19th November 2019, viewed 11th March 2020, <http://www.miit.gov.cn/n1146295/n1652858/n1652930/n3757020/ c7538158/content.html>

³⁵ Next Generation AI Development Plan, State Council, 20th July 2017, viewed 25th May 2020, <http://www.gov.cn/zhengce/content/2017-07/20/content_5211996.htm>

³⁶ Strategy for Innovation and Development of Intelligent Vehicles, NDRC, 10th February 2020, viewed 12th July 2020, <https://www.ndrc.gov.cn/xxgk/zcfb/ tz/202002/t20200224_1221077.html>

³⁷ National Key R&D Programme, Ministry of Science and Technology, 27th September 2019, viewed 12th March 2020,<https://service.most.gov. cn/2015tztg all/20190927/3129.html>

counter to the inclusive practice of similar EU initiatives. The working group believes European companiesespecially those with a research base in Chinashould be given equal access to Chinese research programmes and funds. The working group therefore encourages China to simplify the procedures for participating in funded programmes relating to European ICT companies with R&D investments in China. In the Foreign Investment Law and the accompanying Regulations for Implementation of the Foreign Investment Law, enacted on 1st January 2020, China has included provisions for domestic and foreign companies' equal access to government funding arrangements, project applications and supportive policies. The working group welcomes such progress and believes the effective implementation of these new rules will help ease the concerns of international companies over the lack of equal access to research funding in the Chinese market.

b. Government guidance funds

Emblematic of China's domestic favouritism are government guidance funds. Such funds work in theory much like venture capital funds. In practice, however, they have emerged as a key government tool for achieving industrial policy objectives. Government guidance funds often seek to leverage state funds to attract as much social capital (i.e. non-government capital) as possible into China's numerous governmentbacked projects. Funds are commonly described as public-private partnerships, though in practice the major backers of industrial funds are either state-owned banks or state-owned enterprises (SOEs); in other words, they represent a restructuring of public-sector money. These funds are having an increasingly distortive effect on China's market conditions. It has been reported that by the middle of 2019, there were nearly 1,700 government guidance funds with a target to manage a total of CNY 10 trillion.38

Many of these established funds invest across a variety of sectors. For example, one of the largest is the Central SOE Guochuang Guidance Fund. This fund was set up to invest in 'strategic emerging industries' such as aerospace, clean energy, high-speed rail, quantum communication and robotics. The National IC Fund is particularly influential due to its singular focus on the IC industry. The use of state funds through the National IC Fund to support the domestic IC industry risks creating overcapacity and other market distortions that could potentially lead to decreased profits and innovation capabilities across the entire industry and related value chains. In 2019, the government announced CNY 204 billion for the second phase of the National IC Fund, stating that it would lead another CNY 147 billion fund aimed at transforming and upgrading the country's manufacturing sector.

If allowed to operate on market principles, government guidance funds have the potential to facilitate innovation, necessary infrastructure development and sustainable economic development. The working group believes that China's government guidance funds should follow market principles, rather than indigenous innovation targets. Allowing international companies in China to benefit equally from China's state funding and other forms of support will best ensure the sustainable and healthy development of China's ICT sector.

Recommendations

- Establish fair competition by reforming market access conditions, enhancing post-market supervision and strengthening IPR protection through concrete policy measures.
- Ensure China's guiding industrial policies are conducive to innovation and fair competition and are not used for the short-term promotion of domestic industry.
- Encourage greater reciprocity in ICT innovation and in line with the Foreign Investment Law, and streamline the application process for international companies applying for Chinese ICT R&D programmes by removing unnecessary and overly burdensome documentation requirements and by increasing transparency in the process.
- Ensure equal access for international companies in China to state funding, R&D deductions and other policy incentives in support of China's industrial policies.
- Ensure that government guidance funds operate under market conditions.

^{38 2019} China Government Guidance Fund Development Research Report, Zero2 IPO Research, 25th October 2019, viewed 25th May 2020, <https://m.pedata.cn/ report/detail_1571968901718173.html>



Abbreviations

| 5G | Fifth Generation |
|----------|--------------------------------------|
| AI | Artificial Intelligence |
| CII | Critical Infrastructure Information |
| CNY | Chinese Yuan |
| COVID-19 | Coronavirus Disease 2019 |
| FTZ | Free Trade Zone |
| GACC | General Administration of Customs of |
| | China |
| IC | Integrated Circuit |
| ICT | Information and Communication |
| | Technology |
| IDC | Internet Data Centre |
| IMT | International Mobile Technology |
| loT | Internet of Things |
| IP | Intellectual Property |
| IPR | Intellectual Property Rights |
| IP-VPN | Internet Protocol Virtual Private |
| | Networks |
| 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 |
| SAMR | State Administration for Market |
| | Regulation |
| SCA | State Cryptography Administration |
| SDO | Standards Developing Organisations |
| SOE | State-owned Enterprises |
| ТВТ | Technical Barriers to Trade |
| TC260 | National Information Security |
| | Standardisation Technical Committee |
| US | United States |
| USD | United States Dollars |
| VATS | Value-added Telecoms Services |
| 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 Working Group. The Cybersecurity Sub-working Group focuses on cybersecurity legislation, standardisation and enforcement that will impact a series of industries.

Recent Developments

Cybersecurity Law and Implementation

Having taken effect on 1st June 2017,² the Cybersecurity Law outlines a series of general compliance requirements for network operators, as well as special obligations regarding critical information infrastructure (CII) protection, data localisation and cross-border data transfer security assessment, the Classified Cybersecurity Protection Scheme (CCPS),³ the promotion of 'secure and trustworthy' products and services,⁴ and a comprehensive certification and testing scheme for critical network equipment and specialised network security products, among others.

At the time of writing, China is still drafting regulations and standards necessary for the Cybersecurity Law's roll-out, Intensive legislative and regulatory developments have however been witnessed in 2019 and 2020, bringing significant changes to China's previously proposed regulatory framework. The lack of clear and consistent implementing regulations, as well as divergence from common approaches under international standards, has generated a lot of uncertainty within the business community, and emboldened sectoral government authorities in cybersecurity rule-making to proceed with their own requirements.

Enforcement actions that have taken place within the first three years of the Cybersecurity Law's entry into force have largely surrounded personal information protection, the CCPS, illegal online content and realname registration. With more implementing regulations being rolled out in 2020, the Cybersecurity Sub-working Group expects enforcement efforts to increase and their areas of focus to be expanded.

Personal Information and Important Data Protection

On the 25th of May 2020, the Standing Committee of the National People's Congress (NPC) announced that the legislation plan for China's first Personal Information Protection Law had been included in the NPC's work plan. On 3rd July 2020, the NPC released its first draft of the Data Security Law,⁵ which illustrates systems of data security management, for example, through the calling for classified management of data and risk assessment mechanisms. The draft law further introduces data regulation mechanisms such as the classified protection of data, an important data protection catalogue and export controls. The draft law also divides the roles and responsibilities of the different departments and regional governments in accordance with the data created, collected or processed through their work, and the region and departments shall determine their respective and industrial important data catalogue. This is the first time that China has formulated a single piece of law in regards to data protection, regulating and overseeing the remaining regulations and measures that have been released or to be released related to data protection and security. Previous to this draft law, and in addition to the Cybersecurity Law, other regulations and standards on data protection have been released or are being formulated by a multitude of government authorities.

¹ Plan on Deepening Reform of Party and State Institutions, Xinhua, 21st March 2018, viewed 19th May 2020, <http://www.xinhuanet.com/2018-03/21/ c_1122570517.htm>

² Cybersecurity Law, National People's Congress (NPC), 7th November 2016, viewed 19th May 2020, <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 'secure and trustworthy' 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. According to the CAC, there should be regulatory consistency.

⁵ Data Security Law (Draft) Call for Comments, NPC, 3rd July 2020, viewed 8th July 2020, <http://www.npc.gov.cn/flcaw/userIndex.html?lid=ff80808172b5fee80 1731385d3e429dd>



In May and June 2019 two important drafts were released - the Administrative Measures on Data Security (Draft for Comments) (Data Security Measures),⁶ and the Measures on the Security Assessment of Crossborder Transfer of Personal Information (Draft for Comments) (Personal Information Transfer Measures),⁷ both presenting discrepancies with their upper-level legislation by introducing burdensome requirements. They require network operators to conduct a record filing with local cyberspace authorities when collecting personal sensitive information and ill-defined 'important data' for business purposes; and to perform a security assessment, of which the results should be reported to competent sectoral government authorities or provincial cyberspace authorities for approval before releasing, sharing or trading important data, or providing such data overseas.8

As a recommended national standard, the *Personal Information Security Specification (Specification)* released by the National Information Security Standardisation Technical Committee (TC260) on 18th March 2020, and taking effect on 1st October 2020, has been widely referenced by companies in their efforts to comply with the Cybersecurity Law. Prior to the release, two drafts of the *Specification* were released in February and June 2019.^{9&10}

The Cybersecurity Protection Bureau of the MPS, the Beijing Network Industry Association and the Third Research Institute of the MPS jointly released on 10th April 2019 the *Guidelines on Internet Personal Information Security Protection*. These guidelines contain inconsistencies with the *Specification*, and significantly broaden the scope of data localisation restrictions to all personal information holders, including those using private networks or in non-networked

- 6 Administrative Measures on Data Security (Draft for Comments), CAC, 28th May 2019, viewed 19th May 2020, <http://www.cac.gov.cn/2019-05/28/ c_1124546022.htm>
- 7 Measures on the Security Assessment of Cross-border Transfer of Personal Information (Draft for Comments), CAC, 13th June 2019, viewed 19th May 2020, <http://www.cac.gov.cn/2019-06/13/c_1124613618.htm>
- 8~ For more details, please refer to Key Recommendation 1 of this paper.
- 9 Personal Information Security Specification (Draft for Comments), TC260, 1st February 2019, viewed 13th May 2020, <https://www.tc260.org.cn/front/ postDetail.html?id=20190201173320>
- 10 Personal Information Security Specification (Draft for Comments), TC260, 25th June 2019, viewed 13th May 2020, <https://www.tc260.org.cn/front/bzzqyjDetail. html?id=20190625175932390453&norm_id=20190104153824&recode_ id=34879>

environments.¹¹ The Cybersecurity Sub-working Group invites relevant government authorities to publicly clarify how the *Guidelines* fit into China's overall personal information protection regulatory and standards framework, as well as the roles and responsibilities of various government authorities, and calls for a unified and coordinated approach.

CCPS

On 27th June 2018, the MPS issued a public consultation on the Regulation on Classified Cybersecurity Protection (Draft for Comments) (CCPS Regulation),¹² which is aimed at implementing Article 21 of the Cybersecurity Law requiring China to establish a CCPS. The draft CCPS Regulation sorts networks into five classified protection levels and specifies the corresponding security safeguards that should be adopted. It will be complemented by a series of cybersecurity standards, with some having already been released by TC260, like the Baseline for Cybersecurity Classified Protection or the Evaluation Requirements for Cybersecurity Classified Protection.¹³ On the basis of the previous Administrative Measures on the Classified Protection of Information Systems,¹⁴ the CCPS's requirements will be expanded from mere information systems to new areas such as cloud computing, mobile Internet, the Internet of Things (IoT) and industrial control. The Cybersecurity Sub-working Group is pleased to note that in the final version of the Guidelines on Classified Cybersecurity Protection, networks-the damage of which will lead to extremely serious harm to citizens, legal persons and other organisations-will going forward be classified as level-two.

CII Protection Scheme

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 by the CAC in July 2017, did little to narrow

¹¹ Guidelines on Internet Personal Information Security Protection, National Internet Security Management Security Platform, 10th April 2019, viewed 19th May 2020, <http://www.beian.gov.cn/portal/topicDetail?id=88&token=5169b2a3-94b6-4d38-9923-e2d605cc274b>

¹² Regulation on Classified Cybersecurity Protection (Draft for Comments), MPS, 27th June 2018, viewed 19th May 2020, <http://www.mps.gov.cn/n2254536/ n4904355/c6159136/content.html>

¹³ Three National Standardisations Published, TC260, 16th May 2019, viewed 13th May 2020, <https://www.tc260.org.cn/front/postDetail. html?id=20190516150142>

¹⁴ Administrative Measures on the Classified Protection of Information Systems, Central People's Government of the People's Republic of China, 24th July 2007, viewed 19th May 2020, http://www.gov.cn/gzdt/2007-07/24/content_694380. htm>

down the scope of CII or to clarify its identification procedures.¹⁵ Instead, it contains a number of provisions that are of concern to the sub-working group, for example, those requiring the operation and maintenance of CII to be carried out within China and necessary remote maintenance be reported in advance to the sectoral government authorities, and those enabling government authorities to access and copy security-related files. TC260 is currently formulating the supporting standards, which include the Cybersecurity Protection Requirements of CII,¹⁶ and the Security Controls for CII.¹⁷ It is noteworthy that the principle of CII interacts with multiple additional regulations such as the mandatory certification and review, the Cybersecurity Review Measures, requirements under the Cybersecurity Law and the Cryptography Law.

Cybersecurity Review

On 27th April 2020, the CAC and other 11 agencies, departments and ministries jointly released the Cybersecurity Review Measures (CSRM),¹⁸ which entered into effect on 1st June 2020 and supersedes the previous Measures on the Security Review of Network Products and Services (For Trial Implementation).¹⁹ The CSRM requires reviews for network product and services purchases that will or may affect national security, with a strong emphasis on supply chain security. The review, which may require the disclosure of transaction documents, may be also requested by the applicable authorities. In addition to a lack of transparency on the standards that will be used for the review's purposes, the CSMR also significantly broaden the triggers and scope of the cybersecurity review, by requiring CII operators to proactively anticipate the risk of procurement from the supplier. The CSMR also introduces non-technical factors related to national security risks, such as supply disruptions due to political, diplomatic and trade considerations, as the review's areas of focus. The sub-working group is aware

- 17 Security Controls for CII, TC260, 13th June 2018, viewed 19th May 2020, ">https://www.tc260.org.cn/front/bzzqyjDetail.html?id=20180613180739993240&norm_id=20180523160435&recode_id=29216>
- 18 Cybersecurity Review Measures, CAC, 27th April 2020, viewed 28th April 2020, http://www.cac.gov.cn/2020-04/27/c_1589535450769077.htm
- 19 Measures on the Security Review of Network Products and Services (For Trial Implementation), CAC, 2nd May 2017, viewed 19th May 2020, http://www.cac.gov.cn/2017-05/02/c_1120904567.htm

that standards supporting the review's implementation are being developed by TC260. Many categories of products may be considered network products under the *CSMR*.²⁰

Critical Network Equipment and Specialised Network Security Product Certification and Testing

Article 23 of the Cybersecurity Law requires critical network equipment and specialised network security products to follow the mandatory requirements of relevant national standards and be certified by a qualified establishment or meet the requirements of a security test, before being sold or provided to users. According to the CAC, the new scheme will not be an additional market entry requirement, but instead has been designed to improve coordination among the existing cybersecurity conformity assessment schemes, namely, the Information Security China Compulsory Certification, the Network Access Licensing and the Sales Licensing for Specialised Computer Information System Security Products, managed by the Certification and Accreditation Administration of China (CNCA), the Ministry of Industry and Information Technology (MIIT) and the Ministry of Public Security (MPS) respectively.

A series of rules have been released to implement this new scheme, including:

- the Catalogue on Critical Network Equipment and Specialised Network Security Products (First Batch).²¹
- the List of Entities Undertaking Security Certification and Testing of Critical Network Equipment and Specialised Network Security Products (First Batch).²²
- the Requirements for the Implementation of Security Certification of Critical Network Equipment and Specialised Network Security Products.²³
- · the Rules for the Implementation of Security

- 21 Catalogue on Critical Network Equipment and Specialised Network Security Products (First Batch), CAC, 9th June 2017, viewed 13th May 2020, <http://www. cac.gov.cn/2017-06/09/c_1121113591.htm>
- 22 List of Entities Undertaking Security Certification and Testing of Critical Network Equipment and Specialised Network Security Products (First Batch), CNCA, 19th June 2018, viewed 13th May 2020, http://www.cnca.gov.cn/xxgk/ggxx/2018/201806/t20180619_56714.shtml>
- 23 Requirements for the Implementation of Security Certification of Critical Network Equipment and Specialised Network Security Products, CNCA, 19th June 2018, viewed 13th May 2020, <http://www.cnca.gov.cn/xxgk/ggxx/2018/201806/ t20180619_56715.shtml>

¹⁵ 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.

¹⁶ Cybersecurity Protection Requirements of CII, TC260, 13th June 2018, viewed 19th May 2020, https://www.tc260.org.cn/front/bzzqyjDetail.html?id=20180613 180740102919&norm_id=20180523160438&recode_id=29222>

²⁰ Such as "core network equipment, high performance computers and servers, mass storage device, large database and application software, cybersecurity equipment, cloud computing services, and any other network products and services that have a significant impact on the security of critical information infrastructure".



Certification of Critical Network Equipment and Specialised Network Security Products; and²⁴

• the Implementing Measures on Testing of Critical Network Equipment (Draft for Comments).²⁵

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,²⁶ the National Technical Committee on Communications (TC485), under the 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 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.27

Notably, the MIIT's *National Standard Security Technical Requirements for Critical Network Devices (Draft for Comments)*²⁸ contains requirements that may diverge from existing international standards related to security assurance processes and security capabilities, as well as coordinated vulnerability disclosure (specifically 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).

27 Several Opinions on Strengthening National Cybersecurity Standardisation Work, CAC, 22nd August 2016, viewed 14th July 2020, <http://www.cac.gov. cn/2016-08/22/c_1119430337.htm>

Key Recommendations

1. Ensure that Cybersecurity Schemes Do Not Create Discriminatory Market Access Barriers 14

Concern

Certain cybersecurity schemes may lead to the creation of a discriminatory environment for international businesses, where they are restricted or even prohibited from providing products and services to segments of the Chinese market.

Assessment

The Foreign Investment Law and its implementing rules, in force as of 1st January 2020, contain a number of positive provisions on building a level playing field for foreign investments in China. However, in the field of cybersecurity, certain requirements may still present *de facto* market access barriers for international businesses.

a) CCPS

On 1st December 2019, multiple national standards setting out the requirements for the CCPS came into effect, one release of note being the Classification Guide for Classified Protection of Cybersecurity on 28th April 2020. These standards formulate the main sources for detailed guidance with greater granularity than the laws and regulations. Albeit recommended, these national standards will inevitably have significant implications since they directly support the roll-out of the CCPS Regulation, and are promoted actively by the authorities. CCPS posts quite a few limitations on cloud computing business: it requires that, for network operators over a certain level, the infrastructure of cloud computing be placed within China, the customer data and personal information be stored within China, and that the operation and maintenance should be conducted within China. These would certainly create challenges and *de facto* barriers for businesses that want to manage cloud computing services or that reach the required level in China, 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 their international connectivity.

²⁴ Rules for the Implementation of Security Certification of Critical Network Equipment and Specialised Network Security Products, CNCA, 2nd July 2018, viewed 13th May 2020, <http://www.cnca.gov.cn/xxgk/ggxx/2018/201807/ t20180702_56737.shtml>

²⁵ Implementing Measures on Testing of Critical Network Equipment (Draft for Comments), MIIT, 5th June 2019, viewed 13th May 2020, <http://www.miit.gov. cn/newweb/n1146285/n1146352/n3054355/n3057724/n3057728/c6991606/ content.html>

²⁶ Requirements of National Standards Relating to Critical Network Equipment and Specialised Network Security Products (Draft for Comments), TC260, 16th May 2019, viewed 19th May 2020, <https://www.tc260.org.cn/front/postDetail. httml?id=20190505191507>

²⁸ Comments on 'Flat Glass' and 19 Other Mandatory National Standards for Approval, MIIT, 30th April 2020, viewed 30th May 2020, http://www.miit.gov.cn/ n1146295/n7281310/c7897492/content.html>

b) Cybersecurity Review Measures

The CSRM mandates CII operators to proactively apply for a non-transparent cybersecurity review when their purchases of network products and services affect or may affect national security. In addition to a lack of transparency on the standards that will be used for the review's purposes, the CSRM also significantly broaden the triggers and scope of the cybersecurity review. The review will take into consideration the impact of the purchase of network products or services on the supply chain overall by looking at its impacts on the "security, openness, transparency and diversity of supply source" as well as "political, diplomatic, and trade factors on supply chains,"29 which could lead to market access restrictions for multinational companies. Added to this concern is the fact that relevant government authorities are granted the potential power to review the purchases of network products and services by non-CII operators. Furthermore, the CSRM may put suppliers at risk through the need to disclose confidential information and trade secrets, since disclosure of transaction, and other, documents may be required to complete cybersecurity reviews. Due to these considerations, the sub-working group is concerned that the CSRM will create a long-term environment that favours domestic companies over their international peers.

c) Cryptography Law

The Cryptography Law, which came into effect on 1st January 2020, specifically requires that all business entities, including foreign-invested enterprises (FIEs), be treated equally in research, production and sales of commercial cryptography. While the law removed or loosened some of the long-standing administrative approvals, due to ambiguities in both the law and its implementing regulations, there are still concerns related to the risks of the scope of the newly-established testing and certification system being further broadened, duplicative attestation requirements, unclear import licence and export control requirements, and a reliance on domestic standards. Specifically, certain proposed requirements are incompatible with existing and wellestablished international principles. Such principles call for governments to avoid restrictive or burdensome licensing, certification and other obligations that limit or delay the import, trade and export of mass-marketed ICT products, to which commercial cryptography is

ubiquitous.30

In order to avoid unnecessary market access barriers to FIEs, it is important that the various testing and certification, review, import licence and export control systems that the law seeks to establish remain transparent and narrowly tailored in scope. This includes ensuring that commercial products with cryptography as a secondary feature are *not* subject to restrictions or regulations;; 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; and that adoption of international standards and mutual recognition for certification and attestation are considered.³¹

d) Cross-border data transfer

In May and June 2019 respectively, the new draft Administrative Measures for Data Security (Draft for Comments) and the new 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. A network operator cannot transfer personal information or important data collected or generated during their operations in China to anyone outside of China, unless certain requirements are met; for example, they have completed an official security assessment.³² Certain Chinese regulations, like those relating to the CCPS and CII protection, also call for local operation and maintenance.

In addition to posing strong operational burdens, these requirements can be turned into essentially market access barriers for international companies in China due to FIEs' high frequency of cross-border data

²⁹ *Cybersecurity Review Measures*, CAC, 27th April 2020, viewed 8th June 2020, http://www.cac.gov.cn/2020-04/27/c_1589535450769077.htm

³⁰ Joint Statement of the 17thMeeting of the World Semiconductor Council, World Semiconductor Council, 23rd May 2013, viewed 9th June 2020, <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>

³¹ For more information, please refer to the KR 3 in the Information and Communication Technology Working Group Position Paper.

³² A clear example would be that, in the financial sector, a 2019 CBIRC 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 (AML/CTFs) activities unless permitted by law or regulations. For more information, please refer to the *Banking and Securities Working Group's Key Recommendation 2.*



transfer operations in response to their headquarters' requests, among different reasons. While China talks about its intention to further opening up its markets to foreign investments,³³ international companies might find themselves at a competitive disadvantage, or struggling to provide products and services as a result of the onerous restrictions relating to data localisation and cross-border data transfer.

The European business community is hopeful that Chinese regulators will develop policies and regulations to 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. Furthermore, conformity assessment requirements in China often differ from international standards, 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 their China market strategies. Foreign companies are concerned that such schemes will put their trade secrets in jeopardy and harm the market's perception of them and their credibility.

Recommendations

- Differentiate national security from commercial security in a clear manner, and refrain from broadening the scope of relevant cybersecurity schemes.
- Limit the applicability and influence of the various theoretically non-binding documents, e.g. national standards, in such a manner that it does not overcome the binding legislations.
- Promote mutual recognition, adoption and reliance on 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 15

Concern

The 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) Consistency and Clarity

The omnibus, technology and sector-neutral nature of the Cybersecurity Law is being slowly eroded through an exponentially growing number of additional regulatory texts, adding or detailing obligations, whether per industry sector, technology type, operational or service model, with sometimes overlapping or even contradictory rules, as well as divergent goals, approaches, administrative procedures, interpretations and enforcement actions.

Indeed, over the last four years, a staggering number of regulatory texts has been issued on a number of subjects, including the security of IT products, cloud computing, supply chains, network products and services, critical network equipment and specialised network security products, applications, CII, cryptography and cryptography products and virtual private networks (VPNs). Not to mention additional sector-specific texts for banking, insurance, transportation, healthcare, energy and logistics.

This regulatory development trend, as inferred in the introduction, is only accelerating, with numerous new texts in the works. The ensuing complexity is intensified by the number of concomitant supervisory authorities which, empowered in the cybersecurity regulatory and enforcement sphere, are each coming up with their own rules.

³³ Government Work Report, State Council, 22nd May 2020, viewed 9th June 2020, http://www.gov.cn/premier/2020-05/22/content_5513757.htm

Taking the regulation of personal information as an example, the national standard Personal Information Security Specification was revised and will come 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 Personal Information Security 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 Personal Information Security Specification is not mandatory per se, and this raises much doubt around its coercive force. Clarification is needed regarding to what extent enterprises must adapt themselves to it.

This clarification is especially important now, given that more and more such standards are being published-in January 2020 alone, TC260 issued over a dozen cybersecurity and data-protection-related draft national standards for public comment, covering cloud computing services, information security and other fields. In particular, the 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 consent may be waived from notification. Under this standard, many companies would have to conduct an overall remake of their notification mechanism, especially their privacy policies.

Further examples of the lack of clarity and consistency include China's proposed regulations and standards governing cybersecurity threats and the management of vulnerabilities. The *Cybersecurity Threat Information Publication Management Measures (Draft for Comments)* were released in November 2019 by the CAC, aimed at supporting the Cybersecurity Law by preventing irresponsible disclosure of cybersecurity threat information that could be harmful to national security or the public interest, or compromise cybersecurity.³⁴ In June 2019, the MIIT released the proposed *Cybersecurity Vulnerabilities Administrative Regulation Measures (Draft*)

for Comment).³⁵ Finally, TC260 released a proposed mandatory national standard for critical network equipment and its mandatory certification requirements under the Cybersecurity Law and, potentially, the Cryptography Law, which includes some provisions related to coordinated vulnerability disclosure.³⁶

However, these two regulations have overlapping content on cybersecurity vulnerability management. The proposed regulations and mandatory standard further diverge from international standards on coordinated vulnerability disclosure (CVD), including by proposing specific timelines for remediation development and premature notification requirements (prior to mitigation being available) to specific entities, and further limitations that may hinder external security research activities.

The Cybersecurity Sub-working Group strongly urges the Chinese Government to pursue a unified regulatory environment, with one agency coordinating the different government authorities with respect to vulnerability identification and remediation.

The Cybersecurity Sub-working Group further encourages China to align the proposed regulations with well-established, broadly adopted best practices and international standards in the field of CVD and vulnerability handling.³⁷ The working group supports alignment with these practices, as articulated in International Standardization Organization (ISO) standards such as ISO/IEC 29147 (2018) and ISO/IEC 30111 (2019), given the global nature of technology and vulnerability management processes, and the importance of end-user protection. The sub-working group also recommends adopting international practices as follows:

 Allow ample time for remediation development and testing in appropriate environments for product suppliers to balance the need to develop remediation as soon as possible with the completeness (testing) and effectiveness of mitigation.

³⁴ The Cybersecurity Threat Information Publication Management Measures (Draft for Comments), CAC, 20th November 2019, viewed 8th June 2020, http://www.cac.gov.cn/2019-11/20/c_1575785387932969.htm>

³⁵ Cybersecurity Vulnerabilities Administrative Regulation Measures (Draft for Comment), MIIT, 18th June 2019, viewed 8th June 2020, <http://www.miit.gov.cn/ n1146285/n1146352/n3057724/n3057728/c7005976/content.html>

³⁶ Requirements of National Standards Relating to Critical Network Equipment and Specialised Network Security Products (Draft for Comments), TC260, 16th May 2019, viewed 9th June 2020, https://www.tc260.org.cn/front/postDetail.ht ml?id=2019051620300720190516203007>

³⁷ The CVD process is a standardised, multi-step process through which stakeholders identify, develop, validate, distribute and deploy mitigations for security vulnerabilities.



- Information related to unmitigated vulnerabilities should be disclosed in confidence only to the parties that are necessary to develop and test mitigation measures during the CVD process, and vendors should notify authorities after mitigation measures are available, and information concerning the vulnerability is reported to the public and end-users.
- 3. 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 supports the technology, or where the vulnerability is open source software library/module or a commonly used protocol and there is no clear owner of the technology that is developing a remedy.

Overall, the current regulatory risks are overwhelming and overburden businesses, with compliance potentially being jeopardised. This is especially true for small and medium-sized enterprises (SMEs), which lack the resources to efficiently tackle the associated increasing breadth and number of mandatory requirements.

b) 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 strong operational burden.
- The CCPS requires network operators at level-two and above to perform various filings and assessments, some quite intrusive, such as connecting their networks with the public security organs' systems. Network operators at level-three and above will also need to undergo non-transparent security reviews when their purchase of network products and services may affect national security.
- The Provisions on Internet Security Supervision and Inspection by Public Security Organs,³⁸ 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 inspecting an Internet service provider and network-using unit's compliance.

- 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 competent sectoral government authorities or provincial cyberspace authorities for approval before releasing, sharing or trading important data, or providing such data overseas. They must also apply for a security assessment with provincial cyberspace authorities on their cross-border personal information transfers, keep a record of personal information exported for a period of five years, and submit each year, before 31st December, a record on the circumstances under which personal information is exported and the status of compliance of any contracts with the relevant data recipients.
- Additionally, the draft *Data Security Measures* also states that network operators, when collecting important data or personal sensitive information for business purposes, should file such collection activities with local cyberspace authorities.

These administrative schemes, even when falling under the same requirement, can furthermore be different from one authority to the other. They bring about a significant administrative burden, as well as increased costs for businesses, in most cases without meaningful positive impact on security or privacy.³⁹

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'* requirements 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 in the *Provisions on Internet Security Supervision and Inspection by Public Security Organs*, and the CSRC's requirement to conduct penetration testing in its *Administrative Measures on IT of Securities and Fund Operation Institutions* in 2019. These, and other

³⁸ Provisions on Internet Security Supervision and Inspection by Public Security Organs, MPS, 15th September 2018,viewed 19th May 2020, <http://www.gov.cn/ gongbao/content/2018/content_5343745.htm>

³⁹ On that point, the Cybersecurity Sub-working Group underlines, for example, that filing of data-processing activities was specifically suppressed in the EU's General Data Protection Regulation (GDPR), experience had shown that filing merely increases the costs and complexity of compliance without bringing tangible benefit to data subjects.

intrusive methods, could put the corporate and business networks that are critical to businesses' service offerings at risk.

c) Adverse effect

While the will to create end-to-end, all-encompassing security is understandable, the Cybersecurity Subworking 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 empowered regulatory authorities without proper coordination, and 3) heavy associated administrative procedures, will actually ensure security.

Good regulations are not enough to ensure satisfactory results. A clear and cohesive approach plays a critical role. 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, as a matter of fact, good security.

Indeed, the Cybersecurity Sub-working Group believes that the abovementioned evolution of the industry's regulatory environment, if maintaining its present momentum, will unnecessarily burden both domestic and international companies operating in China, thereby greatly hindering innovation and competition, increasing operational difficulties and harming actual security. In order to work and be effective, rules, their implementation and enforcement need to be clear, consistent and uniform.

The same can be said of the roles, duties and powers of supervisory authorities. Giving the same competences to several different supervisory authorities leads to even more asymmetry, contradictions and inconsistencies in the regulatory framework, especially in connection with implementation, interpretation and compliance, actually weakening supervisory effectiveness.

Excessive regulatory and administrative requirements, as well as associated costs, also prevent new companies from entering a market, thereby stifling innovative activity, creativity and competition. This affects the extent to which companies can develop and exploit new products, services and operating processes so as to maximise operating efficiency.

Recommendations

- Develop clear, consistent and harmonised cybersecurityrelated 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 in cybersecurity management-related articles.
- 3. Ensure Transparency, Consistency, Non-discrimination and Proportionality in Cybersecurity Rule-making and Law Enforcement (1)4

Concern

Transparency, consistency, non-discrimination and proportionality are becoming increasingly important in order to create a healthy cybersecurity environment for domestic and international companies alike, but are not always ensured in current cybersecurity rule-making and law enforcement.

Assessment

To reassure companies that China's cybersecurity environment will remain predictable and stable in the face of a rapidly evolving and constantly tightening regulatory framework, and to avoid unnecessarily compromising business confidence, it is of paramount importance when formulating and implementing any forthcoming laws, regulations and standards, that China ensures the following:

a) Transparency

In uncertain times, such as during the COVID-19 outbreak, legal certainty is needed more than ever. While the subworking group recognises and appreciates the efforts made so far by the CAC and other government authorities, it hopes that transparency can be further improved by guaranteeing that a wider range of businesses are informed of the rule-making progress through appropriate channels. EU experience also speaks to the importance



of applying transparency during the entire cybersecurity rule-making process, and not simply retrospectively after a particular matter has been concluded. Such a perspective is also endorsed by the State Council in its *Notice on Fully Listening to Opinions of Enterprises, Industry Associations and Chambers of Commerce in the Making of Administrative Measures, Provisions and Normative Documents.*⁴⁰

b) Consistency

The sub-working group underlines the need to ensure consistency at several levels.

First, between the Cybersecurity Law and its implementing regulations, for example by limiting the scope of data localisation and cross-border data transfer measures to critical information infrastructure operators as stated in the Cybersecurity Law.

Second, between the Cybersecurity Law and associated regulations, and other laws and regulations like 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 cryptographic products that have been approved or certified by the State Cryptography Administration, regardless of whether such products fall within the product catalogues for testing and certification. Such requirements are incompatible with the Cryptography Law.

Third, between the cybersecurity regulations released and enforcement actions conducted by different authorities. Worryingly, a growing number of government authorities are rolling out implementing regulations in a manner that lacks coordination, with overlapping and even contradictory requirements. This holds true for data regulations and standards released by the CAC and the MPS, and also for the MIIT's *Provisions for Cybersecurity Vulnerabilities Management (Draft for Comments)*⁴¹ and the CAC's *Administrative Measures* for Cybersecurity Threat Information Publication (Draft for Comments)⁴² on the one side; the MPS's CCPS and the MIIT's Classification Guidelines on the Cybersecurity of Industrial Internet Enterprises on the other. Inconsistent requirements pose a significant burden on companies that are already suffering from business and financial difficulties.

An updated clarification on the roles and responsibilities of different government authorities and standardisation bodies involved in cybersecurity rule-making would contribute to solving this issue. This avoids diverting opinions between the relevant authorities such as the CAC and the TC260 on cases like the planned mandatory national standard *Information Security Technology – Security Technical Requirements for Specialised Cybersecurity Products* administered by the MPS rather than TC260.⁴³

c) Non-discrimination

The sub-working group calls for China to eliminate any elements that risk discriminating against international companies. One example being that, in spite of the reassurances from the CAC that the emphasis on secure and trustworthy (and other similar terms) ICT products and services is not targeting international companies, in reality this term still has a close connotation with indigenous innovation and thus puts international companies in China at a competitive disadvantage. Besides, a strict and narrow definition of 'national security' would also help achieve nondiscrimination while allowing China to concentrate resources on what is genuinely important to its national interests.

d) Proportionality

Cybersecurity regulations need to be technically credible and innovation-friendly. Intervention at all levels, from national regulations to business security measures, should be appropriate to and commensurate with the risk, and not limit the opportunities offered by digital transformation nor create unreasonable costs for businesses.

⁴⁰ Notice on Fully Listening to Opinions of Enterprises, Industry Associations and Chambers of Commerce in the Making of Administrative Measures, Provisions and Normative Documents, State Council, 13th March 2019, viewed 7th April 2020, <http://www.gov.cn/zhengce/content/2019-03/13/content_5373423.htm>

⁴¹ Provisions for Cybersecurity Vulnerabilities Management (Draft for Comments), MIIT, 18th June 2019, viewed 7th April 2020, http://www.miit.gov.cn/n1146285/ n1146352/n3054355/n3057724/n3057728/c7005976/content.html>

⁴² Administrative Measures for Cybersecurity Threat Information Publication (Draft for Comments), CAC, 20th November 2019, viewed 7th April 2020, <http://www. cac.gov.cn/2019-11/20/c 1575785387932969.htm>

⁴³ Call for Comments on Planned Mandatory National Standard Information Security Technology – Security Technical Requirements for Specialised Cybersecurity Products, Standardisation Administration of China, 9th April 2020, viewed 16th April 2020, <http://www.sac.gov.cn/gzfw/zqyj/202004/ t20200410 346383.htm>

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 and standardisation bodies 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 |
| DPO | Data Protection Officer |
| EU | European Union |
| FIE | Foreign Invested Enterprises |
| GDPR | General Data Protection Regulation |
| ICT | Information and Communication |
| | Technology |
| IoT | Internet of Things |
| ISO | International Standardization |
| | Organization |
| IT | Information Technology |
| MIIT | Ministry of Industry and Information |
| | Technology |
| MPS | Ministry of Public Security |
| NPC | National People's Congress |
| SME | Small and Medium-sized Enterprises |
| TC260 | National Information Security |
| | Standardisation Technical Committee |
| TC485 | National Technical Committee on |
| | Communication |
| VPN | Virtual Private Network |
| | |



Logistics Working Group

Key Recommendations

1. Customs Issues

- 1.1 Solicit Business Organisations' and Chambers' Opinions in the Process of Revising the China Customs Law
 - Solicit business organisations' and chambers' opinions in the process of revising the China Customs Law to ensure it is practical and implementable.
 - Emphasise the importance of the revision of the China Customs Law in the National Party Congress' 14th Five-year Plan.
- 1.2 Promote the Reform of the 'Two Steps Declaration' Model for Customs Clearance
 - Simplify the number of required declaration elements and customs declaration documents for the 'Step 1' declaration.
 - Allow enterprises to declare accurate information in 'Step 2' of the declaration process if they find an information mis-match after 'Step 1'.
 - Enable the 'Two Steps' model for imports into bonded zones.
- 1.3 Establish Detailed and Enforceable Implementation Guidelines for Voluntary Disclosures and Use of the Customs Declaration Sheet (CDS) (1)2
 - Establish detailed guidelines and executable processes for China Customs.
 - Establish clear rules and requirements to facilitate enterprise amendments on the declared information.
- 1.4 Reform Customs Inspection Procedures on Delicate Goods
 - Design a more reasonable and situational customs inspection mechanism that reduces the extra costs for companies arising from customs inspection procedures.

1.5 Enhance the Customs Clearance System and Improve System Stability (1)2

- Communicate in advance through official channels announcements on system upgrades and maintenance.
- Avoid performing system upgrades during peak periods to prevent clearance delays.
- Activate emergency response plans in a timely manner to ensure resumption of normal operations with minimal impact.

1.6 Optimise the Authorised Economic Operator (AEO) Programme 14

- Optimise the AEO programme by publishing specific facilitated measures for express and crossborder e-commerce enterprises.
- Cover preferential treatment for China Entry-Exit Inspection and Quarantine (CIQ) in the AEO programme.

1.7 Simplify the Low-value Shipment Declaration Process

- Adopt a flat duty rate and rescind the harmonisation system (HS) code classification requirement for low-value goods, while balancing duty collection and trade facilitation.
- 1.8 Clarify Regulations Related to the Uploading of Declaration Documents to the Single Window Platform
 - Clarify regulations related to the uploading of declaration documents to the 'single window' platform.



2. Express Delivery Services

- 2.1 Revert to the Previous Geographical Scope Requirement for Obtaining International Express Licences in China
 - Manage the approvals for international express delivery licences in accordance with the provisions laid out in *Circular No. 23*.
 - Adjust and amend the geographical scope requirement in the spirit of China's World Trade Organization (WTO) commitments to market opening.
- 2.2 Avoid Directly Applying the Management Requirements of the Franchise Model to the Agency Model, Including the Duplicated Licence Requirement
 - Avoid directly applying the management requirements of the franchise model to the agency model, including the duplicated licence requirement.
- 2.3 Increase Coordination in Relation to the Implementation of National Unified Safety Supervision Standards
 - Formulate and implement unified national security inspection standards and technical requirements that all localities can refer to, in order to avoid contradictory standards and regulations at the local level.

2.4 Reduce Burdens Created by Cybersecurity Law Enforcement in the Express Delivery Industry

- Balance network security enforcement with the express delivery industry's regular need to clear customs efficiently by reducing the additional burdens created in regards to cross-border transfer of personal information.
- 2.5 Accelerate the Construction of Infrastructure to Support the Use of New Energy Vehicles (NEVs) in the Express Delivery Industry
 - Take into consideration the complex situation of the express delivery industry when formulating policies on NEVs.
 - Accelerate the constructions of infrastructure to support the use of NEVs in the express delivery industry, including but not limited to constructing charging stations and car parks for delivery NEVs.

3. International Hubs

3.1 Establish a Clear Policy for International Hub Management 133

- 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 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 Key Recommendations

- 1. Allow the Transport of International Cargo Between Chinese Ports (International Relay) (32)
 - Support the development of more efficient Chinese shipping services by permitting international cargo relay by foreign shipping services on a reciprocal basis.



- 2. Apply Non-discriminatory Treatment in Chinese Free Trade Zones (FTZs) 17
 - 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 Fees for Value-added and Optional Services
 - Issue a written guidance on the criteria for filing new surcharges and adjusting existing surcharges.
 - Educate regulators, the market and customers on the differences between mandatory surcharges, behavioural charges and fees for value-added and optional services.
- 4. Set Up a Numerical Percentage as a Minimum Threshold in Determining Non-Compliance in Freight Filing Audits
 - Set up a numerical percentage as a minimum threshold in determining non-compliance in freight filing audits.
- 6. Ratify the Hong Kong Convention for the Safe and Environmentally Sound Recycling of Ships
 - Ratify the Hong-Kong Convention for the Safe and Environmentally Sound Recycling of Ships.
- 7. Monitor the Consequences for Fair Competition Arising from Costal Ports Integration
 - · Closely monitor potential competition law violations by the relevant government authorities.
 - Implement measures and controls to prevent post-merger port groups misusing their dominant position.

Introduction to the Working Group

Logistics is an integral part of global commercial activity, as it facilitates the distribution of products and services across the world according to customer demand. With the emergence of e-commerce, logistics is no longer limited to just purchasing, storing or selling. By utilising online logistics, customers' needs can now be met at a lower cost, which has become the core target of the industry. As it is responsible for transporting goods from supplier to receiver safely and efficiently, the logistics industry also plays a positive role in China's economic development. The country's ongoing efforts to develop its high-end manufacturing sector and increase consumption are set to further increase demand for safe, efficient and affordable logistics services.

The Logistics Working Group was founded in 2003,

and represents a diverse spectrum of logistics service providers in freight forwarding, including sea, air, land and express delivery, as well as warehousing and distribution. The Logistics Working Group is also composed of the International Liner Shipping Subworking Group, with core members from leading international maritime transport enterprises.

Recent Developments

China's logistics industry saw steady growth in 2019. According to the National Development and Reform Commission (NDRC), the total value of external logistics grew to Chinese yuan (CNY) 298 trillion, representing 5.9 per cent year-on-year growth on comparable prices; while the total amount of industrial product logistics was CNY 269.6 trillion, representing 5.7 per cent yearon-year growth. Total revenue in the logistics industry increased from CNY 10.1 trillion in 2018 to CNY 10.3 trillion in 2019, a nine per cent rise.¹

COVID-19

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, 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 13.7 per cent year-on-year decrease.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 and increasing coordination between different ministries for the smooth resumption of work by logistics companies.⁴ 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. As relief efforts continue, the international logistics industry stands with the Chinese and other governments to help defeat the virus.

Air Freight

Because air freight utilises both passenger and cargo flights, the vast reduction of domestic and international passenger flights due to the COVID-19 outbreak resulted in severe supply chain disruptions.⁵ On 24th March 2020, in a State Council executive meeting chaired by Premier Li Keqiang, it was announced that China will further boost its international air freight capacity in order to stabilise internal supply chains.⁶ On 29th March 2020, the Joint Prevention and Control Mechanisms of the State Council announced four major measures to increase China's airfreight capabilities and stabilise supply chains during the pandemic.7 The measures involve: providing green channels at airports for air cargo flights; encouraging cooperation between trading companies and airline companies on meeting the extra demand following the suspension of most international passenger flights; decreasing costs through 16 measures directed towards air freight; and securing the transportation of 'strategic goods'. In addition to increasing traditional cargo flights, the measures also incentivised many airlines to temporarily switch passenger lines to cargo lines. The European Commission simultaneously facilitated air cargo operations, in cooperation with member state authorities and the international aviation community, including air cargo and express service providers, to ensure the stable supply of medical devices.8

Regulatory Environment

With China's e-commerce market booming, express delivery has been one of the fastest growing sectors of the logistics industry. On 23rd January 2018, the General Office of the State Council issued the *Guiding Opinions on Advancing the Collaborative Development of E-commerce and Express Logistics*,⁹ and the E-commerce Law came into force on 1st January 2019.¹⁰ On 7th April 2020, in response to the COVID-19 crisis, the State Council announced its intention to designate 46 more cities as comprehensive pilot zones for cross-border e-commerce, in addition to the previous 59 cities already established in 2018 and 2019.¹¹ The Logistics Working Group supports these efforts by the Chinese Government to ensure the smooth and healthy development of the express delivery sector.

¹ National Logistics Operation in 2019, NDRC, 21st April 2020, viewed 22nd April 2020, https://www.ndrc.gov.cn/fggz/jjyxtj/xdwl/202004/t20200421_1226120. https://www.ndrc.gov.cn/fggz/jjyxtj/xdwl/202004/t20200421_1226120. https://www.ndrc.gov.cn/fggz/jjyxtj/xdwl/202004/t20200421_1226120. https://www.ndrc.gov.cn/fggz/jjyxtj/xdwl/202004/t20200421_1226120. https://www.ndrc.gov.cn/fggz/jjyxtj/xdwl/202004/t20200421_1226120. https://www.ndrc.gov.cn/fggz/jjyxtj/xdwl/202004/t20200421_1226120.

² Economic Operation of Transportation in April, MOT, 27th May, viewed 11th June 2020, <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 the Airport, NDRC, 29th March 2020, viewed 15th May 2020, https://news.cctv.com/2020/03/29/ARTI7SbH8ClinVkl9bfkOHtB200329.shtml>

⁴ Press Conference of the Joint Prevention and Control Mechanism of the State Council, State Council, 6th March 2020, viewed 15th May 2020, <http://www.gov. cn/xinwen/gwylflkjz45/index.htm>

⁵ Press Conference of the Joint Prevention and Control Mechanism of the State Council, State Council, 29th March 2020, viewed 15th May 2020, http://www.gov.cn/xinwen/gwylflkjz73/index.htm

⁶ Li Keqiang: We will Support the Development of Various Ownership Air Cargo Market Entities Equally, State Council, 25th March 2020, viewed 20th April 2020, http://www.gov.cn/guowuyuan/2020-03/25/content_5495239.htm

⁷ CAAC: Increment International Airfreight Capabilities to Support the Supply Chain of the Materials for the Epidemic Prevention, CAAC, 30th March 2020, viewed 19th April 2020, <http://www.caac.gov.cn/XWZX/MHYW/202003/ t20200330_201796.html>

⁸ European Commission Guidelines: Facilitating Air Cargo Operations during COVID-19 outbreak, European Commission, 26th March 2020, viewed on 23rd April 2020, https://ec.europa.eu/transport/sites/transport/files/legislation/ c20202010_en.pdf>

⁹ Guiding Opinions of the General Office of the State Council on Advancing the Collaborative Development of E-commerce and Express Logistics, State Council, 23rd January 2018, viewed 11th June 2020, https://www.gov.cn/zhengce/ content/2018-01/23/content_5259695.htm>

¹⁰ E-commerce Law, NPC, 31st August 2018, viewed 11th June 2020, <http://www. npc.gov.cn/npc/c30834/201808/5f7ac8879fa44f2aa0d52626757371bf.shtml>

¹¹ Li Keqiang Presided Over the Executive Meeting of the State Council, Launched a Series of Measures Such as Adding AaComprehensive Cross-Border E-Commerce Pilot Area, Supporting Processing Trade, Holding the Canton Fair Online, etc, State Council, 7th April 2020, viewed on 23rd April 2020, <http://www. gov.cn/premier/2020-04/07/content_5499975.htm>



Key Recommendations

1. Customs Issues

1.1 Solicit Business Organisations' and Chambers' Opinions in the Process of Revising the China Customs Law

Concern

It is imperative that the China Customs Law process takes into account opinions from the business community to ensure that proposed changes to the Law are practical and implementable.

Assessment

The China Customs Law has served as the basis for all policies and regulations related to customs affairs since its release in 1987. The revision of the China Customs Law, which began in 2019, envisions major amendments that will heavily impact customs operations in China. Since 1987, the law has undergone four minor revisions, and one major revision in 2000. There are currently several areas of the legislation that need to be considered for reform in order to bring the China Customs Law up-to-date with modern business operations. These areas include voluntary disclosure, declaration discrepancy and leveraging new emerging technologies.

In addition, the revision should ensure that the China Customs Law:

- aligns with the consolidated China Entry-Exit Inspection and Quarantine (CIQ) laws; and
- has linkages to other laws relevant to China's trade legal framework, including the Foreign Investment Law, the China Export Control Law and the China E-Commerce Law.

The process of revising the China Customs Law is welcomed by companies operating in China, but the importance of this review needs to be accentuated at the central level to ensure that it will have a positive impact when it comes into effect.

Recommendations

- Solicit business organisations' and chambers' opinions in the process of revising the China Customs Law to ensure it is practical and implementable.
- Emphasise the importance of the revision of the China Customs Law in the National Party Congress' 14th Five-year Plan.

1.2 Promote the Reform of the 'Two Steps Declaration' Model for Customs Clearance

Concern

Many companies are not willing to switch to the 'Two Steps' declaration model for customs clearance due to the complicated requirements and processes involved.

Assessment

As a global best practice, the 'Two Steps' declaration model has been widely implemented in several countries, including the United States and European Union Member States. The model has enhanced the efficiency of import customs clearance and reduced the burden of enterprises by dividing the declaration process into two steps: firstly, a bill of landing, and secondly, the submission of other documents and duty payment.¹² It is therefore very encouraging that the General Administration of Customs of China (GACC) began work on a 'Two Steps' declaration model in 2019. Progress has been swift, with China running successful pilots in some cities before rolling the model out nationwide from 21st January 2020.

Although this is positive, only a small number of importers have been willing to switch to the new model. In order to increase incentives for enterprises to change, the working group suggests simplifying the requirements and processes. One such change would be to further reduce and simplify the required documentation and information for the 'Step 1' preliminary declaration. Based on current requirements, a large number of enterprises report that the 'Step 1' declaration is so burdensome it seems to double their workload.

Additionally, allowing enterprises to provide accurate information in the 'Step 2' declaration if they find mismatches after 'Step 1' would also provide a strong incentive to consider switching to this new model. The 'Step 1' declaration is very preliminary and is made before enterprises receive the physical cargo, therefore 'Step 2' could provide a good opportunity to declare more accurate information. This would constitute an essential step forward in the compliance management of enterprises.

On a different note, under the current 'Two Steps'-

¹² GACC Begins "Two-Step Declaration" for Import Goods, First in Zhejiang Pilot FTZ, GACC, 24th September 2019, viewed 28th May 2020, http://english.customs.gov.cn/Statics/1e5f4abc-020e-4e04-8656-c6f8e29eee59.html>

related regulation, goods are not allowed to be used or consumed after 'Step 1' until 'Step 2' is completed. This not only increases management costs, as there is a requirement to separate the goods imported that have gone through 'Step 2' from those that remain at 'Step 1', but also often leads to the use of goods before the declaration process is concluded and increases the risk of non-compliance. This restriction does not benefit importers, who would like to shorten the customs supervision period.

Finally, the new model is currently limited to supporting imports into non-bonded areas, while imports into bonded zones (special trade zones) are not covered. The working group therefore urges China Customs to enable the new model for bonded zones as well.

Recommendations

- Simplify the number of required declaration elements and customs declaration documents for the 'Step 1' declaration.
- Allow enterprises to declare accurate information in 'Step 2' of the declaration process if they find an information mis-match after 'Step 1'.
- Enable the 'Two Steps' model for imports into bonded zones.
- 1.3 Establish Detailed and Enforceable Implementation Guidelines for Voluntary Disclosures and Use of the Customs Declaration Sheet (CDS) (12)2

Concern

The current Customs Voluntary Disclosure rule in China is very general, lacking actionable guidance and process, while the CDS amendment increases compliance risks for enterprises.

Assessment

China Customs made great progress on voluntary disclosure in 2019 by announcing the GACC *Circular 161*¹³ on the voluntary disclosure process for dutiable imports.

However, the existing Customs Voluntary Disclosure rule in China continues to be 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.

Simultaneously, the CDS amendment remains a challenge to enterprises. For example, there are situations where enterprises unintentionally make wrong declarations, due to mistakes made by overseas suppliers. However, customs will not allow them to amend the wrong declaration, even through a voluntary disclosure. This creates non-compliance risks for enterprises.

Recommendations

- Establish detailed guidelines and executable processes for China Customs.
- Establish clear rules and requirements to facilitate enterprise amendments on the declared information.
- 1.4 Reform Customs Inspection Procedures for Delicate Goods

Concern

For some goods that need a controlled environment, China Customs requires the outer box or packaging to be opened in certain conditions that can cause direct damage to the product.

Assessment

China Customs has included customs inspection and investigation reform as part of the 2020 China Customs Reform Plan, which is a very encouraging sign.

Based on the current rules in China, during the customs inspection, 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 challenges for some goods that need a controlled environment for transport or use is that their outer box or packaging must only be opened in certain acceptable environments, e.g. dust-free rooms. Therefore, if customs opens the outer box or packaging during inspection, direct damage may be caused to the goods, which constitutes a high cost for companies. Although 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 cannot meet the

¹³ GACC 2019 Circular No. 161 (Announcement on the Handling of Matters Related to Voluntary Disclosures of Tax-related Violations), GACC, 17th October 2019, viewed 28th June 2020, http://www.customs.gov.cn/customs/302249/302266/302267/2687641/index.html



demand for such requirements, therefore delaying the customs clearance process.

Recommendations

- Design a more reasonable and situational customs inspection mechanism that helps reduce the extra costs for companies arising from customs inspection procedures.
- 1.5 Enhance the Customs Clearance System and Improve System Stability (32)

Concern

Enterprises frequently encounter customs clearance delays due to system upgrading and maintenance.

Assessment

As one of the key elements of modern customs, paperless declaration benefits both business sectors and customs administrations. China Customs gradually transformed from paper declaration to completely paperless declaration in 2018 with the development of electronic data interchange. In general, the system works well, but there are frequent system upgrades and maintenance, which can result in it being shut down for long periods, during which time no customs declaration can be made. Technology maintenance typically occurs between 6:00 a.m. and 22:00 p.m., although this is a period of high activity for customs clearance. Additionally, delivery services rely on high efficiency and short flight transfers, therefore emergency plans, where manual releases are placed at customs when systems are under maintenance, could help mitigate any delays.

Recommendations

- Communicate in advance through official channels announcements on system upgrades and maintenance.
- Avoid performing system upgrades during peak periods to prevent clearance delays.
- Activate emergency response plans in a timely manner to ensure resumption of normal operations with minimal impact.

1.6 Optimise the Authorised Economic Operator (AEO) Programme (14)

Concern

Despite investing a lot of resources in obtaining and maintaining their AEO qualification, many certificate

holders do not enjoy much more preferential treatment than those without it, which restricts their operational efficiency.

Assessment

An AEO is defined in the World Customs Organization's (WCO's) Framework of Standards to Secure and Facilitate Global Trade (SAFE Framework) as "a party involved in the international movement of goods in whatever function that has been approved by or on behalf of a national customs administration when complying with WCO or equivalent supply chain security standards."¹⁴ This concept, which originally appeared in the Community Customs Code issued by the Council of the European Union, is one of the core concepts of the SAFE Framework. In the AEO system, customs authorities work with qualified business partners to gain additional competitiveness and effectiveness in the facilitation of international supply chains by reducing customs clearance lead time and cost. The AEO certification system is an important part of the Corporate Social Credit System and customs authorities could use it to reduce any conflict that may arise between customs supervision and trade facilitation.

In 2019, China Customs expanded the AEO coverage to international express operators and cross-border e-commerce enterprises with dedicated accreditation criteria. As AEO accreditation for express and crossborder e-commerce companies is stricter and more sophisticated, it requires certificate holders to invest more in both hardware and process management. Although the idea is welcomed by the business community, it is recommended that China Customs publish tangible benefits of the AEO status for express and cross-border e-commerce companies, to incentivise them to gain this qualification.

Additionally, after the CIQ was absorbed into Customs in 2018, the scope of AEO benefits remained the same as its original customs business scope, and no CIQ preferential treatments, e.g. dangerous chemical import/ export processes, were included in the programme.

It is very encouraging to see China make good progress in signing AEO mutual recognition agreements with other countries. China should continue to establish

¹⁴ Framework of Standards to Secure and Facilitate Global Trade, WCO, 2018, viewed on 28th June 2020, http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/safe-framework-of-standards.pdf?la=en

more of these agreements, as it will be very beneficial in improving the efficiency and reducing the expense of cross-border activities.

Recommendations

- Optimise the AEO programme by publishing specific facilitated measures for express and cross-border e-commerce enterprises.
- Cover preferential treatment for CIQ in the AEO programme.
- 1.7 Simplify the Low-value Shipment Declaration Process

Concern

The import and export volume of low-value goods is much higher than for goods of higher value, and the harmonisation system (HS) code of classification results in a huge workload for carriers, thereby slowing down the declaration process.

Assessment

The rapid development of international trade and crossborder e-commerce has resulted in a large increase in the volume of low-value goods (in China, shipment value less than CNY 5,000). The majority of low-value shipments are samples and advertisement materials, which are very time-sensitive and require fast customs clearance. According to the WCO's immediate release guidelines, customs administrations are recommended to set a *de minimis* value threshold for low value goods. This means that shipments below a certain value can be exempted from duty/tax. Thus, there would be no need to contact the importer to confirm the shipment details for HS code classification. If China followed these WCO recommendations, the workload for both enterprises and customs would be reduced, and crossborder trade would be facilitated.

Recommendation

- Adopt a flat duty rate and rescind the HS code classification requirement for low-value goods, while balancing duty collection and trade facilitation.
- 1.8 Clarify Regulations Related to the Uploading of Declaration Documents to the Single Window Platform

Concern

Although Beijing, Shanghai and Guangzhou customs

published a new policy removing the requirement for enterprises to upload customs declarationrelated documents onto the 'single window' platform, enterprises are concerned that they may encounter problems if they want to amend any declarations.

Assessment

Some local customs authorities in China have announced that there is no need to upload declaration documents—such as invoices, packing lists and sales contracts—to the 'single window' platform in an effort to simplify the process for enterprises. The new measure was welcomed by the industry, as it has reduced the burden of declaration while contributing to environmental protection by going paperless. However, enterprises still have some concerns over the implementation of this new process, in particular about whether or not China Customs still recognises documentation provided by enterprises when filing a post-entry amendment.

Recommendation

• Clarify regulations related to the uploading of declaration documents to the 'single window' platform.

2. Express Delivery Services

2.1 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 a barrier to market access to the express 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 geographic scope of international express delivery business licences.

Until 2009, regulators required international express companies to file with the Ministry of Commerce (MOFCOM) and obtain an International Freight Forwarder Record-filing Certificate, which had no geographic



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. Since then, the geographic scope of international express delivery business licences has been restricted to the provincial level, and includes autonomous regions and province-level municipalities.

However, on 1st April 2019 the State Post Bureau (SPB) issued the Notice on Strengthening the Approval of the Geographical Scope of Express Delivery Business Operating Licences, which declared that the geographical scope of business licences for express delivery entities needs to be verified at the city level. This notice was internally distributed, without officially notifying the express delivery industry. The adjustment of the geographic scope for express licensing from province, autonomous region and municipality level, to city, districts, prefecture and autonomous prefecture level, represents an additional market access barrier for the express industry. This is inconsistent with the State Council's repeated requirements for the expansion, opening up and improvement of the business environment for foreign-invested enterprises (FIEs). It is also incompatible with China's World Trade Organization (WTO) commitments on market opening.¹⁵

Recommendations

- Manage the approvals for international express delivery licences in accordance with the provisions laid out in *Circular No. 23*.
- Adjust and amend the geographical scope requirement in the spirit of China's WTO commitments to market opening.
- 2.2 Avoid Directly Applying the Management Requirements of the Franchise Model to the Agency Model, Including the Duplicated Licence Requirement

Concern

Regulators often do not differentiate between the regulatory management practices of agency models used in international express delivery 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 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 the 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 license at the port city. However, under the agency model, the international express enterprise is also required to hold the city-level licence in the agency city, which causes an issue with duplicated licences and is inconsistent with the characteristics of the agency model.

¹⁵ Additionally, in the *Opinions on Further Capitalising on Foreign Investment*, the State Council requested to "protect the lawful rights of foreign-invested enterprises (FIEs)." It also stated that "all regions and departments shall execute the administrative licence in strict accordance with the laws and regulations, including the Foreign Investment Law and Administrative Licence Law, and may not change the scope, procedure and standard of the administrative licence without authorisation."

Recommendation

• Avoid directly applying the management requirements of the franchise model to the agency model, including the duplicated licence requirement.

2.3 Increase Coordination in Relation to the Implementation of National Unified Safety Supervision Standards

Concern

Some local Public Security Bureaus (PSBs) require express delivery enterprises to purchase security inspection equipment that meets local safety standards in addition to equipment already purchased to comply with national safety standards.

Assessment

In some provinces, autonomous regions or provincelevel municipalities, local PSBs require international express delivery enterprises to deploy and operate in their international hubs integrated 'intelligent delivery and security inspection' machines that comply with technical standards of the local PSBs. The Chinese customs authorities supervise these sites. In many of these hubs, FIEs have already purchased and configured the security equipment required by national airport and customs authorities. If FIEs are required to purchase additional equipment to comply with local PSB requirements, it will increase costs and reduce business efficiency.

Recommendation

 Formulate and implement unified national security inspection standards and technical requirements that all localities can refer to, in order to avoid contradictory standards and regulations at the local level.

2.4 Reduce Burdens Created by Cybersecurity Law Enforcement in the Express Delivery Industry

Concern

The tedious and burdensome requirements and procedures for Cybersecurity Law enforcement limit customs clearance efficiency in the express delivery service industry, which in turn impedes the competitiveness of the services that enterprises can provide.

Assessment

The Cybersecurity Law came into effect in June 2017, with subsequent supporting implementing regulations and policies that regulate the information-sharing of stakeholders. Among the regulations, the express delivery industry has been especially involved in draft measures concerning security assessments for crossborder transfers of 'personal information' and 'important data', specifically two releases by the Cyberspace Administration of China (CAC); one in 2017 on the Measures on the Security Assessment of Crossborder Transfer of Personal Information and Important Data (Draft for Comments),¹⁶ and the other in 2019 on Measures on Security Assessment of the Cross-border Transfer of Personal Information (Draft for Comments)¹⁷, both of which included the express delivery industry in their scope of supervision. Implementation of the Law particularly impacts express delivery companies due to their services having significant involvement in issues related to customer information and cross-border data transfers. The existing regulations require the 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 express delivery services will negatively impact the entire industry on a large scale.18

Recommendation

- Balance network security enforcement with the express delivery industry's regular need to clear customs efficiently by reducing the additional burdens created in regards to cross-border transfer of personal information.
- 2.5 Accelerate the Construction of Infrastructure to Support the Use of New Energy Vehicles (NEV) in the Express Delivery Industry

Concern

The introduction of NEV quotas is not optimal for the express delivery industry.

¹⁶ Measures on the Security Assessment of Cross-border Transfer of Personal Information and Important Data (Draft for Comments), CAC, 11th April 2017, viewed 11th June 2020, <http://www.cac.gov.cn/2017-04/11/c_1120785691.htm>

¹⁷ Measures on Security Assessment of the Cross-border Transfer of Personal Information (Draft for Comments), CAC, 13th June 2019, viewed 11th June 2020, <http://www.cac.gov.cn/2019-06/12/c_1124613618.htm>

¹⁸ For more detailed information on the Cybersecurity Law and regulations related to personal information and cross-border data transfer, please refer to the Key Recommendations of the Cybersecurity Sub-working Group Position Paper.



Assessment

The government recently issued several policies to promote green transportation. However, the working group notes that specific provinces and cities have introduced requirements and metrics that hold the express delivery industry to a higher standard than other industries, due to NEV quotas for express delivery in urban areas.

These special standards in the express delivery industry bring significant burdens for businesses. Vehicles for express delivery have to contend with the challenges of transporting packages over long distances and must also be able to make deliveries in urban areas. 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 that express delivery vehicles often encounter complicated situations, such as the continuous parking of NEV delivery cars running down battery power during the 'last mile' delivery.19 Therefore, additional support from governments and authorities is needed to help express delivery companies comply with the new requirements without creating an excessive burden for them. One pressing issue would be the construction of infrastructure that supports the usage of NEVs in China.

Recommendations

- Take into consideration the complex situation of the express delivery industry when formulating policies on NEVs.
- Accelerate the constructions of infrastructure to support the use of NEVs in the express delivery industry, including but not limited to constructing charging stations and car parks for delivery NEVs.

3. International Hubs

3.1 Establish a Clear Policy for International Hub Management 33

Concern

The current regulatory framework reduces the efficiency of enterprises and holds back hub development.

Assessment

The role of an international hub is to gather different manufacturing and service industries, and 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. They require import permits and approvals from the relevant regulators even if just being transferred between aircraft in airport secured zones. For this reason, when dealing with a variety of goods, numerous enterprises encounter multiple challenges in warehousing, transportation and centralised shipping, which reduces 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, where the existing customs legal system has very few regulatory requirements or guidelines on the matter.

Recommendation

- Establish a complete and comprehensive system covering inbound and outbound air, sea and land shipments of transit goods, transit cargo and throughgoods for international cargo.
- Promote cooperation between China Customs 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.

¹⁹ 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 kilometers require cars of sizes that are more suitable for urban mobility, and its costs can be quite substantial in the logistics process. This part of the delivery entails a number of short stops throughout the city, with all deliveries assigned to be completed each day. Therefore, there is a need to be able to recharge NEV batteries to accommodate the complexity of this delivery process.

Abbreviations

| AEO | Authorised Economic Operator |
|----------------|--------------------------------------|
| CAC | Cyberspace Administration of China |
| CDS | Customs Declaration Sheet |
| CIQ | China Entry-Exit Inspection and |
| | Quarantine |
| CNY | Chinese Yuan |
| FIE | Foreign Invested Enterprises |
| GACC | General Administration of Customs of |
| | China |
| HS | Harmonisation System |
| MOFCOM | Ministry of Commerce |
| MOT | Ministry of Transport |
| NDRC | National Development and Reform |
| | Commission |
| NEV | New Energy Vehicles |
| PSB | Public Security Bureau |
| SAFE Framework | Framework of Standards |
| | to Secure and Facilitate Trade |
| SPB | State Post Bureau |
| WCO | World Customs Organization |
| 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 costeffective 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 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

While the international liner shipping industry saw modest growth in 2019, the industry is facing unprecedented challenges during 2020. The outbreak of Coronavirus Disease 2019 (COVID-19) has caused serious disruption to trade flows, leading to reduced cargo volumes and eroding the already slim margins of the maritime industry.² While the impact of the COVID-19 outbreak on the economy has led to an increased focus on how to support companies producing for export markets, it is important to realise that the maritime industry is also under intense pressure due to dropping demand and market insecurities. In such circumstances, the industry is looking for support similar to that offered to other industries, specifically on cost of empty repositioning and cost of transhipment cargos.

Further complicating conditions for liner shipping companies is the fact that protectionist sentiments are gaining ground around the world. Protectionism is poison for trade, and by extension for the maritime industry. Moreover, uneven market access continues to create unfair advantages, as some companies are benefitting from both a protected home market and open markets in key overseas locations. With this in mind, the maritime industry very much welcomes the Chinese authorities examining the possibility of permitting transhipment, otherwise known as international relay, in the Port of Shanghai on a reciprocal basis. Permitting international relay in Chinese ports will set a powerful example and demonstrate China's commitment to opening its markets to the countries and regions that have already opened their markets to Chinese shipping companies.

The International Liner Shipping Sub-working Group values the recent improvements to China's regulatory environment for the maritime industry. As a result of these changes, three of the recommendations raised in the working group's *Position Paper 2019/2020* (i.e. "Ensure Effective Implementation of the Global Sulphur Cap 2020", "Provide Guidance on the Application of China's Cybersecurity Law for Shipping Lines" and "Crack Down on Deliberate Misdeclaration of Container Weight") have been effectively resolved and are thus no longer a concern to the maritime industry.

However, the International Liner Shipping Sub-working Group is highly concerned by stipulations in the 'Notice on Stabilising Foreign Trade' (Decree No. [2020] No. 139) of April 2020 that claimed that the Chinese Government "supports enterprises engaged in foreign trade to improve their bargaining power for ocean freight, and guide our enterprises to choose Cost, Insurance, and Freight (CIF) term for export and Free on Board (FOB) for import".'³ This notice is essentially promoting a move of cargo control from overseas companies to Chinese companies. The International Liner Shipping

Introduction to IMO, International Maritime Organisation, 2019, viewed 9th May 2020, <http://www.imo.org/en/About/Pages/Default.aspx>

² COVID-19: Impact on Global Shipping and China's Economy, The Diplomat, 17th March 2020, viewed 1st June 2020, https://thediplomat.com/2020/03/covid-19impact-on-global-shipping-and-chinas-economy/>

³ Notice on better stabilizing foreign trade, State Council, viewed 16th June 2020,<http://www.gov.cn/zhengce/zhengceku/2020-04/20/content_5504497.htm>

Sub-working Group is of the firm belief that discussions related to trade terms are to be resolved between the parties of commercial transactions according to the principles of a free and open markets and should not be influenced by the political agenda of the home country of any of the two contracting parties.

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.⁴

Key Recommendations

1. Allow the Transport of International Cargo Between Chinese Ports (International Relay) (20)

Concern

International relay may only be carried out by Chineseflagged vessels operated by wholly-owned Chinese companies, a market access barrier that remains an issue of the highest priority for the 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 European Union (EU) which, as a single market, allows for unrestricted transport of cargoes between its major container hub ports (many individual countries 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, leading to shorter transit times, lower transport costs and less pollution. As a major shipping nation, China should take responsibility for optimising the global efficiency of sea freight. Alongside supporting China's domestic economic situation, permitting international relay would bring significant benefits to the EU as well.

Economic benefits for China

- International relay 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.
- International relay will benefit Chinese importers and exporters by enabling flexible service choices with lower supply chain costs.
- 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'.

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 use a domestic feeder service, as the latter increases costs. Therefore, domestic shipping lines are not benefitting from the ban on international relay.

Recommendation

 Support the development of more efficient Chinese shipping services by permitting international cargo relay by foreign shipping services on a reciprocal basis.

2. Apply Non-discriminatory Treatment in Chinese Free Trade Zones (FTZs) 17

Concern

Foreign-flagged vessels owned by a Chinese company

⁴ EU-China Maritime Dialogue a Good Template, says European Shipowners, ECSA, viewed 1st June 2020, https://www.ecsa.eu/news/eu-china-maritime-dialogue-good-template-say-european-shipowners>



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 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 in Beijing) on the possibility of allowing international relay in Shanghai on a reciprocal basis. The International Liner Shipping Subworking Group hopes that this will ultimately lead to a relaxation of relay restrictions and reciprocity in terms of market access.

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 Fees for Value-added and Optional Services

Concern

The regulations related to collection of surcharges, behavioural charges and fees for value-added services in the maritime transportation industry remain vague, unclear and seemingly arbitrary, which makes it difficult for carriers to achieve compliance and causes 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 for filing by the SSE.

The MOT has confirmed during meetings with working group representatives that the collection of local surcharges is a practice regulated by the market, as was also confirmed and noted in minutes during the annual EU-China Maritime Transport Agreement Implementation Meeting in Finland in June 2019.⁵ 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, subworking group members report that customers, the SSE and some authorities do not appear to distinguish between:

- · Mandatory surcharges, such as the THC;
- Behavioural charges, which are imposed due to customer behaviour, such as delays in submitting required information that incurs additional cost; and
- Fees for value-added and optional services, which are carried out based on customer requests, such as making changes to created documentation.

⁵ The meeting took place from 17th-19th June in Helsinki. The EU delegation was led by Magda Kopczynska, director of Waterbourne Transport and Ports Affairs at the EU Commission, and the Chinese delegation by Liu Peng, deputy directorgeneral, Water Transport Bureau, MOT. See *Finland Hosts an EU-China Maritime Meeting*, Finnish Ministry of Transport and Communications, 17th June 2019, viewed 1st June 2020, <https://www.lvm.fi/-/finland-hosts-an-eu-china-maritime meeting-1013640>.

Such circumstances cause the sub-working group to believe that carriers collect multiple numbers of surcharges mandatorily without knowing that most are in fact incurred by customers or at the customers' request, and therefore not the carriers' responsibility. Industry training, through joint efforts by the MOT and the International Liner Shipping Sub-working Group, on the different types of charges would raise awareness of this issue.

Recommendations

- Issue a written guidance on the criteria for filing new surcharges and adjusting existing surcharges.
- Educate regulators, the market and customers on the differences between mandatory surcharges, behavioural charges and fees for value-added and optional services.

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 efforts on enhancing the accuracy of their freight-rate filing, and substantial improvements have been achieved so far. Considering the huge amount 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 serve as encouragement for 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.

5. Improve Methods of Monitoring for Misdeclaration of Contents

Concern

A number of containers originating in China are found to have an inaccurate content declaration, which causes health and safety risks for carriers and crews.

Assessment

Working group members have experienced that the contents of a significant number of containers originating in China are intentionally wrongly declared by companies and individuals in order to save on cost, for example, to avoid the extra cost associated with shipping dangerous cargoes because these require special handling. This results in significant risks of vessel damage, additional costs, terminal operation failures, container damage, and most importantly, increased risk of injury and even death of crews and terminal workers.

Recommendation

 Draft and implement strict and enforceable regulations to punish companies and individuals who intentionally mis-declare the contents of containers for commercial benefit, at great risk to the safety of personnel and assets.

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 years after 15 states—which must represent 40 per cent of global merchant shipping by gross tonnage, and on

⁶ The Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships, IMO, viewed 1st June 2020, http://www.imo.org/en/About/ Conventions/ListOfConventions/Pages/The-Hong-Kong-International-Conventionfor-the-Safe-and-Environmentally-Sound-Recycling-of-Ships.aspx>



average 3 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 Conventions 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 pollution in the 13th Five-year Plan.⁷ 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 Consequences for Fair Competition Arising from Costal Ports Integration

Concern

The integration of coastal ports and recently formed port groups over the past two 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 in the past two years may weaken competition. For example, the Shandong Port Group listing dated 2nd August 2019⁸ covers Qingdao, Rizhao, Yantai, Weihai and the Bohai Bay Area (Weifang, Dongying and Binzhou);⁹ and the Liaoning Province Port Group listing from 4th January 2019 covered Dalian, Yingkou, Panjin, Huludao, Dandong (under negotiation) and Jinzhou (under plan).¹⁰ Such integration creates monopolies and limits competion and choice of terminal operators in the region, as the terminals in the same region are all operated by the same operator.

Recommendations

- Closely monitor potential competition law violations by the relevant government authorities.
- Implement measures and controls to prevent postmerger port groups misusing their dominant position.

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 |

⁷ Barbara Finamore, *Tackling Pollution in China's 13th Five Year Plan: Emphasis on Enforcement*, Natural Resources Defense Council, 11th March 2016, viewed 17th June 2020, https://www.nrdc.org/experts/barbara-finamore/tackling-pollution-chinas-13th-five-year-plan-emphasis-enforcement

⁸ Seven Ports in Shandong, Xinhua, 22nd August 2019, viewed 17th June 2020, http://www.xinhuanet.com/fortune/2019-08/22/c_1124905404.htm

⁹ Shandong Port Group Sees Throughput Rebound After Outbreak Subsides, China Daily, 19th March 2020, viewed 1st June 2020, <http://shandong.chinadaily. com.cn/2020-03/19/c 463929.htm>.

¹⁰ About Us, Group Events, Liaoning Port Group, viewed 1st June 2020, <http:// www.liaoningport.com/wap/about/jtdsj wap.html>.



Section Five 5

Financial Services



Financial Services

The European Chamber has 3 separate working groups that cover the financial services sector:

- · Banking and Securities
- Consumer Finance and Non-banking Financial Institutions
- Insurance

European financial services companies have witnessed in recent years the acceleration of opening up measures in the sector. On 7th November 2019, the State Council released a document on *Further Utilisation of Foreign Investment*, in which it orders the abolishment of equity caps on foreign securities companies, securities investment fund management companies, futures companies and life insurance companies by 2020.¹ This announcement advances the previously announced timeline by one year.²

The United States (US)-China 'Phase One' Trade Deal was signed on 15th January 2020. China agreed to grant improved access to its financial services market for foreign companies, including banking, insurance, securities and credit rating services. The move is aimed at addressing a number of longstanding complaints from foreign-invested enterprises (FIEs) about investment barriers in the sector, including foreign equity limitations and discriminatory regulatory requirements.³

However, within a month, the Coronavirus Disease 2019 (COVID-19) outbreak threatened a pronounced negative impact on China's real economy and financial markets. Financial institutions were faced with the hidden dangers of a sudden increase in non-performing assets and a concentrated outbreak of credit risks. To stabilise the market and boost FIEs' confidence amid the pandemic, the Chinese authorities further accelerated the pace of opening up. On 3rd February 2020, the People's Bank of China (PBOC) pumped over Chinese yuan (CNY) 1.2 trillion (euro (EUR) 150 billion) of liquidity into the domestic financial system as a countermeasure to minimise the consequences of the virus on business.⁴ On 1st April 2020, foreign securities and fund management firms were allowed to establish fully-owned units in China, to show Beijing's commitment to continuous opening-up of the financial sector.⁵ In May 2020, the PBOC, along with three other central authorities, released new measures supporting the financial reform and opening-up of the Greater Bay Area to boost cross-border capital flows in the region.⁶

The financial services' working groups acknowledge the Chinese Government's efforts in further opening up the financial services market to FIEs. Nevertheless, the working groups call for any reforms to be significant enough for European players to capitalise on them, as working group members perceive the opening-up to be too little too late. For example, the European Chamber's *Business Confidence Survey 2020* found that respondents felt the financial services sector opening only took place after the entire

¹ State Council: Fully Remove Restrictions on the Business Scope of Foreign Banks, Securities Companies, Fund Management Companies and Other Financial Institutions in China, Ministry of Commerce, 8th November 2019, viewed 17th July 2020, http://www.mofcom.gov.cn/article/ii/jyjl/e/201911/20191102911277.shtml

² State Council's Circular on Several Measures to Promote the Growth of Foreign Investment, State Council, 16th August 2017, viewed 17th July 2020, http://www.gov.cn/zhengce/content/2017-08/16/content_5218057.htm

³ Economic and Trade Agreement between the Government of the United States of America and the Government of the People's Republic of China, Office of the US Trade Representative, 15th January 2020, viewed 17th July 2020, https://ustr.gov/sites/default/files/files/agreements/phase%20one%20agreement/Economic_And_Trade_Agreement_Between_The_United_States_And_China_Text.pdf

⁴ The Central Bank Will Invest 1.2 Trillion Yuan in Liquidity, Renmin Daily, 3rd February 2020, viewed 17th July 2020, <http://paper.people.com.cn/rmrb/html/2020-02/03/nw.D110000renmrb_20200203_1-10.htm>

⁵ Foreign Ownership Limits on Securities and Fund Management Firms Lifted From Today, People.com, 1st April 2020, viewed 17th July 2020, http://money.people.com.cn/n1/2020/0401/c42877-31657416.html

⁶ China's Greater Bay Area in 2020: Opening up the Financial Industry, Promoting Integration, China Briefing, 22nd May 2020, viewed 2nd July 2020, https://www.china-briefing.com/news/chinas-greater-bay-area-2020-opening-financial-industry-promoting-integration/

market was saturated with Chinese state-owned enterprises, leaving only niche, albeit profitable, roles to the few European players that were able to obtain the necessary operating licences.⁷ The working groups also call for enhanced clarity and the issuance of guidelines on the implementation process of the opening-up measures, in order to be able to strategically plan and develop their business in China.

Furthermore, the lack of transparency in China's regulations on financial market management and the redundant procedures of gaining access to licences have prevented foreign investors from performing to the best of their ability in China. This is particularly the case in the banking sector. While Chinese banks in the European Union (EU) market can open branches and obtain necessary business licences easily, foreign banks in China face difficulties in business planning and resource management due to complex administrative requirements. In this regard, the working groups expect to once again address the need for reciprocal treatment during the next round of negotiations of the Comprehensive Agreement on Investment between China and the EU.

The financial services working groups will continue to monitor progress in the opening up of China's financial sector and assess to what extent European financial services firms can mitigate and relieve the impact of COVID-19. Through careful observations and detailed recommendations in the following papers, the working groups hope to make meaningful contributions to this end.



This icon represents the number of years the working group has been making this recommendation.

7 European Business in China Business Confidence Survey 2020, European Union Chamber of Commerce in China, 10th June 2020, viewed 10th July, 2020, https://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020>



Banking and Securities Working Group

Banking & Securities Key Recommendations

1. Lift Restraints Affecting Organic Growth

1.1 Exclude Intra-group Exposure in Large Exposure Management

• Exempt European financial institutions in China from intra-group exposure during large exposure management on a reciprocity basis.

1.2 Allow Flexible Treatments on Certain Liquidity Ratios and Deposit Ratios.

- Consider the 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 a corporate deposit.
- Treat deposits from corporate finance companies as corporate deposit 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 (AFC) loans as corporate loans in the LMR.
- Increase the weight for bonds and certificates of deposit (CDs) in the LMR for a residual maturity below three months and include intragroup funding into the LDR at a reasonable weight.
- Consider foreign bank's 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

- 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 update the process to be in line 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 13

- 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), '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 (13)

- 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.
- 1.6 Allow Financial Institutions Flexibility in the Adaptation of their Local Set-up, making it Possible to Downsize or Exit Some Activities or Unprofitable Segments/Locations
 - Publish comprehensive, systematic guidelines for selling/closing a business, or reducing a product offering in an orderly fashion.

1.7 Remove the Long-term Foreign Debt Quota 1.9

- Remove the long-term foreign debt quota and for foreign financial institutions and also foreigninvested enterprises (FIEs) in China.
- 1.8 Allow Foreign Banks to Become Bond Connect Market Makers Without the Precondition of Being a Chinese Interbank Bond Trial Market Maker
 - 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 qualification so as to enable them to become Bond Connect Market Makers.
- 1.9 Implement Consolidated Value-added Tax (VAT) Filing Mechanism for Banks to Reduce VAT Burden Imbalances Across Subsidiaries/Branches
 - 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.
- 2. Limit Data Localisation and Prescriptive Cybersecurity Requirements
- 2.1 Allow Free Cross-border Data Flow and Adopt International Best Practice on Cybersecurity and Technology to Enable a Globalised and Efficient Financial Sector
 - Refrain from mandating banks to localise their data or their entire information technology (IT) systems.
 - Explicitly allow companies and their head quarter/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-affiliate informationsharing to enable shared utility model.

2.2 Narrowly Scope Critical Information Infrastructure (CII)

- Narrowly scope CII to ensure effective CII protection.
- Adopt a regulatory approach to CII that is risk-based, aligned with global best practices and avoids mandating the adoption of certain products or services.
- 2.3 Adopt Industry Best Practices Regarding Cybersecurity Inspections and Penetration Testing
 - Adopt industry best practices for penetration testing as outlined in the Global Financial Market Associations Framework for the Regulatory Use of Penetration Testing in the Financial Services Industry, including recognition of firm-led pen testing.
- 2.4 Ensure an Open and Inclusive Financial Industry Standard-setting Process
 - Open up the China Financial Standards Technical Committee (TC180) to participation by foreign companies
- 2.5 Open a Communication Channel for Banks to Present Their Cases and Issue Regulatory Guidelines in Relation to Cloud Services Standards
 - Open a communication channel for banks to present their case and issue regulatory guidelines in relation to cloud services standards.



3. Enforce Close-out Netting Protections

- Amend the Bankruptcy Law to remove uncertainty with regards so there is no remaining uncertainty with regards to the enforceability of close-out netting.
- Issue netting legislation; or clarify the process for applying close-out netting.

4. Refrain from the Introduction of Quotas and Window Guidance 12

- Refrain from using loan growth quotas.
- · Refrain from using window guidance for deposit rates.
- · Promulgate all regulations publicly in writing.

Introduction to the Working Group

The banking industry and capital markets play a key role in helping the economy allocate money efficiently. Banks operate payment systems, offer loans, take deposits, and help companies and private individuals with investments. However, in order to function properly, they need to be able to assess credit risk correctly and have access to a liquid and well-functioning interbank market underpinned by the central bank's policy rate. Since banks cannot cover all the credit needed in an economy, debt capital markets—such as the bond market—also play an important role. The importance of the banking market and debt capital markets differs significantly depending on the country they are based in, but both are necessary in order to create an efficient and vibrant economy.

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 some market barriers have been reduced in recent years and there has been an acceleration of the opening up in the sector, the financial services industry and its liberalisation are still strictly controlled. Barriers to the Chinese financial services market have existed for many years, and domestic and foreign suppliers are still treated differently. 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 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. Published on 23rd June 2020, the 2020 Negative List has kept the definite commitments to abolishing these limits that previous lists had,² yet the response from the international community has been very mild. The working group believes that this opening-up 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; or implementing better auditing regulations.

The US-China 'Phase One' Trade Deal

On 15th January 2020, the United States (US) and China signed a much-anticipated 'Phase One' trade

¹ The latest figure shows that total assets of foreign banks in China are CNY 3.37 trillion, less than 1.2 per cent of total assets of China's banking industry. See, Foreign Banks Establish 41 Legal Person Lenders in China, Total Assets Approach \$480 Billion, China Banking News, January 2020, viewed 7th July 2020, <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 3rd July 2020, http://www.gov.cn/zhengce/zhengceku/2020-06/24/content_5521520. htm>

deal in Washington DC.³ The deal was perceived as the first sign of de-escalation in the protracted US-China trade war. In the financial services sector, the trade deal helped to accelerate opening up in some areas, namely, banking, insurance, asset management, and payment and fund management.⁴

In this sense, the working group welcomes the lifting of foreign ownership limits on securities firms. As of 1st April 2020, foreign securities companies have been allowed to set up wholly-owned branches in Mainland China. The working group hopes this precludes a wider opening-up of China's financial industry.⁵

Impact of Coronavirus Disease 2019 (COVID-19) Outbreak

The European banking sector is fully committed to helping the Chinese economy navigate through the difficulties posed by the global COVID-19 pandemic, and to do its best to support countries' economic fabric.

Many of the recommendations outlined in this document aim to allow foreign banks be of better service to the Chinese real economy and inject more money into it. Foreign banks want to increase the amount of loans they can provide in the country, thus helping companies in China to overcome problems that have arisen as a consequence of this crisis. The working group firmly believes that adopting many of the recommendations highlighted in this document would be highly beneficial for the Chinese economy.

Key Recommendations

1. Lift Restraints Affecting Organic Growth

1.1 Exclude Intra-group Exposure in Large Exposure Management

Concern

The Measures for the Administration of the Large

*Exposures of Commercial Banks*⁶ does not exclude intra-group exposure, such as intra-group guarantees, derivative exposure, borrowing and placing, which impacts foreign banks' ability to expand their services in China.

Assessment

Clause 9 of the *Measures for the Administration of the Large Exposures of Commercial Banks* issued on 4th May 2018 by the CBIRC states that, '[t]he risk exposure of commercial banks towards single financial institution client or group client should not exceed 25 per cent of its Tier 1 capital.¹⁷ Considering the unique business model and limited capital size of subsidiary foreign banks in China, they would usually rely on group support for risk hedging, liquidity and client credit enhancement. Limitations on intra-group exposure impacts the capacity of foreign banks to develop specialised business or facilitate foreign direct investment (FDI) into China and serve the real economy.

At the same time, Chinese banks' branches and subsidiaries in Europe also rely on support from their parent banks in China. Most of the European banking regulators, such as the European Central Bank (ECB), have already noticed this and exempt Chinese groups under large exposure management from intra-group requirement controls.

Recommendation

• Exempt European financial institutions in China from intra-group exposure during large exposure management on a reciprocity basis.

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

³ Economic and Trade Agreement between the Government of the United States of America and the Government of the People's Republic of China, United States Trade Representative, 15th January 2020, viewed on 11th May 2020, <https://ustr.gov/sites/default/files/files/agreements/phaseper cent20oneper cent20agreement/Economic_And_Trade_Agreement_Between_The_United_ States_And_China_Text.pdf> Chinese version: <http://images.mofcom.gov.cn/ www/202001/20200116104122611.pdf>

⁴ US, China Sign Phase One Trade Deal: How to Read the Agreement, China Briefing, 17th January 2020, viewed on 11th May 2020, <https://www.chinabriefing.com/news/us-china-phase-one-trade-deal-takeaways-businessesglobal-trade/>

⁵ China Lifts Foreign Ownership Limits on Securities, Fund Management Firms, April 1st 2020, viewed on 3rd April 2020, <http://www.xinhuanet.com/ english/2020-04/01/c_138938273.htm>

⁶ Order [2018] No.1, CBIRC, 24th April 2018, viewed on 13th May 2020, <http:// www.cbrc.gov.cn/chinese/newShouDoc/338115BD0E6C43AAA979221670632 DC5.html>



Risk of Commercial Banks,⁸ banks have to maintain a liquidity matching ratio (LMR) and a high-quality liquid asset adequacy ratio (HQLAAR) of over 100 per cent, effective from 1st January 2020, and to maintain 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 capital⁹ is not considered as a stable resource for 'sources of weighted funds' in the LMR.¹⁰ Tier 1 capital is also not counted as a resource for the LDR, whereas in practice Tier 1 capital 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 for such loans comes from different types of sources.¹¹
- In the HQLAAR, the intragroup deposit is treated as 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 a longer period than normal corporate deposits.¹²
- In the LMR, an auto finance company (AFC) is treated as interbank instead of a 'corporate' counterpart, which means the development of interbank lending activities will be penalised as the LMR funding required for AFCs is higher. The banking relation with AFCs is more driven by a corporate relation rather than an interbank relation and should be treated as such. In the LMR, the weight funds for bonds issued and certificates of deposit (CD) below three months (zero per cent),
- 8 Order [2018] No. 3, CBIRC, 23rd May 2018, viewed on 20th April 2020, <http:// www.cbrc.gov.cn/chinese/newShouDoc/8189EEE949DB48F8993ACCCA638E D24B.html>

9 'Tier 1 capital is used to describe 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 6th July 2020, <https://www. investopedia.com/terms//tier1capital.asp>

- 10 Order [2018] No. 3, CBIRC, 23rd May 2018, viewed on 20th April 2020, <http:// www.cbrc.gov.cn/chinese/newShouDoc/8189EEE949DB48F8993ACCCA638E D24B.html>
- 11 Intragroup funding is more stable than interbank funding given the relation between the subsidiary and its parent entity.
- 12 In the same fashion, in the HQLAAR, the deposit from corporate finance companies (CFCs) is treated as an interbank deposit. However, deposits of group member entities that are more than three months old make up a large part of the sources of funding for CFCs, and hence are very stable.

similar to interbank borrowing or deposits from banks, are too low and would not favour the market of bonds or CDs 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 18th June 2018.¹³ It has become more difficult for small banks to control the DDR ratio variation due to passive deposit banking, and sometimes banks have to sacrifice customers deposit needs and service quality to meet the DDR ratio requirement; otherwise, they will 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 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.¹⁴
- Consider foreign banks' situation and give flexible treatment or waive the requirement of DDR for banks with a small balance sheet.

1.3 Allow Foreign Banks to Underwrite Foreign Government Bonds

Concern

European banks' access to the bond underwriting market in China is still limited.

Assessment

In February 2016, the China Interbank Bond Market (CIBM) was opened up to foreign institutional investors with the People's Bank of China (PBOC) promulgation

¹³ Order [2018] No. 48, CBIRC, 18th June, 2018, viewed 7th July 2020, <http:// www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=181941&itemId=928&g eneraltype=0>

¹⁴ Though it does not correspond to corporate resources, the stability of the intragroup and the support from the head office allow foreign banks to fund commercial loans.

of *Announcement No.* 3,¹⁵ which complemented the Qualified Foreign Institutional Investor (QFII) and Retail Qualified Foreign Institutional Investor (RQFII) schemes. Yet to date, only three locally-incorporated foreign banks have been allowed to underwrite corporate bonds as lead underwriters.¹⁶

There are also strict requirements for becoming a qualified primary dealer (PD),¹⁷ 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.¹⁸

European banks are seeking to obtain cross-border and onshore custodian licences. The main difficulty in receiving a licence for onshore activities is the high capital requirement. While it may be targeted at smaller Chinese banks, the CNY 20 billion requirement¹⁹ 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 instead of the local capital requirement of CNY 20 billion. Chinese banks can access these licences in the European Union (EU), so the working group calls for European banks to be granted the same, reciprocal rights in China.

On the other hand, the National Association of Financial Market Institutional Investors (NAFMII) has yet to change its application process to qualify foreign bank branches to underwrite foreign government bonds, despite the 2019 revision of the *Detailed Implementation Rules on Administration of Foreign Banks*²⁰ stipulates that foreign banks can do so.

Recommendations

· Increase access to the bond underwriting market

- 18 List of Primary Dealers in the Open Market Business, China Bond, 27th March 2019, viewed on 11th May 2020, https://www.chinabond.com.cn/Info/151209093>
- 19 China Securities Regulatory Commission Measures for the Administration of the Securities Investment Fund Custody Business (Draft for Comments), Ministry of Justice, 9th May 2020, accessed 8th July 2020, http://www.moj.gov.cn/news/ content/2020-05/09/zlk_3248314.html>
- 20 State Council Order No. 720, The State Council, 30th September 2019, viewed on 20th April 2020, http://www.gov.cn/zhengce/content/2019-10/15/ content_5439956.htm>

and further extend the scope for foreign banks to underwrite foreign enterprise bonds issued in the onshore market, i.e. panda bonds, and update the process to be in line 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 13

Concern

Foreign banks face funding restrictions due to the State Administration of Foreign Exchange (SAFE) regulatory approvals, have limited access to the China Foreign Exchange Trade System (CFETS) interbank market and also encounter problems associated with the issuance of *renminbi* (RMB)-denominated debt instruments in China, which stifles their growth.

Assessment

Access to the CFETS interbank market for foreign banks is limited to 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, without regulatory approval from the SAFE, the foreign debt of international financial institutions cannot be exchanged to RMB or sold on through a swap deal. In the context of limited access to onshore liquidity for foreign banks (small balance sheet size, limited corporate deposits base, no retail banking activity), allowing them to swap overseas sources into RMB would help increase 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: 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 (e.g. Dim Sum, Lion City).²¹

¹⁵ People's Bank of China Announcement (2016) No. 3, PBOC, 2016, viewed on 11th May 2020, <http://www.fdi.gov.cn/1800000121_23_72846_0_7.html>

¹⁶ BNP Paribas Gains Licence to Underwrite 'Panda Bonds' in China, Financial Times, 9th December 2018, viewed on 11th May 2020, <https://www.ft.com/ content/f9ff7dea-fc2a-11e8-aebf-99e208d3e521>

¹⁷ Regulation for Open Market Operation and Primary Dealer, China Bond, 21st April 2007, viewed on 11th May 2020, https://www.chinabond.com.cn/cb/en/C318913/regulations/20080920/805854.shtml

²¹ 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 on 24th June 2019. Please note, this was a non-public client note courtesy of Credit Agricole.



Locally-incorporated foreign banks are legally allowed to issue debt securities and onshore asset-backed securities (ABS) in the Chinese interbank bond market for funding purposes – as long as they can meet regulatory requirements and receive pre-approval from CBIRC and PBOC.^{22&23} However, it is currently still impossible for foreign banks' branches to do so.

Recommendations

- Remove the two times capital limitation for all foreign bank branches 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' heaquarters to issue RMB-denominated bonds (panda bonds).
- Permit foreign bank branches to issue 'CNY bonds' and ABS for funding purposes.

1.5 Allow Easier Branch and Sub-branch Business Expansion (13)

Concern

Foreign banks face difficulties in business planning and resource management due to the complex system of submissions required to expand their branch and subbranch network.

Assessment

A foreign bank needs to go through several complex and often unnecessary submissions to regulators in order to expand their branch and sub-branch network. While the working group understands the need for detailed submissions, it recommends a planned strategic approach, whereby multiple branch and subbranch 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.

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.
- 1.6 Allow Financial Institutions Flexibility in the Adaptation of their Local Set-up, Making it Possible to Downsize or Exit Some Activities or Unprofitable Segments/Locations

Concern

The process of exiting certain business activities is complex and lacks clear rules, which results in financial institutions often being forced to continue providing banking services even when there is no more group support.

Assessment

After having obtained a licence for a branch in a local province, it is almost impossible to close it, even if it has not become profitable after several years. Financial institutions are expected to demonstrate to the province their long-term commitment and maintain an overly-large, minimum set-up – usually around 10 people, including branch manager, deputy branch manager, and 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 financial institutions being prohibited from selling some portfolio assets, transferring some assets to other institutions or ceasing certain activities for which a licence has been obtained.

Exit barriers result in foreign institutions being considered 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 should provide detailed guidelines on how foreign banks can exit the market or dispense with product offerings.

Recommendation

 Publish comprehensive, systematic guidelines for selling/closing a business, or reducing a product offering in an orderly fashion.

²² Foreign Bank Regulations, CBRC, 11th December 2006, viewed on 11th May 2020, <www.cbrc.gov.cn/chinese/home/docView/2855.html>

²³ National Bond Market Issuance Regulations for Financial Bonds, ChinaBond, 1st June 2005, viewed on 11th May 2020, <http://www.chinabond.com.cn/ Info/843356>

1.7 Remove the Long-term Foreign Debt Quota

Concern

The limitations imposed by the long-term foreign debt quota are an obstacle to banks that want to service businesses with genuine financing needs.

Assessment

While China, since the 13th Five-Year Plan was launched in 2016, has moved to a new 'macro-prudential framework' and abandoned the short-term debt quota, the long-term debt quota still maintains strict limits under the administration of the National Development and Reform Commission (NDRC). These limitations make foreign currency funding unnecessarily expensive for foreign and Chinese enterprises. No similar restrictions are imposed on Chinese banks operating in Europe, highlighting the unequal treatment of European banks in China. The working group is concerned about the following rules:

- Direct financing through foreign shareholder loans is restricted through the foreign debt quota for foreigninvested 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 some business scenarios.
- Financing for FIEs, especially small and mediumsized enterprises within China, often depends on collaterals by guarantee of foreign banks or their parent companies. Since foreign guarantees to secure financing would be eventually 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 financial institutions as well as FIEs in China.

1.8 Allow Foreign Banks to Become Bond Connect Market Makers Without the Precondition of Being a Chinese Interbank Bond Trial Market Maker

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 compared to their Chinese peers in terms of balance sheet size cannot easily compete with their Chinese peers 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 approach them to get market updates and recommendations to access the onshore CIBM markets. Therefore, difficulties in obtaining the Bond Connect Market Makers qualification are limiting foreign banks' ability to develop business and bring investment into China.

Recommendations

 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 qualification so as to enable them to become Bond Connect Market Makers.

1.9 Implement Consolidated Value-added Tax (VAT) Filing Mechanism for Banks to Reduce VAT Burden Imbalances Across Subsidiaries/Branches

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

²⁴ Caishui [2016] No. 36, State Tax Administration (STA), 23rd March 2016, viewed 29th May 2020, http://www.chinatax.gov.cn/n810341/n810755/c2043931/content.html



can apply for VAT consolidation and be regarded as one taxpayer if they have the approval of China's Ministry of Finance (MOF) and the State Taxation Administration (STA). However, the relevant regulation was abolished by *Caishui [2017] No. 58*.²⁵ On 27th November 2019, the MOF and the STA jointly issued the draft VAT Law.²⁶ The draft VAT Law brought back this consolidation principle, a very welcome development. The working group will pay close attention to the scope and requirements for application during the implementation period. 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.
- 2. Limit Data Localisation and Prescriptive Cybersecurity Requirements
- 2.1 Allow Free Cross-border Data Flow and Adopt International Best Practice on Cybersecurity and Technology to Enable a Globalised and Efficient Financial Sector

Concern

Stringent data localisation requirements and prescriptive cybersecurity risk breaking financial institutions' global operation 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 both financial regulations and the Cybersecurity Law (CSL), 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 financial institutions (FIs) investing in China. For more information on CSL related measures, please refer to the *Cybersecurity Working Group Position Paper*.

Data localisation

Data localisation and limitations on the free flow of data can seriously limit 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 the Anti-Money Laundering (AML) and Counter-Terrorism Financing (CTF) regulations, are challenging for FIs operating in China and make it impossible for multinational FIs to use their global operational model. This results in increased operational challenges for existing FIs, and dramatically raising the threshold for new FIs entering the Chinese market.

Nonetheless, the working group applauds China's endorsement of the G20 Osaka Leaders Declaration²⁸ promoting free data flow with trust, and urges China to explicitly allow cross-border transfer of data internally and among affiliates as a first step to truly open up the financial sector.

²⁵ Caishui [2017] No. 58, STA, 11th July 2017, viewed 29th May 2020, <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 29th May 2020, <http://www.gov.cn/xinwen/2019-11/28/content_5456569.htm>

²⁷ Those measures include, but are not limited to: Commercial Banking IT Risk Management Rules (2009), CBRC, 3rd March 2009, viewed on 20th April 2020, <http://www.cbrc.gov.cn/chinese/home/docDOC ReadView/20090601FC296 F80D3957B65FFFA9EDA836D7300.html>: PBOC's Notice to Urge Banking Financial Institutions to Protect Personal Information (2011), State Council, 2011, viewed on 20th April 2020, <http://www.gov.cn/gongbao/content/2011/ content_1918924.htm>; CBIRC's Banking Financial Institutions Anti-money Laundering and Counter Terrorist Financing Management Measures (2019), State Council, 29th January 2019, viewed on 20th April 2020, http://www.gov. cn/gongbao/content/2019/content 5446227.htm>: Cyberspace Administration of China on Soliciting Public Opinions on the Measures for Cybersecurity Censorship (Exposure Draft), CAC, 24th May 2019, viewed on 20th April 2020, <https://www.cac.gov.cn/201905/24/c_1124532846.htm>; Notice of the Cyberspace Administration of China on Soliciting Public Comments on the Administrative Measures on Data Security (Exposure Draft), CAC, 28th May 2019, viewed on 20th April 2020, <https://www.cac.gov.cn/2019-05/28/ c 1124546022.htm>: Notice of the Cyberspace Administration of China 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 on 20th April 2020, https://www.cac.gov.cn/2019-06/13/ c 1124613618.htm>

²⁸ G20 Osaka Leaders' Declaration, European Council, 29th June 2019, viewed 13th May 2020, https://www.consilium.europa.eu/media/40124/final_g20_osaka_leaders_declaration.pdf>

Data-sharing among affiliates to enable shared utility service mode

A long-standing issue for many working group members is the regulatory restrictions over information-sharing among affiliates, which is costly for foreign FIs as different information technology (IT) systems are required, discourages foreign investment and presents problems if China intends to attract best-in-class global FIs. The working group advocates for financial regulators to remove unnecessary information-sharing firewall rules and to recognise the importance of crossaffiliates 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 that China signed up to in the G20 Osaka Leaders Declaration.
- Remove unnecessary information-sharing firewall rules and allow cross-affiliate information-sharing to enable the shared utility model.

2.2 Narrowly Scope Critical Information Infrastructure (CII)

Concern

CII should be narrowly scoped in order to prioritise the protection of truly critical systems, and should not expand at a later date.

Assessment

The CSL gives prioritised protection to CII, and requires CII operators to localise personal information and ill-defined important data in China, and conduct maintenance, technical support and reviews on the use of encryption, technology and services, among others. These requirements would have significant implications for the financial sector's globalised systems and operation models.

The working group understands the need for prioritised protection for CII, and advocates for a regulatory approach to CII that is risk-based, narrow in scope, aligned with global best practices and avoids mandating the adoption of certain products or services. In view of the already limited portion of the Chinese market that foreign FIs occupy, including them in the scope of CII would deviate from the prioritised protection approach demanded by the CSL, while being counter-productive from a security and cost-effectiveness perspective.

Recommendations

- Narrowly scope CII to ensure effective CII protection.
- Adopt a regulatory approach to CII that is riskbased, aligned with global best practices and avoids mandating the adoption of certain products or services.

2.3 Adopt Industry Best Practices Regarding Cybersecurity Inspections and Penetration Testing

Concern

Increasing cybersecurity inspections and penetration testing requirements brings unintentional risks to FIs and interconnected global financial systems.

Assessment

European FIs are concerned about mandated penetration testing of banks' IT systems, as required in the China Securities Regulatory Commission's (CSRC's) *Measures for the IT Management of Securities and Fund Operators (2018)*²⁹ and the Ministry of Public Security (MPS)'s Provisions on Internet Security Supervision and Inspection by Public Security Organs (2018).³⁰ While the industry understands regulators' intention of underpinning FIs' cyber resiliency, European FIs are concerned that the approach may increase or exacerbate existing risks, as pen-testing³¹ or system scanning may introduce new vulnerabilities and unintentionally or unessentially expose FIs' most sensitive information to a third party.

²⁹ Order No. 152, CSRC, 19th December 2018, viewed 20th April 2020, <http://www. csrc.gov.cn/pub/zjhpublic/zjh/201812/t20181221_348485.htm>

³⁰ Decree No. 151 of the Ministry of Public Security, State Council, 15th September 2018, viewed 20th April 2020, <http://www.gov.cn/gongbao/content/2018/ content_5343745.htm>

^{31 &#}x27;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. Penetration testing can be automated with software applications or performed manually. Either way, the process involves gathering information about the target before the test, 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 7th July 2020,



The working group strongly advocates that the CSRC and the MPS adopt the Global Financial Market Associations (GFMA)'s Framework for the Regulatory use of Penetration Testing in the Financial Services Industry, a best practice developed by FIs, and recognise firm-led scanning or pen-testing. European FIs are willing to initiate open dialogues with Chinese regulators to explore other important resilience tools, such as training and awareness.

Recommendation

 Adopt industry best practices for pen-testing as outlined in the GFMA Framework for the Regulatory Use of Penetration Testing in the Financial Services Industry, including recognition of firm-led pen testing.

2.4 Ensure an Open and Inclusive Financial Industry Standard-setting Process

Concern

An increasing number of financial industry standards are developed and referenced by Chinese financial regulators for guidance or even compliance, however, foreign FIs appear not to have been consulted in the drafting process.

Assessment

European FIs noticed the PBOC's recent issuance and promotion of several financial industry standards drafted by the China Financial Standards Technical Committee (TC180), including the *Personal Financial Information Security Specification (2020)*³² and the *Financial Distributed Ledger Security Specification (2020)*,³³ among others. Unfortunately, to the knowledge of the working group, the drafting of these standards is not open to foreign FIs' participation or public consultation.

The working group welcomes regulators' promise that foreign companies should enjoy equal participation rights and be treated equally in the standard drafting process, as outlined in the *Regulation for Implementing the Foreign Investment Law of the People's Republic of China*,³⁴ and encourages the PBOC and the TC180 to provide equal participation opportunities to foreign FIs.

Recommendation

- Open up the TC180 to participation by foreign companies.
- 2.5 Open a Communication Channel for Banks to Present Their Cases and Issue Regulatory Guidelines in Relation to Cloud Services Standards

Concern

The CBIRC has requested banks to do pre-filing before entering into a cloud service agreement with a service provider, but some applications are still pending without further guidance, which brings uncertainties to banks' cloud migration.

Assessment

Outsourcing to a cloud service provider is a global trend and a common approach by multinational institutions. The CBIRC's unclear review process brings uncertainties to banks' cloud migration.

Foreign bank branches rely on the support of their headquarters, but due to constrains on cloud services, cannot follow their company's operational process. Alternative arrangements may mean significant additional cost. Furthermore, not following the standard international process brings additional operational risks to foreign bank branches in China.

Recommendation

 Open a communication channel for banks to present their case and issue regulatory guidelines in relation to cloud services standards

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,³⁵ causing legal uncertainty for European

³² Yin Fa [2020] No.45, PBOC, 4th March 2020, viewed 20th April, 2020, <http:// www.pbc.gov.cn/zhengwugongkai/127924/128038/128109/3983078/index. html>

³³ JR/T 0184—2020, National Public Service Platform for Standards Information, 5th February 2020, viewed 20th April 2020, http://std.samr.gov.cn/hb/search/std HBDetailed?id=A0A42EAAE2464654E05397BE0A0A0947>

³⁴ Order No. 723, State Council, 26th December 2019, viewed 13th May 2020, http://www.gov.cn/zhengce/content/2019-12/31/content_5465449.htm

³⁵ 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 in 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 7th July 2020, <https://www.investopedia. com/ask/answers/062515/what-difference-between-payment-netting-andcloseout-netting.asp>

international banks that want to trade in China, 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, where a party has become insolvent, given that the right of a non-defaulting party to terminate transactions would be subject to a stay after the bankruptcy petition is accepted by the People's Court under Article 18 of the Enterprise Bankruptcy Law ('Bankruptcy Law'), there is a market perception that the close-out netting against such counterparty may be unenforceable. Some participants have opted to 'switch on' the automatic early termination (AET) provision with respect to their counterparties, to terminate all transactions automatically before the acceptance of a bankruptcy petition by the court. 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 the court.

The working group is working closely with Chinese regulators to look into the close-out netting issue.³⁶ However, so far there is no timeline for when the uncertainty of the enforceability of close-out netting could be resolved.

Recommendations

paper.pdf>

- Amend the Bankruptcy Law so there is no remaining uncertainty with regards to the enforceability of close-out netting.
- Issue netting legislation, or clarify the process for applying close-out netting.

4. Refrain from the Introduction of Quotas and Window Guidance <a>2

Concern

Instances of window guidance³⁷ and quotas have been highly disruptive to the day-to-day operations of European banks and companies alike.

Assessment

The practice of window guidance and the stipulation of quotas by various regulators are disruptive to the operations of European banks and, as such, should not be applied to regulate the market. In the past, window guidance as well as inflow/outflow quotas stipulated by the SAFE have caused difficulties for European banks operating in China. While not an acute problem, the working group remains vigilant to ensure that this does not happen again. Ad hoc loan growth quotas by the PBOC make business unpredictable for banks, resulting in some being unable to extend loans to clients.

Recommendations

- · Refrain from using loan growth quotas.
- Refrain from using window guidance for deposit rates.
- Promulgate all regulations publicly in writing.

Abbreviations

| ABS | Asset-backed Security |
|----------|------------------------------|
| AET | Automatic Early Termination |
| AFC | Auto Finance Company |
| CBIRC | China Banking and Insurance |
| | Regulatory Commission |
| CD | Certificate of Deposit |
| CFC | Corporate Finance Company |
| CFETS | China Foreign Exchange Trade |
| | System |
| CIBM | China Interbank Bond Market |
| CNY | Chinese Yuan |
| COVID-19 | Coronavirus Disease 2019 |
| CSRC | China Securities Regulatory |
| | Commission |
| CSL | Cybersecurity Law |
| DDR | Deposit Deviation Ratio |
| EU | European Union |
| | |

37 The Banking and Securities Working Group would define 'window guidance' as regulations and orders given by regulatoryagencies to banks in an informal way, such as verbally over the phone, as a way of persuading banks and other financial institutions to adhere to official guidelines. A key concern is that these regulations and orders are never promulgated in official legislation.

³⁶ It is noted that the UK-China Netting Working Group was set up in February 2018 pursuant to the Policy Outcomes of the 9th UK-China Economic and Financial Dialogue. See, *Policy Outcomes of the 9th UK-China Economic and Financial Dialogue*, UK Government, 16th December 2017, viewed 13th May 2020, <https://assets.publishing.service.gov.uk/government/uploads/system/ uploads/attachment_data/file/668717/9th_UK_China_EFD_policy_outcomes_



| Fls | Financial Institutions |
|--------|--------------------------------------|
| FIE | Foreign-invested Enterprise |
| GFMA | Global Financial Market Associations |
| HQLAAR | High-quality Liquid Asset Adequacy |
| | Ratio |
| НО | Head Office |
| LDR | Loan to Deposit Ratio |
| LMR | Liquidity Matching Ratio |
| MOF | Ministry of Finance |
| MPS | Ministry of Public Security |
| NPC | National People's Congress |
| PBOC | People's Bank of China |
| PD | Primary Dealer |
| RMB | Renminbi |
| SAFE | State Administration of Foreign |
| | Exchange |
| STA | State Taxation Administration |
| VAT | Value-added Tax |

Consumer Finance and Non-banking Financial Institutions Working Group

Key Recommendations

- 1. Strengthen and Optimise Electronic Mechanisms
- 1.1 Create Internet Courts Able to Resolve Batch Claims Related to Online Loans in the Consumer Finance Industry
 - Develop and adopt the widespread use of specialised internet courts that can provide fast and fair support to the growing number of online consumer finance businesses.
 - · Allow batch submissions of claims.
- 1.2 Implement the Use of Electronic Signatures in Order to Gather Information and Limit Forgery and Money Laundering
 - Consistently recognise the use of electronic signatures in the contractual process.
- 2. Ensure Consistency and Opportunities for Foreign Equipment Leasing Companies to Operate in China
- 2.1 Strengthen the Protection of Ownership of Leased Assets
 - Enforce consistent regulation for asset mortgage and registration throughout the country.
- 2.2 Maintain the Right for Equipment Leasing Companies to Provide Factoring
 - Allow equipment leasing companies that have a factoring licence to do factoring business, and assert their right to purchase receivables from vendors.
- 3. Allow Consumer Finance Companies (CFCs) and Auto Finance Companies (AFCs) to Run Concurrent Insurance Agency Businesses
 - Allow CFCs and AFCs to run concurrent insurance agency business and act as an agent of insurance companies to sell insurance products related to consumer loans to customers while providing consumer financial services to them.

4. Broaden Funding Channels

- 4.1 Allow CFCs to Borrow from Foreign Financial Institutions and Issue Asset-Backed Securities (ABS) on Exchange and Yindeng Markets (3) 6
 - Allow CFCs to borrow from overseas financial institutions.
 - Specify the relevant regulations on Yindeng ABS transactions and allow CFCs to participate in this market.
 - Allow CFCs to issue ABS on the securities market with no restrictions.
- 4.2 Allow Leasing Companies to Obtain Cross-border Corporate Guarantees and Cross-border Bank Guarantees
 - Allow European leasing companies to obtain cross-border corporate guarantees and cross-border bank guarantees.
- 5. Provide Clear Guidelines that Allows CFCs to Sell Non-Performing Loans (NPLs) in Batches to Asset Management Companies (AMCs) and Collection Agencies ³⁴
 - Lift restrictions on batch transfers of NPLs in the consumer finance industry and issue clear supportive guidance on this process.





- Lower the qualification threshold for NPL assignees and open the primary bad assets market up to more qualified participants, including collection agencies that have vast experience in dealing with NPLs.
- 6. Establish a System for Managing Personal Bankruptcy
 - Adopt a personal bankruptcy law and develop a proper personal bankruptcy system throughout China.

Introduction to the Working Group

Consumer finance and leasing companies contribute to the economic development of China by providing easy access to financing for individuals, very small and micro-sized enterprises (VSMEs) and small and medium-sized enterprises (SMEs). Consumer credit empowers individuals to both achieve their dreams and to face everyday challenges with ease, as it provides them with a reasonable and fair solution to afford what they want when they need it, as well as to respond to contingencies in a timely manner. Consumer credit and leasing give the many full access to what would be otherwise only affordable to the few. Thus, it is an essential engine in the realisation of the Chinese plan to develop a consumer-based society while adding to the well-being and growth of the nation.

European consumer credit firms and leasing companies are active and essential players in the implementation of the State Council's *Plan for Advancing the Development of Financial Inclusion (2016–2020)*, which aims to improve "the availability, uptake, and quality of financial products and services in China, with a clear emphasis on expanding and deepening financial inclusion for historically unserved and underserved population segments, including VSMEs, rural residents, low income urban groups, the poor, the disabled, and the elderly."¹

Whereas the China Banking and Insurance Regulatory Commission (CBIRC) have regulatory responsibility for financial leasing companies, the Commission's local Financial Regulatory Bureaus regulate commercial factoring companies, pawn mortgage actors and equipment leasing companies. The Consumer Finance and Non-banking Financial Institutions (NBFIs) 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 (e.g. guarantee companies) in China. As of 2020, the working group also includes financial leasing companies and equipment leasing companies. This working group reflects the importance attached to the emerging consumer finance and leasing industry in China, its relevance to the State Council's major policy objectives and the attention European players pay to this agenda.

Recent Developments

Since the G20 Hangzhou Summit in September 2016, the consumer finance and NBFI industry has been rightly recognised as a fundamental engine of financial inclusion in China. Consumer finance and leasing have become embedded in China's economic system and are important catalysts for promoting China's transition to a consumption-driven economy, rather than relying purely on investments and exports. Consumer finance helps to meet consumers' needs, promotes the upgrading of consumption, increases consumption awareness and boosts the economy overall.²

One of the Chinese Government's recent top priorities has been the building of a healthy financial sector that can support the real economy. Part of this plan has entailed structural reforms to the domestic financial system, development of a multi-capital market and allocating the People's Bank of China (PBOC) more policy-making responsibilities by merging the former China Banking Regulatory Commission (CBRC) and

¹ Notice of the State Council on Printing and Publishing of Plan for Advancing Inclusive Finance Development (2016–2020) GF[2015] No. 74, World Bank, 31st December 2015, viewed 17th April 2020, https://pubdocs.worldbank.org/ en/335801453407732220/ENGLISH-Advancing-Financial-Inclusion-in-China-Five-Year-Plan-2016-2020.pdf>

² Hu Qun, China Will Have More Consumption Finance Unicorns, eeo.com.cn, 27th March 2018, viewed 17th April 2020, <http://www.eeo.com.cn/2018/0327/325431. shtml>

the former China Insurance Regulatory Commission (CIRC) into the CBIRC in March 2018.³ During the 2018 'Two Sessions',⁴ Premier Li Keqiang mentioned in his government work report that China would "vigorously expand consumption and promote effective investment".⁵

During the 2019 'Two Sessions', PBOC Governor Yi Gang announced that China will adopt a "prudent monetary policy to support financing of small- and micro-sized enterprises and private businesses".⁶ The financial priorities that have been set also reflect regulators' ongoing commitment to eliminate financial risk and increase overall consumer protection. This is reflected in the stricter regulatory environment for nonbank lending, which was introduced in 2017 and 2018, especially in the peer-to-peer (P2P) lending segment. As a result of the new regulatory environment, more than 90 per cent of existing P2P companies in China were forced out of the market, according to a report released by Fitch in March 2019.⁷

In his 2020 work report, Premier Li Keqiang highlighted that the government would target effective prevention and control of financial risks while continuing to pursue economic reform and opening up. In the wake of the economic distress caused by the COVID-19 pandemic, better access to loans and overall financing for VSMEs and SMEs were also promised.⁸ The working group expects that consumer finance and leasing will continue to develop rapidly over the next few years as reforms are further intensified to open up China's financial sector and emphasis is put on the protection of the consumer and small businesses.

Updates on Individual Loan Regulatory Framework

Given the absence of stringent regulations, the P2P industry boomed in China, with the number of P2P

3 Special Report: China's 2019 Two Sessions, APCO Worldwide, March 2019, viewed 14th May 2020, <https://apcoworldwide.com/wp-content/uploads/2019/03/ Chinas-2019-Two-Session-Report.pdf>

- 4 The Two Sessions refers to the annual plenary sessions of the National People's Congress and the national committee of the Chinese People's Political Consultative Conference.
- 5 Government Work Report, National People's Congress, 22nd March 2018, viewed 29th June 2020, <http://www.gov.cn/premier/2018-03/22/content_5276608.htm>
- 6 Special Report: China's 2019 Two Sessions, APCO Worldwide, March 2019, viewed 14th May 2020, <https://apcoworldwide.com/wp-content/uploads/2019/03/ Chinas-2019-Two-Session-Report.pdf>
- 7 China Peer-to-Peer Lending Dashboard 2019, Fitch Ratings, 27th March 2019, viewed 17th April 2020, https://www.fitchratings.com/site/re/10067190
- 8 Key Points from China's Report on the Work of the Government, CGTN, 22nd May 2020, viewed 27th May 2020, <https://news.cgtn.com/news/2020-05-22/Key-points-from-China-s-report-on-the-work-of-the-government-in-2020-QH9Ins4daw/index.html>

lenders going from 50 in 2011 to 4,000 in early 2017.⁹ Despite China's efforts to ensure orderly growth of the sector, the industry kept ballooning. On the top of that, a study by the PBOC published in late 2016 showed that nearly 40 per cent of P2P companies were in fact Ponzi schemes.¹⁰

Nonetheless, it is essential to note that some P2P platforms have played a crucial role in China's credit system, as they provided access to loans to a certain kind of borrowers, and the ability to lend to lenders, that would be otherwise have been excluded. From a consumer point of view, P2P represented in most cases a valid investment opportunity. In fact, given the extreme volatility of the Chinese stock market, especially after the 2015 crash, and the high entry barriers to the real estate market, P2P offered a valid alternative for investing small sums of savings. At the same time, in a landscape dominated by state-owned banks that direct 60 per cent of their loans to other state-owned enterprises (SOEs) and 30 per cent of the remaining 40 per cent to large domestic companies or individuals willing to buy their first home, P2P and individual loans often constituted the only way for VSMEs, SMEs and consumers to access credit.11

As a result, when it comes to evaluating the stricter regulatory environment that policy-makers started to enforce from mid-2017, it is essential to keep in mind the fact that P2P constituted, and still constitutes, a vital tool to assure financial inclusion in China. On top of this, despite the many distortions that characterise the sector, when the industry peaked in 2017, all the P2P players combined accounted for only 0.5 per cent of the loans in China, worth a total of Chinese yuan (CNY) 1 trillion.¹² Therefore, when regulators started to implement new policies to reform the industry in late 2017, the main goal was not preventing systemic risks, but rather enforcing consumer protection. According to a report published by Euromonitor in October 2019,

⁹ China P2P Lending Crackdown May See 70% of Firms Close, Bloomberg, 2nd January 2019, viewed 17th April 2020, <https://www.bloomberg.com/ news/articles/2019-01-02/china-s-online-lending-crackdown-may-see-70-ofbusinesses-close>

¹⁰ Dick Lee, P2P Lending Crisis in China: Will This be the End to P2P Lending?, TFAGeeks, 20th August 2018, viewed 17th April 2020, <http://tfageeks. com/2018/08/20/p2p-lending-crisis-china-will-end-p2p-lending/>

¹¹ Trivedi, Anjani, China Despairs of Its Dark Financial Underbelly, Bloomberg, 30th November 2018, viewed 17th April 2020, https://www.bloomberg.com/opinion/articles/2018-11-30/china-s-p2p-purge-underscores-shadow-banking-challenge>

¹² Nicole Jao, China's Online P2P Lending Industry is Going Through a Massive Shake Out, (paywall) Technode, 21st February 2019, viewed 17th April 2020, https://technode.com/2019/02/21/chinas-online-p2p-lending-industry-isundergoing-of-a-massive-shake-out/>



the stricter regulations enforced on the P2P segment of shadow banking is expected to lead to capital flowing back into the formal banking system.¹³

While the PBOC has aimed to ease access to credit for private businesses, the lack of a standardised credit system, coupled with the fact that the general business environment continues to favour SOEs, means that many VSMEs and SMEs still do not have access to bank credit.

Updates on Leasing Regulatory Framework

During the National Financial Work Conference in 2017, implementation of a unified supervision mechanism for financial leasing companies was presented. It put forward the principle of requiring the financial industry to go back to its fundamental purpose and improve the compliance of operations performed by leasing companies. On 14th May 2018, the Ministry of Commerce (MOFCOM) announced that regulatory responsibility for foreign-invested financial leasing companies, commercial factoring companies and pawn mortgage industry actors had been transferred to CBIRC as of 20th April 2018. Nevertheless, in Shanghai, an interim period was provided. On 10th July 2018, the Shanghai MOFCOM reported that the CBIRC had requested them to collect within the next two weeks the financial statements and detailed business data of financial leasing companies at the contract level from the beginning of 2018.¹⁴ The Shanghai Municipal Financial Regulatory Bureau did not officially take over regulatory responsibility until 30th November 2018.

Leasing market penetration in China was around seven per cent of total equipment expenditure in 2018, or roughly CNY 1,750 billion. There has been a dramatic increase of leasing companies in China, from 560 in 2012 to 12,130 in 2019.^{15&16} This growth has been mainly driven by the increase of foreign-invested leasing companies, which accounted for CNY 2,070 billion out of the total market value of CNY 6,654 billion at the end

13 Country Report: Consumer Lending in China, Euromonitor, October 2019, viewed 18th March 2020, <https://www.euromonitor.com/consumer-lending-in-china/ report> of 2019.¹⁷ It is commonly agreed that equipment leasing contributes to financing roughly 15 per cent of total equipment expenditure in mature markets.^{18&19}

The doubling of the number of domestic lessors in two years—from 204 in 2016 to 397 in 2018—was mainly due to a regulatory shift, with regional commercial departments and tax bureaus relaxing approval standards.²⁰ Investors took the opportunity to establish domestic leasing companies before stricter approval mechanisms took effect after reforms to the financial system in 2018.

In the eyes of the working group, the tightening of regulation has resulted in two outcomes. First, the growth rate of leasing investment volume has dramatically decreased. Second, leasing companies have had to cut business ties with local government funding vehicles (LGFVs). To the working group's knowledge, several local Financial Regulatory Bureaus (including Beijing, Shanghai and Shenzhen) conducted on-site compliance inspections of leasing operations throughout 2019. One core aim of these inspections was to close shell leasing companies. 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. Although more and more leasing companies are making the effort to replace sale-and-leaseback models with direct leases, the transition is expected to be extremely difficult. Saleand-leaseback will still be the dominant leasing model in China over the next few years.

17 Ibid.

20 Global and China Financial Leasing Industry Report 2019–2025, Research In China, April 2020, viewed 20th April 2020, <https://www.reportlinker.com/ p05779380/?utm_source=PRN>

¹⁴ Notice on Preparation for Three Types of Institutions' Transfer under CBIRC's Supervision, Shanghai MOFCOM, 10th July 2018, viewed 28th June 2020, <http:// sww.sh.gov.cn/gt/20180710/0023-244676.html>

^{15 2019} Equipment Leasing & Finance Industry Horizon Report, Equipment Leasing & Finance Foundation, viewed 20th April 2020, https://www.store.leasefoundation.org/cvweb/cgi-bin/msascartdll.dll/ProductInfo?productcd=Horizon2019>

^{16 2019} China Leasing Industry Development Report, China Leasing Alliance, 1st March 2020, viewed 26th April 2020, http://www.zgzllm.com/>

¹⁸ The European Leasing Market in 2018, Leaseurope, viewed 20th April 2020, ">http://www.leaseurope.php?page=key-facts-figures>">http://www.leaseurope.php?page=key-facts-figures>">http://www.leaseurope.php?page=key-facts-figures>">http://www.leaseurope.php?page=key-facts-figures>">http://www.leaseurope.php?page=key-facts-figures>">http://www.leaseurope.php?page=key-facts-figures>">http://www.leaseurope.php?page=key-facts-figures>">http://www.leaseurope.php?page=key-facts-figures>">http://www.leaseurope.php?page=key-facts-figures>">http://www.leaseurope.php?page=key-facts-figures>">http://www.leaseurope.php?page=key-facts-figures>">http://www.leaseurope.php?page=key-facts-figures<">http://www.leaseurope.php?page=key-facts-figures

¹⁹ China Financial Leasing Industry Report, 2017-2021, Research In China, August 2017, viewed 20th April 2020, <https://www.reportlinker.com/p02912889/China-Financial-Leasing-Industry-Report.html>

Key Recommendations

- 1. Strengthen and Optimise Electronic Mechanisms
- 1.1 Create Internet Courts that will be Able to Resolve Batch Claims Related to Online Loans in the Consumer Finance Industry

Concern

As traditional courts do not allow claim submissions in batches and can only handle a small number of cases consecutively, procedures are time-consuming and costly, and are insufficient for large companies that often need to resolve hundreds, or even thousands, of claims per month relating to online loans.

Assessment

Having a clear, legal framework enforced by courts would significantly reduce the number of disputes and complaints relating to online loans, especially as CFCs would not have to use their collections to enforce creditors' rights on their own. In order to make a filing to a traditional court, all relevant documents must be scanned and printed, and courts can only handle a small number of cases consecutively, which make proceedings time-consuming and costly. In addition, traditional courts do not allow submissions in batches, with every single case having to be filed separately. This is not an efficient process, particularly for big companies, which usually need to resolve hundreds (or even thousands) of claims per month.

In August 2019, the General Office of the State Council issued the *Guiding Opinions on Promoting Healthy Development of the Platform Economy*, which recognises the importance of internet-based businesses to consumption growth in China.²¹ The working group therefore believes that a fast and effective online claim handling system would be of great support. The absence of an effective dispute resolution process pushes large CFCs to adopt practices to protect their rights that do not involve the courts (e.g. home visits, repeated calls and employment of external collection agencies).

Recommendations

· Develop and adopt the widespread use of specialised

internet courts that can provide fast and fair support to the growing number of online consumer finance businesses.

- · Allow batch submissions of claims.
- 1.2 Implement the Use of Electronic Signatures in Order to Gather Information and Limit Forgery and Money Laundering

Concern

The number of cases of signature and contract forgery frequently encountered by many financial institutions could be reduced by permitting the use of electronic signatures, which are currently not consistently legally recognised.

Assessment

The *Electronic Signature Law of the People's Republic of China* provides that parties to a contract may agree to execute it using e-signatures.²² However, in practice, not all Chinese courts accept e-signature contracts, as it is still not a prevailing method of contracting in China. If not all courts accept e-signatures, the risk of future litigation is increased. This inconsistency between courts also prevents leasing companies and other NBFIs from adopting and/or generalising the use of e-signatures. The whole market, and VSMEs and SMEs in particular, would benefit if the use of e-signatures was consistently adopted throughout China.

Recommendation

- Consistently recognise the use of electronic signatures in the contractual process.
- 2. Ensure Consistency and Opportunities for Foreign Equipment Leasing Companies to Operate in China
- 2.1 Strengthen the Protection of Ownership of Leased Assets

Concern

As the protection of ownership of leasing companies' assets is interpreted differently by various State Administration for Market Regulation (SAMR) local bureaus as well as local courts, the security of leasing companies is reduced, thereby impacting their capacity to finance equipment to SMEs.

²¹ Guidelines for Regulating Healthy Development and Promoting of the Platform Economy [2019] No. 38, General Office of the State Council, 8th August 2019, viewed 24th April 2020, <http://www.gov.cn/zhengce/content/2019-08/08/ content_5419761.htm>

²² Electronic Signature Law of the People's Republic of China (2019 Amendment), Invest in China, 23rd April 2019, viewed 24th April 2020, <http://www.fdi.gov. cn/1800000121_23_74875_0_7.html>



Assessment

When providing sales and lease-back equipment financing, industry practice is for equipment leasing companies to register a mortgage on the equipment in order to secure their ownership. Some local SAMR bureaus will not mortgage the equipment to a foreign equipment leasing company, or may limit the company to dealing with local banks. In cases of default, working group members report incidences of local courts wanting to allocate the leasing equipment to the bulk of bankruptcy assets and distribute the proceeds among all creditors. Taking truck registration as an example, as the registered party may not be the legal owner, the legal owner and the vehicle user must be clearly identified in the registration documents. If not, it may lead to infringement of the ownership of the equipment by leasing companies.

Recommendation

- Enforce consistent regulation for asset mortgage and registration throughout the country.
- 2.2 Maintain the Right for Equipment Leasing Companies to Provide Factoring

Concern

Limiting the right of companies, or requiring the establishment of a specialised entity, to manage factoring will have a dramatic negative impact on the industry as a whole.

Assessment

Under current practice by local Municipal Financial Bureaus regulation, there is no limitation on equipment leasing companies providing factoring (e.g. assignment of accounts receivables) as long as they obtain a factoring licence. However, members of the working group report being questioned and challenged on their factoring business during audits conducted at the end of 2019. Factoring is performed by equipment leasing companies in order to finance the products/ solutions of their vendors that are not eligible for leasing, such as software and services. For equipment leasing companies, factoring can cover different types of products and services (spare parts, maintenance and repair products). Factoring constitutes a critical complement to equipment leasing companies' offering to their vendors.

Factoring essentially provides more flexibility for

equipment leasing companies to ensure that dealers abide by their payment terms and policies to distributors (tenure, pricing, invoicing process). The assignment of receivables performed by leasing companies is different from that performed by pure factoring players, which use a large bulk of invoices to be paid within a short tenure. The working group therefore believes that factoring can support further foreign investment in China, and that both foreign and domestic leasing companies would benefit from relevant regulation to provide for this. Factoring is moreover a form of inventory financing, which aims to support the sustainable growth of original equipment manufacturers (OEMs) and dealers' business with immediate cash, thereby greatly improving their cash flow. Business demand for factoring by leasing companies mainly comes from inventory and parts within account receivables (AR) between OEMs and dealers, and AR between dealers and customers, as well as maintenance, software and warranty services. Factoring is the only financial product which can be used to support such inventory financing. In this regard, to speed up the inventory turnover with advanced cash is critical for OEMs and dealers to maintain a healthy and long-term working capital and reduce their AR management overhead costs.

Recommendation

- Allow equipment leasing companies that have a factoring licence to do factoring business, and assert their right to purchase receivables from vendors.
- 3. Allow Consumer Finance Companies (CFCs) and Auto Finance Companies (AFCs) to Run Concurrent Insurance Agency Businesses

Concern

Consumer finance and auto finance companies do not currently qualify for concurrent insurance business licences, which prevents them from selling insurance products.

Assessment

Compared with traditional commercial bank customers, CFC and AFC customers have a higher credit risk: they are more vulnerable, and more likely to default and obtain bad personal credit records. At the same time, these customers might be unfamiliar or do not proactively seek the security net that insurance provides.

The Administrative Measures on Insurance Agency Business of Commercial Banks ([2019] No. 179) (Measures), issued by the CBIRC on 23rd August 2019,23 only stipulate the requirements for banks engaging in insurance. However, the working group believes that CFCs and AFCs could be categorised as 'other financial institutions', as per Article 66 of these Measures. The working group therefore argues that this item in the Measures is open for interpretation, leaving the CBIRC free to interpret it in a favourable way for CFCs and AFCs and allow them to apply for to act as insurance agents in the same way that banks do. It is worth noting that the Administrative Measures on the Pilot Scheme for Consumer Finance Companies, formulated by the former CBRC,²⁴ stipulate that a CFC may undertake all or part of several *renminbi*-denominated businesses, including the sale of insurance products relating to consumer loans in the capacity of an agent.

Recommendation

 Allow CFCs and AFCs to run concurrent insurance agency business and act as an agent of insurance companies to sell insurance products related to consumer loans to customers while providing consumer financial services to them.

4. Broaden Funding Channels

4.1 Allow CFCs to Borrow from Foreign Financial Institutions and Issue Asset-Backed Securities (ABS) on Exchange and Yindeng Markets (3)6

Concern

For the consumer finance industry, funding has a comprehensive impact on daily operations, but CFCs' access to funding remains limited and there is no level playing field among various consumer finance providers in terms of the funding channels available.

Assessment

To finance loans, CFCs must resort to the wholesale money market, the capital market and other providers of finance. Currently, the major sources of funding for CFCs are banks, trusts, ABS and financial bonds. The working group believes that CBIRC-licensed CFCs should lead and be the backbone of promoting credit services to enhance consumption. In order to function successfully, it is imperative that CFCs have access to diversified and abundant funding sources. Introducing new funding channels can be beneficial and can alleviate liquidity pressure on CFCs. The Administrative Measures on the Pilot Scheme for CFCs stipulate that they are only allowed to borrow money from domestic institutions.²⁵ At the same time, there is no restriction on such activity from either the State Administration of Foreign Exchange (SAFE) or the PBOC. However, other market players, such as financial leasing companies and AFCs, can enjoy overseas sources of funding. There does not seem to be any substantial reason for denying the same privilege to CFCs. Furthermore, CFCs are not encouraged to issue ABS on the Yindeng platform; neither are they allowed to issue ABS on the securities market.²⁶ No regulation explicitly prohibits this, and the CBIRC's view on these issues remains vaque.

Recommendations

- Allow CFCs to borrow from overseas financial institutions.
- Specify the relevant regulations on Yindeng ABS transactions and allow CFCs to participate in this market.
- Allow CFCs to issue ABS on the securities market with no restrictions.

4.2 Allow Leasing Companies to Obtain Crossborder Corporate Guarantees and Cross-border Bank Guarantees

Concern

As leasing companies are not allowed to obtain crossborder corporate guarantees or cross-border bank guarantees (even from their parent companies), the ability of European equipment leasing companies to invest in new machinery and equipment in China is significantly limited.

Assessment

The *Regulations on the Administration of Foreign Exchange for Cross-Border Guarantees*, issued by the SAFE on 15th May 2015, only allow banks registered

²³ Administrative Measures on Insurance Agency Business of Commercial Banks, State Council, 28th August 2019, viewed 17th April 2020, http://www.gov.cn/xinwen/2019-08/28/content_5425215.htm

²⁴ Administrative Measures on Pilot Scheme for Consumer Finance Companies, State Council, 14th November 2013, viewed 17th April 2020, <http://www.gov.cn/ gongbao/content/2014/content_2567177.htm>

²⁵ Ibid.

²⁶ Notice on Adjusting Supervision Requirements for Loan Losses of Commercial Banks (Yin Jian Fa [2018] No.7), Yi Yin Investments & Fund, 28th February 2018, viewed 28th June 2020, ">http://www.yivintz.com/news.asp?act=xx&parentid=53&id=1236>



in Mainland China to obtain cross-border guarantees.²⁷ This limits the ability of European leasing companies to support foreign investment in China. As a result, Chinese SME subsidiaries of foreign companies have difficulties accessing local financing.

Foreign-invested leasing companies receive crossborder guarantees in some lease contracts for securing the lessee in China (in order to fulfill 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. Leasing companies are not regarded in China as a financial institution and therefore are not eligible for the *Onshore Borrowing with Offshore Guarantee (waibao neidai)*, which allows China-based subsidiaries to receive money from their parent company outside of China.²⁸ The working group estimates that around 20 to 30 per cent of additional business is not realised due to this constraint on foreign leasing companies.

Recommendation

- Allow European leasing companies to obtain crossborder corporate guarantees and cross-border bank guarantees.
- 5. Provide Clear Guidelines that Allow CFCs to Sell Non-Performing Loans (NPLs) in Batches to Asset Management Companies (AMCs) and Collection Agencies (34)

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 local recognised AMC.

Assessment

The sale of NPLs is an inherent feature of the consumer finance market. With the development of the CFC industry in China, a large amount of NPLs have accumulated in the market. It is difficult for CFCs to

dispose of NPLs, and they often have to resort to writing them off. Unfortunately, China still has no regulatory mechanism that allows and guides the sale of NPLs by CFCs.

The Administrative Measures on NPL Batch Transferring of Financial Enterprises are applicable to all financial institutions that are invested by Chinese capital and explicitly forbid the sale of individual NPLs in batches of over ten households' worth of loans.²⁹ However. one business particularity of CFCs is that they grant smallticket loans to multiple individual borrowers, thus the only feasible way for them to sell NPLs is to do so in large batches. Even if CFCs were to be allowed to sell individual NPLs in batches, the current regulation only allows transfers of batch NPLs to financial AMCs and local AMCs, which impacts fair pricing for selling NPLs. In the working group's opinion, more assignee participants in the market would be beneficial in terms of fair pricing for selling NPLs, especially if the qualification threshold for NPL assignees was to be lowered and the primary bad assets market opened up to more gualified participants, including collection agencies that have vast experience in dealing with NPLs.

Recommendations

- Lift restrictions on batch transfers of NPLs in the consumer finance industry and issue clear supportive guidance on this process.
- Lower the qualification threshold for NPL assignees and open the primary bad assets market up to more qualified participants, including collection agencies that have vast experience in dealing with NPLs.

6. Establish a System for Managing Personal Bankruptcy

Concern

Currently, there is no personal bankruptcy law in China, however recent market developments, especially in the area of consumer finance, justify the need for it.

Assessment

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As Chinese households take on more debt and inevitably sometimes default on payments, due to various economic challenges or incidents, the need for

²⁷ 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 2020, <http:// www.safe.gov.cn/shenzhen/2015/0515/133.html>

²⁸ Notice on the Administration of the Registration of External Debt, SAFE, 3rd May 2013, viewed 30th June 2020, http://www.gov.cn/zwgk/2013-05/03/content_2395170.htm

²⁹ Administrative Measures on NPL Batch Transferring of Financial Enterprises, CBIRC & MOFCOM, 31st May 2017, viewed 17th May 2020, <http://www.waizi. org.cn/law/19744.html> (Issued in 2012 by the former CIRC and the Ministry of Finance)

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a proper bankruptcy system that could be practiced by courts around China has become a pressing matter.

In the aftermath of the P2P crackdown and P2P transformation, which the working groups welcomes, a new phenomena emerged - as P2P were shutting down, some borrowers managed to avoid debt repayment as they could no longer rely on the shadow banking system³⁰ to refinance their obligations from other financial institutions, thus becoming insolvent. The working group therefore calls for the advancement of the legislative process of the Personal Bankruptcy Law, through legal procedures, to protect those who have temporarily lost the ability to repay, but are willing to work with their lenders and repay the part they can afford and restructure their remaining debt.

After an individual's bankruptcy is implemented, legal procedures should be used to prevent defaulters from being continuously chased by collectors. This can prevent judicial proceedings leading to individuals that lose lawsuits being granted a lower social credit score³¹ and distrusted by their peers due to debts unpaid.

In 2019, several Chinese government bodies expressed the intention of developing a personal bankruptcy system. In July 2019, the National Development and Reform Commission, together with 13 other government departments, jointly issued the Reform Plan for Accelerating the Improvement of a Market Entity Exit System, which mentions studying and establishment of a personal bankruptcy system.³² While the city of Wenzhou implemented a pilot of this system in September 2019,33 there unfortunately appears to have been no further progress with the findings. In June 2020, the Shenzhen Municipal Government sought comments on a draft Personal Bankruptcy Law.³⁴ The draft Law would allow residents of the city who cannot

- 33 Wenzhou Launches Pilot of Personal Debt Central Clean-up, Wenzhou People's Government 12th September 2019 viewed 17th April 2020 <http://www wenzhou.gov.cn/art/2019/9/12/art_1217832_38056897.html>
- 34 Announcement on the Shenzhen Special Economic Zone Personal Insolvency Regulations (Draft for Comments) for Public Consultation, City of Shenzhen Municipal Government, 2nd June 2020, viewed 5th June 2020, <http://www.szrd. gov.cn/szrd zyfb/szrd zyfb tzgg/202006/t20200602 19246539.htm>

pay their debts to apply for personal bankruptcy, under the precondition that they have paid social insurance in the city for a period of at least three years. If eligible, applicants would be on a supervised probation period of three years until all, or part of, their debts are paid.³⁵ If implemented, the Law would be first of its kind in China.

Recommendation

· Adopt a personal bankruptcy law and develop a proper personal bankruptcy system throughout China.

Abbreviations

| ABS | Asset-backed Security |
|--------|--|
| AFC | Auto Finance Company |
| AMC | Asset Management Company |
| AR | Accounts Receivables |
| CBIRC | China Banking and Insurance Regulatory |
| | Commission |
| CBRC | China Banking Regulatory Commission |
| CFC | Consumer Finance Company |
| CIRC | China Insurance Regulatory Commission |
| CNY | Chinese Yuan |
| FIE | Foreign-invested Enterprise |
| MOFCOM | Ministry of Commerce |
| NBFI | Non-banking Financial Institution |
| NPL | Non-performing Loan |
| PBOC | People's Bank of China |
| P2P | Peer-to-Peer |
| OEM | Original Equipment Manufacturer |
| SAFE | State Administration of Foreign Exchange |
| SAMR | State Administration for Market |
| | Regulation |
| SMF | |
| OIVIL | Small and Medium-sized Enterprise |
| VSME | Small and Medium-sized Enterprise Very Small and Micro-sized Enterprise |

³⁰ Shadow banking is a term for the activities of non-bank financial intermediaries that provide services similar to traditional commercial banks but outside normal banking and lending regulations.

³¹ 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.

³² Reform Plan for Accelerating the Improvement of Market Entity Exit System, NDRC, 16th July 2019, viewed 17th April 2020, <http://www.gov.cn/ guowuyuan/2019-07/16/5410058/files/bbaef6612fed4832b70a122b39f1d5bd.pdf>

³⁵ Shenzhen Drafts China's First Personal Bankruptcy Laws as Virus Pressures Economy, Reuters, 3rd June 2020, viewed 5th June 2020, <https://www.reuters. com/article/us-china-economy-bankruptcy/shenzhen-drafts-chinas-first-personalbankruptcv-laws-as-virus-pressures-economv-idUSKBN23B1EG>



Insurance Working Group

Key Recommendations

1. Speed up the Issuing of Insurance Licences to Foreign Applicants

- Communicate official receipt of application materials in a timely manner and process application approvals according to the stipulated time frame.
- 2. Provide More Details for Foreign Insurance Group Companies on How to Invest in Insurance Intermediaries and for Domestic-registered, Foreignfunded Insurance Group Companies to Invest in Insurance Entities
 - Issue supporting regulations to allow foreign insurance group companies to set up insurance intermediaries, including insurance brokers, agencies and adjustors.
 - Release further detailed rules on qualification requirements for foreign-funded insurance group companies and allow alternative ways to invest in insurance entities in China.
- 3. Allow Foreign-invested Insurers to Apply for Branch Licences in More than One Province Per Time Per Year (1)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 is necessary.

4. Update and Expand the Existing Regulations on Reinsurance

4.1 Revise the Calculation Status for Solvency Ratios <a>2

- Allow foreign reinsurer branches in China to continue using their parent companies' solvency ratio to satisfy China Banking and Insurance Regulatory Commission (CBIRC) solvency supervision requirements.
- 4.2 Expand the Defined Business Scope of Foreign Reinsurance Licences
 - Revise the *Establishment of Reinsurance Companies (Baojianhuiling [2002: 4])* to allow foreigninvested reinsurers to apply for and obtain consulting business licences.
- 5. Create More Opportunities for Foreign Insurers to Contribute to China's Pension Reform 66
 - Create more opportunities for foreign insurers to contribute proposals for China's pension reform.
 - Grant licences for pension insurers or enterprise annuity trustees to select foreign insurers (even on a trial basis) for new pension schemes.
 - Liberalise the extremely strict product regulation, and allow a minimum guarantee of zero per cent at maturity to suffice.

6. Clarify Internet Insurance Business

- 6.1 Clarify Guidance on How to Obtain an Online Insurance Licence
 - Clarify guidance on how to obtain an online insurance licence, to help insurance companies prepare long-term strategies.
 - Allow foreign insurers to participate in CBIRC online insurance pilot programmes.



- 6.2 Relax Restrictions on Foreign Insurance Companies' Applications for Value-added Telecom Service (VATS) Licences
 - Remove restrictions on the shareholding cap of foreign-invested insurance companies, and ease access for them to apply for the Internet Content Provider (ICP) licence (B25 sub-category).
 - Shorten the application period and simplify the overall process for foreign insurers applying for the B21 licence.
- 6.3 Optimise Data Management Fees and Inquiry Penalties Charged by the China Banking and Insurance Information Technology Management Co Ltd (CBIIT)
 - Optimise or remove data management fees, inquiry fees and penalty fees charged by the CBIIT to relieve the financial burden on small and medium-sized insurance companies and improve their digital capabilities.

Introduction to the Working Group

The Insurance Working Group is the voice of Europe's insurance industry in China. It represents leading European insurers, brokers and other service providers engaged in life, non-life, reinsurance and 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 force for freedom, as it enables companies and households to spend their resources without having to worry about unforeseen events. Insurance is also a formidable engine of local and regional economic growth because it enables trade, innovation and risk protection. The insurance industry 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

The impact of the COVID-19 outbreak on the Chinese insurance market has been pronounced. The most immediate concern for insurers, foreign and domestic, was to protect the health and safety of employees and distribution partners in the agent/broker community, while striving to maintain business continuity and serving their clients. An additional situation that insurers have had to consider is how to accommodate claims adjusters, who often need to travel-both locally and long distance-in order to perform their jobs and maintain sales, as some of the more complex insurance products often require face-to-face client meetings. Under these circumstances, the working group believes that insurers that had previously invested in digital capabilities were better positioned to maintain their services for clients and connections with their distribution partners.

COVID-19 has had a large impact on economic activity, and the insurance industry is not exempt from this. Post-crisis, a greater awareness among the public of the importance of health insurance and life cover, coupled with greater digitalisation, might give rise to more digital health services and a rise in sales of health insurance. While declining interest rates would weigh heavily on the industry, the working group believes this would have the largest impact on the life insurance and annuity sectors, as their insurance products and investments are more sensitive to interest rate fluctuations. The nature of interest rates and their relation to investment portfolios is such that a decline in interest rates negatively impacts the profitability of insurance companies.

¹ Buckley, Chris, Xi Jinping Thought Explained: A New Ideology for a New Era, New York Times, 26th February 2018, viewed 11th May 2020, <https://www. nytimes.com/2018/02/26/world/asia/xi-jinping-thought-explained-a-new-ideologyfor-a-new-era.html>



Non-life insurers are expected to see more claims from business interruption; however, this depends on the terms of coverage of each policy, as in many cases there is an exclusion clause for epidemics.² The combination of business interruptions and the application of force majeure in commercial dealings has had a strong impact on claims for trade credit insurance, as an increasing number of businesses faced bankruptcy due to containment measures, worker's compensation claims and disruptions to supply chains.³ Most insurers took a pragmatic approach and kept monitoring the situation, while a minority took dramatic actions, with at least one insurer cancelling trade insurance limits for buyers in Hubei Province.⁴ In addition, a significant rise in travel insurance claims coupled with a sharp drop in travel insurance premiums are to be expected throughout 2020.⁵

On 23rd January 2020, the China Banking and Insurance Regulatory Committee (CBIRC) and twelve other government agencies jointly issued the *Opinions on Promoting the Development of Commercial Insurance in the Field of Social Services.*⁶ The document proposes providing continued support to develop commercial insurance by improving products and services related to health insurance, investing more resources in health and elderly long-term care, and enhancing the protection function of pension insurance. This followed the guidelines on management, sales and product development of health insurance products that came into effect 1st December 2019.⁷

On 15th February 2020, the CBIRC issued the *Notice on Optimising Financial Services to Support Enterprises during Epidemic Prevention*, which encouraged insurance institutions to provide preferential insurance services—such as accident insurance, health insurance, medical insurance and pension insurance—to staff on the frontlines of epidemic prevention.⁸ The working group therefore believes that, in the long run, greater public awareness of the importance of health insurance is likely to underpin insurers' ongoing shift towards higher-margin health policies in China.

'Opening Up'

During 2019, foreign-invested insurance and reinsurance companies operating in China saw some significant changes in their industry. In March 2018, the Chinese authorities granted a full-operating licence to two European insurance companies.^{9&10} In March 2019, Heng An Standard Life Insurance received approval to set up the first foreign-invested pensions insurance joint venture (JV) company and, in January 2020, Allianz (China) Holding commenced business operations in Shanghai as the first wholly foreign-owned insurance holding company in China.¹¹ However, as of 2019, 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-stands at a significant 60 per cent, against the combined seven per cent share of foreign-invested companies (split into non-life insurance 1.9 per cent, and life insurance 9.5 per cent).12&13

At a press conference during the 2019 'Two Sessions', People's Bank of China (PBOC) Governor Yi Gang announced 11 detailed measures on facilitating opening up. Especially notable for the Insurance sector was the *Relevant Measures for Further Opening up the Financial Sector*, issued by the Financial Development



² Fitch Ratings: Coronavirus to Reduce Chinese Insurers' Earnings, Fitch Ratings, 30th January 2020, viewed 8th April 2020, https://www.fitchratings.com/research/ insurance/coronavirus-to-reduce-chinese-insurers-earnings-30-01-2020>

³ Hay, Laura, Do Insurers Have Covid-19 Covered?, KPMG Insights, viewed 4th June 2020, <https://home.kpmg/xx/en/home/insights/2020/03/do-insurers-havecovid-19-covered.html>

⁴ Smith, Eleanor, COVID-19: What are the Trade and Insurance Implications? MARSH, 25th February 2020, viewed 8th April 2020, <https://www.marsh. com/uk/insights/risk-in-context/covid-19-trade-insurance-implications. html?sf118018246=1>

⁵ Fitch Ratings: Coronavirus to Reduce Chinese Insurers' Earnings, Fitch Ratings, 30th January 2020, viewed 8th April 2020, https://www.fitchratings.com/research/ insurance/coronavirus-to-reduce-chinese-insurers-earnings-30-01-2020>

⁶ CBIRC and Other 12 Government Agencies Jointly Issue the Opinions on Promoting the Development of Commercial Insurance in Social Services, CBIRC, 23rd January 2020, viewed 2rd July 2020, <http://www.cbirc.gov.cn/en/ view/pages/ItemDetail.html?docId=890474&itemId=981>

⁷ Cripps, M., & He, M., CBIRC Issues Newly-revised Health Insurance Regulations, Clyde & CoWestlink JLV, 15th November 2019, viewed 6th July 2020, https://www.clydeco.com/insight/article/cbirc-issues-newly-revised-health-insurance-regulations>

⁸ Notice on Optimising Financial Service to Support Enterprises during Epidemic Prevention, CBIRC, 15th February, viewed 8th April 2020, http://www.cbirc.gov.cn/en/view/pages/ItemDetail.html?docId=891864&itemId=980>

⁹ Willis Towers Watson Becomes the First Global Insurance Broker to be Granted a Full License in China, Willis Towers Watson Press Release, 15th May 2018, viewed 3rd July 2020, <https://www.willistowerswatson.com/en-SG/news/2018/05/ Willis-Towers-Watson-becomes-the-first-global-insurance-broker-to-be-granteda-full-license-in-China>

¹⁰ Yiu, Enoch, Allianz Wins Approval for China's First Wholly-owned Foreign Insurance Holding Company – Four Years Earlier Than Promised by Beijing, SCMP, 25th November 2018, viewed 13th May 2020, https://www.scmp.com/business/investor-relations/article/2174899/allianz-wins-approval-chinas-firstwholly-owned-foreign>

¹¹ Heng An Standard Life Granted Approval to Develop Pensions Business in China, Standard Life Aberdeen, 20th March 2019, viewed 8th April 2020, https://www.standardlifeaberdeen.com/news-and-media/news-articles/2019/march-2019/hengan-standard-life-granted-approval-to-develop-pensions-business-in-china>

¹² QZR Insurance Net, 2019 Property and Casualty Insurance Premium Income Rankings, 22nd February 2020, viewed 11th May 2020, <https://mp.weixin.qq.com/ s/V7zLBLsSdVaWEhjQ_CNpZw>

¹³ QRZ Insurance Net, 2019 Life Insurance Company Premium Income Rankings, 22nd February, viewed 11th May 2020, <https://mp.weixin.qq.com/s/WgLCB4w1zznHI73_Dz156A>

Stability Committee on 20th July 2019, which grant foreign companies the right to hold up to a 51 per cent stake in a life insurance JV, and abolishes the upper stakeholder limit after three years.¹⁴ Furthermore, in May 2019, Chair of CBIRC and Party Secretary of the PBOC, Guo Shuqing, unveiled plans to issue a dozen measures aimed at further opening up the Chinese financial sector.15

For the insurance sector, these 12 Opening-up Measures include: 1) allowing offshore financial institutions to invest in the equity of foreign-invested insurers in China; 2) cancelling the requirement that insurance brokers wishing to engage in insurance brokerage in China must have been in operation for at least 30 years, and have total assets of no less than United States dollars (USD) 200 million; 3) allowing foreign insurance group companies to invest in the establishment of insurance institutions; and 4) allowing foreign-invested insurance group companies in China to establish insurance institutions "with reference to the qualification requirements for Chinese-invested insurance group companies".¹⁶ The working group welcomes these measures and hopes that clarity can be provided in the coming months as to how foreign insurance group companies can invest in foreignfunded insurance intermediates, and whether the qualification requirements can be further detailed. In its current wording, this clause has caused confusion for the working group, which is further elaborated on in Key Recommendation 2 on page 365.

In early July 2019, Premier Li Kegiang announced that limits on foreign investment in Chinese life insurance companies would be removed in 2020¹⁷ and was consequently removed in the Special Administrative Measures on Access to Foreign Investment (Negative List) 2020.18 This is a whole year earlier then detailed

16 Ibid.

in the General Plan for Risk Reduction and Reform of the Insurance Industry, a high-level policy document made public on 2nd January 2018, which serves as a cornerstone for the restructuring of the financial sector.¹⁹

In October 2019, the State Council amended the Regulations on Foreign-funded Insurance Companies. Especially notable is the addition of two new articles: Article 40, which states that "foreign insurance group companies are allowed to establish foreign-invested insurance companies in China"; and Article 41, which stipulates that "overseas financial institutions are allowed to become shareholders of foreign insurance companies".20

Adhering to the decision of the central government to further expand the opening up of the insurance sector, the CBIRC revised and promulgated the *Implementation* Rules of the Regulations on Foreign-funded Insurance Companies (Implementation Rules). The revised Implementation Rules require foreign-funded insurance companies to have at least one normal-operating insurance company as the main shareholder. In terms of unifying the regulatory standards for domestic and foreign-funded companies, the Implementation Rules remove provisions on the management of branches of foreign-funded insurance companies. Policies on foreign-funded insurance companies setting up branch offices are in line with those on Chinese insurance companies. The qualification requirements of Chinese applicants to establish JV insurance companies are subject to the Rules on Equity Holdings of Insurance Companies to ensure the consistency of regulatory standards over domestic and foreign companies.²¹ Most of these measures have been implemented, as promulgated in the Detailed Rules for the Implementation of the Management Measures on Foreign-invested Insurance Companies issued by the CBIRC in December 2019.

The CBIRC has also pushed forward opening up by allowing European reinsurers to increase their investments in China. In November 2019, German

¹⁴ Wu, Yujian & Zhang, Thomas, In Depth: How China's Freeze on Insurance Licenses Has Impacted the Market, Caixin Global, 18th July 2019, viewed 12th May 2020. <https://www.caixinglobal.com/2019-07-18/in-depth-how-chinasfreeze-on-insurance-licenses-has-impacted-the-market-101441233.html>

¹⁵ CBIRC Unveils 12 New Measures for Open¬ing of Chinese Banking and Insurance Sectors, China Banking News, May 2019, viewed 8th April 2020, http://www.chinabankingnews.com/2019/05/02/cbirc-unveils-12-new-measures- for-opening-of-chinese-banking-and-insurance-sectors/>

¹⁷ Lin, Jinbing, China to Scrap Foreign Ownership Caps on Financial Firms a Year Early, Caixin, 12th July 2019, viewed 8th April 2020, <https://www.caixinglobal. com/2019-07-02/china-to-scrap-foreign-ownership-caps-on-financial-firms-avear-earlv-101434443.html>

¹⁸ Special Administrative Measures on Access to Foreign Investment (Negative List) 2020, NDRC, 24th June 2020, viewed 3rd July, 2020, <https://www.ndrc.gov. cn/xwdt/xwfb/202006/t20200624 1231928.html>

¹⁹ General Plan for Risk Reduction and Reform of the Insurance Industry, CIRC, 2nd January 2018, viewed 13th May 2019, http://bxjg.circ.gov.cn/web/site0/tab5225/ info4096225.htm>

²⁰ Amendments to Regulations in Finance Sector. State Council, 15th October 2019. viewed 8th April 2020, <http://english.www.gov.cn/policies/latestreleases/201910/15/ content WS5da57b97c6d0bcf8c4c1524e.html>

²¹ CBIRC Revises and Releases the Implementation Rules of the Regulations on Foreign-funded Insurance Companies, CBIRC, 6th December 2019, viewed 8th April 2020, <http://www.cbirc.gov.cn/en/view/pages/ItemDetail. html?docId=858742&itemId=981>



General Reinsurance AG Shanghai Branch received approval to increase its registered capital from CNY 300 million to CNY 4.39 million. In April 2020, Swiss Re Beijing Branch was approved to increase its registered capital from CNY 300 million to CNY 1.36 billion, and in May 2020, Hannover Re Shanghai Branch received approval to increase its registered capital from CNY 2.55 billion to CNY 4.11 billion.²²

The Insurance Working Group welcomes these developments and appreciates that the CBIRC listened to and cooperatively engaged with the industry and its representatives throughout the process aimed at opening up the sector. The working group believes that continuing along this path of mutually beneficial engagement is in the interests of both China and foreign-invested companies.

Key Recommendations

1. Speed up the Issuing of Insurance Licences to Foreign Applicants

Concern

In the past year, no insurance (property and casualty insurance (P&C), life) nor reinsurance preliminary licences have been approved or issued to any foreign applicants.

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 entering the Chinese market. To the working group's knowledge, several foreign applicants have already submitted their application documents to the CBIRC and are waiting in line. 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.

Recommendations

 Communicate official receipt of application materials in a timely manner and process application approvals according to the stipulated timeframe. 2. Provide More Details for Foreign Insurance Group Companies on How to Invest in Insurance Intermediaries and for Domestic-registered Foreign-funded Insurance Group Companies to Invest in Insurance Entities

Concern

Recent opening-up measures lack clarity as to how foreign insurance group companies can invest in foreign-funded insurance intermediates, and it remains unclear whether the same shareholder qualifications for establishing insurance entities applicable to domestic insurance groups will be applied to foreign-funded group companies.

Assessment

According to Article 40 of the recently amended Regulations on Foreign-funded Insurance Companies, foreign insurance group companies are now allowed to establish foreign-invested insurance companies in China. However, the article only covers insurance companies, not group companies that have an interest in investing in intermediary companies in China. The 12 Opening-up Measures, furthermore allow domesticallyregistered, foreign-funded insurance group companies to incorporate insurance entities in China, by making reference to the gualification requirements applicable to domestic insurance group companies.²³ This clause is causing confusion for the working group, as it remains unclear whether the same shareholder qualifications for establishing insurance entities applicable to domestic insurance groups will be applied to foreign-funded group companies.

Furthermore, while domestic group companies are allowed to hold up to 100 per cent equity of any insurance entity by way of incorporation, or merger or acquisition, only the method of 'incorporation' is mentioned in the *Opening-up Measures*. It is therefore not clear whether foreign-funded insurance group companies can also invest in insurance entities by way of merger or acquisition.

Recommendations

 Issue supporting regulations to allow foreign insurance group companies to set up insurance intermediaries,

²² CBIRC Pushes Forward High Level Opening Up and Supports Foreign Reinsurers to Increase Investment in China, CBIRC, 11th May 2020, viewed 19th May 2020, <http:// www.cbirc.gov.cn/en/view/pages/ItemDetail.html?docId=903797&itemId=980>

²³ The 12 Opening-up Measures were announced by CBIRC Chairman and PBOC Party Secretary Guo Shuqing in May 2019. For more detailed information refer to the 'Opening-Up' section of this paper on page 389

including insurance brokers, agencies and adjustors.

- Release further detailed rules on qualification requirements for foreign-funded insurance group companies and allow alternative ways to invest in insurance entities in China.
- 3. Allow Foreign-invested Insurers to Apply for Branch Licences in More than One Province Per Time Per Year 18

Concern

Because foreign insurers are restricted to applying for licences one province at a time—and generally the CBIRC only approves one such application per insurance company per year—their operational capabilities are severely limited, particularly because the procedure lacks a precise timeline.

Assessment

The CBIRC's *Detailed Rules for Implementation of Regulations of the People's Republic of China (PRC) on the Administration of Foreign-funded Insurance Companies* limit foreign-invested insurers that wish to apply for licences in China to do so one province at a time.²⁴ Furthermore, working group members report that the CBIRC generally only approves one such application per insurance company per year. Chinese insurance companies, however, have in the past had no such restrictions. In addition, when a foreign-invested insurance company applies to register a new branch in a new province, its operational capabilities are severely limited by the fact that the application procedure lacks a precise timeline.

These measures distort the market and limit foreigninvested companies' ability to expand within China and compete on an equal footing with their Chinese competitors. Such constraints do not exist in Europe, where insurance licences are granted by national regulators for the entire territory of one member state. Companies approved in one member state can provide services in all other member states by way of the 'European passport' system, as a result of the freedom of establishment and the freedom to provide services under the Treaty on the Functioning of the European Union.²⁵

Recommendations

- Allow foreign-invested insurance companies to apply at any time for approval licences to open new branches in as many provinces as they believe is necessary.
- Provide a clear timeline with a clear deadline ideally within three months—for the approval of new branch registrations.
- 4. Update and Expand the Existing Regulations on Reinsurance
- 4.1 Revise the Calculation Method for Solvency Ratios (3)2

Concern

The requirement for foreign reinsurers operating in China to calculate their solvency separately, independent from their international head offices, constitutes a significant market barrier and makes the China market less attractive.

Assessment

According to the China Risk Oriented Solvency System (C-ROSS), foreign reinsurers operating in China currently have to calculate their solvency ratio independently from their international head office solvency ratio. However, from a reinsurers' perspective, determining their China branch solvency status according to the solvency status of its head office, in accordance with Regulation of the Reinsurance Business Management (Baojianhuiling [2010:8], revised in 2015) issued by the former China Insurance Regulatory Committee (CIRC),²⁶ would in fact be more consistent with regulatory and administrative reforms undertaken to open up the financial sector, and the most beneficial way for both foreign investors and foreign reinsurers operating in China. If a branch has to comply with the solvency regulation based on its own figures, as the C-ROSS currently requires, the amount of capital to be deployed locally would be much higher, and periodical capital increases would be required if the branch's business develops. This constitutes a significant barrier, and makes the China market less attractive to foreign reinsurers. Thus, the solvency ratio constitutes a key concern for any reinsurance company either operating or considering establishing an operation in China.

²⁴ Detailed Rules for Implementation of Regulations of the PRC on the Administration of Foreign-funded Insurance Companies, China Insurance Regulatory Commission (CIRC), 25th November 2015, viewed 13th May 2020, <http://bxjg.circ.gov.cn/web/ site0/tab7758/info3980764.htm>

²⁵ Consolidated Version of the Treaty on the Functioning of the European Union, EUR-Lex, viewed 16th May 2019, <https://eur-lex.europa.eu/legal-content/EN/ TXT/?uri=celex%3A12012E%2FTXT>

²⁶ Regulation of the Reinsurance Business Management (Baojianhuiling 2010:8, revised in 2015), CIRC, 3rd December 2015, viewed 12th May 2020, <http://bxjg. circ.gov.cn/web/site0/tab5224/info3981595.htm>



Recommendation

 Allow foreign reinsurer branches in China to use their parent companies' solvency ratio to satisfy CBIRC solvency supervision requirements.

4.2 Expand the Defined Business Scope of Foreign Reinsurance Licences

Concern

While domestic reinsurance companies have started to receive approval for conducting reinsurance-related consulting services, foreign reinsurers do not have equal access to the required business licence.

Assessment

The Establishment of Reinsurance Companies (Baojianhuiling [2002:4]) states that the defined business scope of reinsurance companies is limited to the reinsurance business only.²⁷ However, at present, domestic reinsurance companies have started to receive approval for conducting reinsurance-related consulting services. The working group therefore proposes revising the regulation so that foreign reinsurers can also apply for consulting business licences.

Recommendation

 Revise the Establishment of Reinsurance Companies (Baojianhuiling [2002:4]) to allow foreign-invested reinsurers to apply for and obtain consulting business licences.

Create More Opportunities for Foreign Insurers to Contribute to China's Pension Reform 66

Concern

China's three-pillar pension system—conceptually similar to many European countries but far more imbalanced, with low coverage and insufficient benefit adequacy—is not equipped to cater to China's rapidly ageing society.

Assessment

Since 2014, the Chinese Government and the CBIRC have shown that they are firmly resolved to reform the existing pension system, with a focus on the development of non-public pillars – this includes

the second pillar (enterprise annuity) and the third pillar (private pension insurance). Life and pension insurers are expected to benefit from these reforms and to expand their pension businesses accordingly. However, non-public pillars are still underdeveloped, and virtually no foreign insurers (including those in JVs with Chinese partners) are actively engaged in China's pension system. The central government plays a vital role in building up such a system and facilitating the development of the second and the third pillars by offering tax breaks and subsidies to the insured.

The Ministry of Finance's Pilot Programme of Personal Tax-deferred Commercial Pension Insurance (issued jointly with several other ministries, and taking effect on 1st May 2018), for Shanghai, Fujian Province and Suzhou Industrial Park in Jiangsu Province, expired on 30th April 2019.²⁸ Under the programme, individuals could defer tax on part of their income that is used to buy commercial pension insurance until they retire and draw money from the fund. When drawing the money, 25 per cent of the policyholder's income would be tax-free, while the income tax on the rest would be levied at a rate of 10 per cent.²⁹ To the working group's understanding, relevant government agencies are currently in the process of collecting feedback and summarising participants' experience of the pilot programme. The working group hopes that in the future, licences will be granted for pension insurers or enterprise annuity trustees to select foreign insurers (even on a trial basis) for new pension schemes.

For European insurance providers that wished to participate in the tax-deferred commercial pension insurance, the CBIRC's *Circular of the China Banking and Insurance Regulatory Commission on Issuing the Interim Administrative Measures for Individual Taxdeferred Commercial Pension Insurance Business* regulations stipulated that certain pre-conditions must

²⁷ Establishment of Reinsurance Companies (Baojianhuiling [2002] 4), CIRC, 20th December 2015, viewed 12th May 2020, http://bxjg.circ.gov.cn/web/site0/tab5224/info19522.htm

²⁸ Notice of the Ministry of Finance, the State Administration of Taxation, and the Ministry of Human Resources and Social Security, et al on Conducting the Pilot Program of Personal Tax-Deferred Commercial Pension Insurance, No. 22 [2018], MOF, issued 2nd April 2018, viewed 11th May 2020, <http://www.chinatax. gov.cn/n810341/n810755/c3389866/content.html>

²⁹ Pension Business to see Explosive Growth, Ecns.cn, 24th May 2019, viewed 12th May 2020, <http://www.ecns.cn/news/2019-05-24/detail-ifziqifn8552904.shtml>

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be met.³⁰ In addition, insurance companies must satisfy administrative provisions on solvency ratios³¹ and must have been continuously been carrying out pension annuity insurance or pension fund management or other pension insurance business within the territory of China (excluding Hong Kong, Macao and Taiwan) for more than three years and have mature experience in the management of pension insurance business. The working group believes that this creates additional barriers for foreign insurers to enter this business area. There are also specific and detailed requirements on the insurance product offered, which makes each company's products look similar, creating competition based on existing scale not product diversity of the participating insurers. This prevents European insurance providers from taking advantage of their experience in products and mature markets.^{32&33}

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. Moreover, the current setting includes several special features (e.g. 50 per cent cap on unit-linked insurance products) which are different from standard mainstream business. The working group believes that this causes additional administrative expenses, which will ultimately reduce the performance of the policies. This could more simply be replaced by the zero per cent floor on pension schemes, leaving it to market dynamics and product innovation to generate good performance with limited risk in the interests of future pensioners.

Recommendations

- Create more opportunities for foreign insurers to contribute proposals for China's pension reform.
- Grant licences for pension insurers or enterprise annuity trustees to select foreign insurers (even on a trial basis) for new pension schemes.
- Liberalise the extremely strict product regulation, and allow a minimum guarantee of zero per cent at maturity to suffice.

6. Clarify Internet Insurance Business

6.1 Clarify Guidance on How to Obtain an Online Insurance Licence

Concern

There have been no new online licences approved over the past six years, and no foreign-invested insurers are represented within the CBIRC's authorised pilot programmes.

Assessment

The CBIRC has already permitted four authorised online insurance companies to pilot operations in China.³⁴ As newcomers to a Chinese insurance market that is inundated with homogenous products, foreign insurers suffer from a lack of scale and limited geographic footprints, as well as limited control over their distribution networks, which take years to build and bear fruit.

An online insurance licence would allow foreign insurers to operate nationwide without having to apply for permits province by province, thereby creating a level playing field for both domestic and foreign players. In addition, the online insurance segment provides an opportunity to benefit from the innovative expertise of foreign insurers, allowing them to catch up with domestic players and make contributions to the sustainable development of the Chinese insurance industry.

Recommendations

- Clarify guidance on how to obtain an online insurance licence, to help insurance companies prepare longterm strategies.
- Allow foreign insurers to participate in CBIRC online insurance pilot programmes.

³⁰ Minimum pre-conditions entailed an annual comprehensive solvency adequacy ratio of not lower than 150 per cent and a core solvency adequacy ratio of not lower than 100 per cent, registered capital and net assets of not less than CNY1.5 billion each, strong product actuarial technical ability and an actuarial team with not less than five specialised persons (in principle) with actuarial experience of more than three years and with qualification certificates for formal members of actuaries and strong long-term capital investment management ability and an investment team with not less than five specialised persons (in principle) with pension asset management experience of more than five years. In addition, the insurance company has to have a perfect tax-deferred pension insurance information platform established by China Insurance Information Technology Management (CBIIT) and has obtained the acceptance certificate issued by CBIIT.

³¹ The solvency of insurance companies, at the end of 2018 and the immediately preceding quarter, and its comprehensive solvency adequacy ratio mustn't be lower than 150 per cent and its core solvency adequacy ratio not lower than 100 per cent, except for pension insurance companies that only deal in entrusted businesses.

³² Circular on Issuing the Interim Administrative Measures for Individual Taxdeferred Commercial Pension Insurance Business [2018:23], CBIRC, issued 18th May 2018, viewed 11th May 2020, <http://www.cbirc.gov.cn/cn/view/pages/ ItemDetail.html?docId=179968&itemId=928&generaltype=0>

³³ Circular on Issuing the Interim Administrative Measures for Individual Taxdeferred Commercial Pension Insurance Business [2018: 20], CBIRC, issued 29th May 2018, viewed 11th May 2020, <http://www.cbirc.gov.cn/cn/view/pages/ ItemDetail.html?docId=359825&itemId=928&generaltype=0>

³⁴ Online Insurance Ushers in a New Era of Development, cs.com.cn, 9th Oct 2019, viewed 18th May 2020 <http://www.cs.com.cn/jg/05/201910/t20191009_5988656. html>



6.2 Relax Restrictions on Foreign Insurance Companies' Applications for Value-added Telecom Service (VATS) Licences

Concern

Due to various VATS restrictions, foreign-invested insurers are deprived of opportunities to establish online insurance businesses and effectively compete in the insurtech market.

Assessment

The rapid development of the online insurance business has prompted many insurers to explore opportunities in this area. However, foreign insurers are deprived of the opportunities to compete effectively due to various VATS restrictions listed in the Telecoms Catalogue. revised in 2015.³⁵ Even though there are available options for foreign insurers to establish an online insurance business in free trade zones (FTZs) and within the Closer Economic Partnership Agreement programme,³⁶ foreign insurers do not have the flexibility to conduct business in preferred locations other than FTZs and the Greater Bay Area. Moreover while restrictions on foreign ownership has been eased for the insurance sector, restrictions have yet to be relaxed for the information and communication technology sector and VATS licences. This paradox is illustrated further in the Special Administrative Measures on Access to Foreign Investment (Negative List) 2020, whereby the 51 per cent restriction on foreign shares in life insurance companies is to be removed in 2021, but the restriction on the ratio of foreign shares of VATS business at 50 per cent or less is kept.

B25 Sub-category

Providing content-based services for the purposes of profit through an online platform constitutes a VATS, and thus can only be carried out by a holder of a B25 licence, which is issued by MIIT. Charging fees for consulting, advertising and other content-based services have become an integral part of domestic insurance providers and a driving force for business growth and innovation. However, foreign insurers must have no more than 50 per cent foreign-invested shareholding in order to offer these services. Therefore, foreign health insurers that wish to conduct online health consulting are not eligible.

B21 Sub-category

If an online platform provides services for setting up deals, data processing and settlement in the manner of immediate response, then an Electronic Data Interchange licence (B21) is required. Although there is no shareholding limit for foreign insurers, members of the working group report that the application process can take up to a year, while it appears to take much less time for domestic insurance providers.

Recommendations

- Remove restrictions on the shareholding cap of foreigninvested companies, and ease access for them to apply for the Internet Content Provider licence (B25 sub-category).
- Shorten the application period and simplify the overall process for foreign insurers applying for the B21 licence.
- 6.3 Optimise Data Management Fees and Inquiry Penalties Charged by the China Banking and Insurance Information Technology Management (CBIIT)

Concern

The CBIIT's current pricing for data management and price-quotation-orientated data retrieval services goes against the interests of small and medium-sized insurers, and adds additional expenses for insurance companies.

Assessment

The CBIIT centrally manages customers' insurance claim data. All insurers operating in China are required to submit their data to the CBIIT, which then charges for both data management and data retrieval for the pricing of quotations.³⁷

When a quote or a conversion ratio exceeds ten times the benchmark, which is the average monthly nationwide quote/conversion ratio, a high penalty will be charged to the insurer. In such cases, the

³⁵ Telecoms Catalogue, MIIT, 28th December 2015, viewed 8th May 2020, <http:// www.miit.gov.cn/n1146285/n1146352/n3054355/n3057709/n3057714/c4564270/ content.html>

³⁶ The Closer Economic Partnership Arrangement (CEPA), is an economic agreement between the Government of the Hong Kong Special Administrative Region and the Central People's Government of the People's Republic of China, signed on 29 June 2003. One of the main aim is to further enhance the level of the Services Agreement, to deepen the liberalisation of trade in services between the Mainland and HKSAR, as well as to strengthen the bilateral economic partnership.

³⁷ CBIIT. is a company founded by CBIRC. < http://www.cbit.com.cn/>

working group believes that the CBIIT fails to take into consideration the fact that online behaviour of customers when inquiring about insurance premiums is beyond the control of insurers. Insurers may even fall victim to malicious individuals or companies that can take advantage of this loophole by conducting unlimited price quotes, incurring unjustified quoting and penalty expenses for their competitors. The working group therefore believes that a revision to the CBIIT fee mechanism is required, coupled with the lifting of the threshold for inquiry penalties to match the common standard of an internet company, which is roughly around 100 times the conversion ratio. This would alleviate financial burdens on small and medium-sized insurers and accelerate their healthy and sustainable growth in the digital area.

Recommendation

 Optimise or remove data management fees, inquiry fees and penalty fees charged by the CBIIT to relieve the financial burden on small and mediumsized insurance companies and improve their digital capabilities.

Abbreviations

| CBIIT | China Banking and Insurance |
|--------|-----------------------------------|
| | Information Technology Management |
| | Co Ltd |
| CBIRC | China Banking and Insurance |
| | Regulatory Commission |
| CIRC | China Insurance Regulatory |
| | Commission |
| CNY | Chinese Yuan |
| C-ROSS | China Risk Orientated Solvency |
| | System |
| FTZ | Free Trade Zone |
| ICP | Internet Content Provider |
| JV | Joint Venture |
| MOF | Ministry of Finance |
| NDRC | National Development and Reform |
| | Commission |
| P&C | Property and Casualty Insurance |
| PBOC | People's Bank of China |
| PICC | People's Insurance Company of |
| | China |
| VATS | Value-added Telecom Service |



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 events of interest to all European Chamber members. Established in 2005, it is now comprised of more than 250 member companies that cover a wide range of corporate functions, such as sustainability/CSR, marketing and communications, public relations, government relations, corporate governance and compliance, human resources, the environment, and health and safety.

The Corporate Social Responsibility Forum promotes best practices already established by European companies and emphasises the importance of a strategic and innovative approach to CSR. The forum fosters CSR collaboration and co-innovation between the European Chamber, Chinese Government agencies, professional organisations and local nongovernmental organisations.

The concept of CSR is engrained in the makeup of European Chamber member companies. This was clearly demonstrated through the support they instigated for and voluntarily provided to China as the COVID-19 crisis developed there. Over 120 member companies made donations of medical supplies and devices as well as finances, with the total value exceeding Chinese yuan (CNY) 1 billion. Similarly, when the situation in Europe rapidly deteriorated, the European Chamber launched a call to members to cooperate with the European Union (EU) Emergency Response Coordination Centre, to give support by donating medical equipment. Many hospitals and health organisations, which were in demand of medical equipment, have been able to benefit from the donations of members. Also, through organising several webinars, the Chamber facilitates the exchange of best practises amongst members when dealing with issues related to crisis situations and work resumption.

In 2019/2020, the forum held 30 activities including meetings, seminars, roundtables and conferences in both Beijing and Shanghai. Regular forum meetings covered a wide range of topics such as corporate sustainability strategy planning, women's empowerment, CSR transparency initiatives, circular supply chains management, the positive impact of CSR programmes on access to education, corporate inclusion employment, environmental risk assessment and management, and the Zero Plastic Campaign.

In 2019, the European Chamber held its third Sustainable Business Awards, its 6th CSR Awards, and continues to host dialogues on topics related to CSR through its Corporate Social Profitability CEO/VIP Talk series. This series brings together corporate leaders for high-level discussions on the importance of incorporating sustainability and innovation into companies' strategic decision-making to improve their bottom lines.

The European Chamber has established strong partnerships with governmental stakeholders such as the EU Delegation to China, the Norwegian Consulate General Shanghai, the Dutch Embassy, the Swedish Embassy and the German Embassy, to help encourage CSR in the business community. To better promote sustainable trade in China, a Sustainable Trade Task Force was also launched under the Corporate Social Responsibility Forum. The task force aims to contribute to the development of responsible, competitive and sustainable businesses, by sharing observations and providing recommendations to members of the European Chamber and their supply chain partners. It has supported activities focusing on compliant logistics networks, tackling CSR risks and greater workplace safety.

In 2020/2021, the Corporate Social Responsibility Forum will continue to foster dialogue between European Chamber member companies and their Chinese stakeholders in order to promote the best European CSR practices and explore new, innovative ways to act sustainably.



Government Affairs Forum

Established in 2011, the Government Affairs Forum consists of government affairs (GA) professionals from 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 quarterly meetings that feature speakers from academia, industry and the Chinese Government, and has established itself as a platform for sharing best practices and where members can learn more about recently enacted policies and the latest GA trends.

In 2019, the forum analysed and translated key documents promulgated by the Chinese Government, with the aim of subsequently making them available to all European Chamber members. These included the Foreign Investment Law and the *Implementation Regulations of the Foreign Investment Law*, among others. Supporting research and analysis were conducted on topics such as the *Negative List for Foreign Investment and Encouraged Catalogue for Foreign Investment*, the process for investing in China and the Corporate Social Credit System.

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. The forum organised discussions regarding the *Regulations for Optimising the Business Environment* and shared the resulting feedback with the relevant departments. In addition, the forum also conducted regular surveys on how to further improve the business environment in China and presented the findings to relevant government units.

In 2019, the forum invited Mr Huang Qifan, vice chair of the China Centre for International Economic Exchanges and a former vice chair of the National People's Congress Financial and Economic Affairs Committee, to present the new trends and patterns of international trade in the new era. Forum Chair Dong Mei and Vice Chair Liu Chang met with Liu Hongkuan, director general inspector, Foreign Capital and Overseas Investment Department, National Development and Reform Commission (NDRC), on various topics like the United States (US)-China trade conflict and further opening up, as well as Zhang Xiaoqiang CEO, vice chair, China Centre for International Economic Exchanges, on innovative technology support.

In addition, the forum organised quarterly meetings with the Development Research Department of the China Council for the Promotion of International Trade to discuss the concerns of foreign-invested enterprises. These meetings came as the Chinese leadership increased efforts to make China's business environment more attractive to overseas companies.

Frequent exchanges on heated topics such as US-China trade conflict and the expansion of Chinese businesses in fullyopen foreign markets, GA crisis management, economic outlook and the Corporate Social Credit System were organised on a monthly basis.



Marketing and Communications Forum

Members of the Marketing and Communications Forum are marketing and communications professionals from a wide range of industries. It is comprised of nearly 400 member companies from 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.

Throughout 2019, the forum organised 20 activities in total across the three chapters, focussing mainly on the following topics:

- Social-media-focussed activities on trends, customer acquisition, utilising WeChat for e-commerce and B2B brands, and practical training on copywriting.
- Crisis communication activities covering content from the basics of crisis management, to crises in the context of China and in the age of social media, and practical strategies on handling such situations.
- Sports-related seminars covering China's sports business opportunities and how to enhance branding through sports marketing.
- Seminars on digitalisation and related cybersecurity issues.

The forum also collaborated with the Legal and Competition Working Group on dealing with consumers improperly protect their rights with inappropriate, violent or aggressive acts, and with the Human Resources Working Group on employer branding. Other activities were on traditional marketing topics such as visual brand strategies and how to acquire customers through offline events.

Due to the novel coronavirus (COVID-19) outbreak, starting from the end of 2019, companies' crisis management preparedness was tested as normal business operations were severely interrupted and consumer demand dropped. At the same time, the crisis further accelerated the process of digital transformation, which was already more advanced in China, and pushed companies to further adapt to more uncertain market conditions. The impact of digital transformation will continue to reshape the Chinese marketing landscape, and will result in changes in consumer behaviour such as higher rates of bulk-buying, spending more time online and focussing more on health and wellbeing.

In the first four months of 2020, the Marketing and Communications Forum has hosted webinars on strategic views on, and the practicality of, business transformation and digitalisation, trends in e-commerce, and measures to help brands recover and rebound stronger from the pandemic crisis. During the year ahead, the forum will continue to monitor industry trends and help members mitigate the impact of COVID-19 with further high quality and insightful activities.



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 functions as a platform for sharing practical information between members and supporting their operations in China. Its membership covers a wide range of industries such as automotive, chemicals, consumer goods, electronics, energy, healthcare, medical devices, pharmaceutical companies that support manufacturers with a focus on Environment, Health and Safety, lean management and quality services.

In 2019, the forum organised 24 activities including working group meetings, factory tours, seminars and training courses. These events addressed topics such as: the 'smart factory' and digital manufacturing; 'Industry 4.0'; experience-sharing among healthcare suppliers; attracting and keeping talent within the manufacturing industry; maintenance and safety management; and quality management; among others.

The forum also has a WeChat group to allow members to share timely information and exchange experiences and ideas in a more convenient and efficient manner. Issues that emerged for discussion in the WeChat group include:

- local regulation updates;
- industry information;
- human resources concerns;
- · requests for help from the European Chamber; and
- requests for help from members.

In early 2019, the Manufacturing Forum also created a Healthcare Manufacturing sub-group, which held meetings in September and November 2019. This sub-group aims to support members in the healthcare and healthcare equipment industry by organising events on regulatory issues and seminars to generate discussions on topics specific to the industry. Plans are in place for the further expansion and development of this sub-group.

In 2020/2021, the Manufacturing Forum will continue to engage members, improve its activities and enlighten members on industry-related topics such as manufacturing innovation, supply chain management, regulations and tax incentives. Innovation and environmental regulation compliance will be areas of particular focus for the forum over the coming year.



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 European SMEs to share experiences and gain practical information on how to successfully operate their business 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 the increasingly competitive markets in China, none more so than the task of securing domestic and international supply chains to maintain production while dealing with the fallout from the COVID-19 pandemic. To overcome these challenges, the Small and Medium-sized Enterprise Forum provides a strong network for companies to share resources and information on the regulatory environment. This forum also works closely with relevant working groups of the European Chamber to ensure that specific requirements and concerns of SMEs are voiced in their advocacy activities.

In 2019, the Small and Medium-sized Enterprise Forum held 24 activities in the European Chamber's Beijing, Shanghai and South China chapters. These events focused on areas including policy environment, China's E-Commerce Law, technology transfer, regional business opportunities and digital marketing, among others.

In 2020/2021, the forum will organise further meetings and seminars to provide 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 continue to provide a platform and opportunities for European SMEs to share solutions to common problems in their respective industries and to foster their success in China.



Section Seven Appendix

Abbreviations

| 13FYP | 13 th Five-year Plan |
|-------|--|
| 3Rs | Reduce, Reuse, Recycle |
| 5G | Fifth Generation |
| ABS | Asset-backed Security |
| ADR | Alternative Dispute Resolution |
| AEB | Autonomous Emergency Braking |
| AEO | Authorised Economic Operator |
| AET | Automatic Early Termination |
| AFB | Agriculture, Food and Beverage |
| AFC | Auto Finance Company |
| AHWP | Asia Harmonization Working Party |
| AI | Artificial Intelligence |
| AICM | Association of International Chemical Manufacturers |
| AIIB | Asian Infrastructure Investment Bank |
| AMC | Asset Management Company |
| AML | Anti-monopoly Law |
| AMR | Administration for Market Regulation |
| ANS | Air Navigation Services |
| APP | Aviation Partnership Project |
| AQSIQ | General Administration of Quality Supervision, Inspection and Quarantine |
| AR | Accounts Receivables |
| ATC | Air Traffic Control |
| ATFM | Air Traffic Flow Management |
| ATM | Air Traffic Management |
| AUCL | Anti-unfair Competition Law |
| B2B | Business to Business |
| B2C | Business to Consumer |
| BASA | Bilateral Civil Aviation Safety Agreement |
| bcm | Billion Cubic Meters |
| BCS | Business Confidence Survey |
| BEV | Battery Electric Vehicles |
| 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 |
| CAIA | China Automotive Industry Association |
| CAN | Chinese Nutrition Association |
| CBRC | China Banking Regulatory Commission |
| CBIIT | China Banking and Insurance Information Technology Management |
| CBIRC | China Banking and Insurance Regulatory Commission |
| CCC | China Compulsory Certificate |
| CCER | Chinese Certified Emission Reduction |
| CCPS | Classified Cybersecurity Protection Scheme |
| CCS | China Classification Society |
| | |



| CD | Certificate of Deposit |
|-----------------|--|
| CDE | Centre for Drug Evaluation |
| CDMD | Consumable and Disposable Medical Devices |
| CDR | Centre for Drug Re-evaluation |
| CDS | Customs Declaration Sheet |
| CFC | Consumer Finance Company |
| CFC | Corporate Finance Company |
| CFDA | China Food and Drug Administration |
| CFETS | China Foreign Exchange Trade System |
| CFSA | China National Centre for Food Safety Risk Assessment |
| CGAC | China Quality Supervising and Test Centre for Gas Appliances |
| CGHC | China Gas Heating Speciality Committee |
| CGT | Compensated Gross Tonnage |
| ChP | Chinese Pharmacopeia |
| CIBM | China Interbank Bond Market |
| CII | Critical Information Infrastructure |
| CIQ | China Entry-Exit Inspection and Quarantine |
| CIRC | China Insurance Regulatory Commission |
| CIT | Corporate Income Tax |
| CM2025 | China Manufacturing 2025 |
| CMA | China Metrology Accreditation |
| CMDE | Centre for Medical Device Evaluation |
| CNCA | Certification and Accreditation Administration of China |
| CNFIA | China National Food Industry Association |
| CNIPA | China National Intellectual Property Administration |
| CNIS | China National Institute of Standardisation |
| CNY | Chinese Yuan |
| CO ₂ | Carbon Dioxide |
| COCIR | European Coordination Committee of the Radiological, Electromedical and Healthcare IT Industry |
| CoO | Country of Origin |
| COP | Conference of the Parties |
| CORSIA | Carbon Offsetting Scheme for International Aviation |
| COVID-19 | Coronavirus disease 2019 |
| CPC | Communist Party of China |
| CPCCC | Central Committee of the Communist Party of China |
| CPCIF | China Petroleum and Chemical Industry Federation |
| C-ROSS | China Risk Orientated Solvency System |
| CRS | Computer Reservation System |
| CSAR | Cosmetics Supervision and Administration Regulations |
| CSIC | China's Shipbuilding Industry Corporation |
| CSL | Cybersecurity Law |
| CSP | Construction Service Provider |
| CSRC | China Securities Regulatory Commission |
| CSRM | Cybersecurity Review Measures |
| CSSC | China State Shipbuilding Corporation |
| СТМО | China Trade Mark Office |
| CV | Commercial Vehicle |
| CVD | Coordinated Vulnerability Disclosure |
| DDR | Deposit Deviation Ratio |
| DES | District Energy Systems |

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| DG GROW | Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs |
|---------|--|
| DHA | Docosahexaenoic Acid |
| DPO | Data Protection Officer |
| DRG | Diagnostic-related Groups |
| DVFA | Danish Veterinary and Food Administration |
| EASA | European Aviation Safety Agency |
| ECHA | European Chemicals Agency |
| ECHI | Europe China Heating Initiative (the Heating Sub-working Group) |
| ECIPE | European Centre for International Political Economy |
| EDV | Essentially Derived Varieties |
| EFSA | European Food Safety Authority |
| EHS | Environmental, Health and Safety |
| EPR | Extended Producer Responsibility |
| ERAC | Regulation on Environmental Risk Assessment and Control of Chemicals |
| ESCO | Energy Service Companies |
| ETS | Emissions Trading System |
| EU | European Union |
| EUR | Euro |
| EV | Electric Vehicle |
| FASCO | Foreign Aviation Service Company |
| FCM | Food Contact Materials |
| FCPA | Foreign Corrupt Practices Act |
| FCV | Fuel Cell Vehicles |
| 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 |
| FIR | Finite Impulse Response |
| FOP | Front of Package Labelling |
| FSMP | Food for Special Medical Purpose |
| FTZ | Free Trade Zone |
| FWP | Foreigner's Work Permit |
| GA | General Aviation |
| GAC | General Administration of Customs |
| GACC | General Administration of Customs of China |
| GAVI | Global Alliance for Vaccines and Immunisation |
| GB | Guobiao or Chinese national standard |
| GBA | Greater Bay Area |
| GCW | Gross Combination Weight |
| GDP | Gross Domestic Product |
| 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 Microorganism |
| CIVIIVI | |



| GMP | Good Manufacturing Practices |
|--------|---|
| GPA | Government Procurement Agreement |
| GPL | Government Procurement Law |
| GPSD | General Product Safety Directive |
| GQCE | Generic Quality Consistency Evaluation |
| GS1 | Global Standards 1 |
| Gt | Gigatonnes |
| HC | Hazardous Chemicals |
| HNTE | High and New-Technology Enterprise |
| НО | Head Office |
| HQLAAR | High-Quality Liquid Asset Adequacy Ratio |
| HR | Human Resources |
| HS | Harmonisation System |
| HSA | Health Security Administration |
| HTA | Health-Technology Assessment |
| IATA | International Air Transport Association |
| IC | Integrated Circuit |
| ICAO | International Civil Aviation Organization |
| ICAP | International Carbon Action Partnership |
| ICCA | International Council of Chemical Associations |
| ICD | Innovation Cooperation Dialogue |
| ICE | Internal Combustion Engine |
| ICH | International Conference on Harmonization of Technical Requirements for Registration of |
| | Pharmaceuticals for Human Use |
| ICP | Internet Content Provider |
| ICT | Information and Communication Technology |
| ICV | Intelligent Connected Vehicle |
| IDC | Internet Data Centre |
| IDF | International Dairy Federation |
| IEA | International Energy Agency |
| IEC | International Electrotechnical Commission |
| IEC | International Electrotechnical Commission |
| IFRS | International Financial Reporting Standards |
| IFU | Instructions For Use |
| IIT | Individual Income Tax |
| IMCT | International Multi-centres Clinic Trial |
| IMDRF | International Medical Device Regulators Forum |
| IMO | International Maritime Organization |
| IMT | International Mobile Technology |
| IOC | International Oil Company |
| IoT | Internet of Things |
| IP | Intellectual Property |
| IPI | International Procurement Instrument |
| IPR | Intellectual Property Rights |
| IP-VPN | Internet Protocol Virtual Private Networks |
| IRC | Internet Resources Collaboration |
| ISO | International Standardization Organization |
| IT | Information Technology |
| ITU | International Telecommunication Union |
| IV | Intelligent Vehicle |

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| IVD | In-vitro Diagnostics |
|--------|---|
| JV | Joint Venture |
| Kg | Kilogrammes |
| KM | Kilometres |
| KR | Key Recommendation |
| L | Litres |
| LDR | Loan to Deposit Ratio |
| LFCV | Low Fuel Consumption Vehicles |
| LMR | Liquidity Matching Ratio |
| LNG | Liquefied Natural Gas |
| LPG | Liquefied Petroleum Gas |
| LPWAN | Low-Power Wide-Area Network |
| M&A | Mergers and Acquisitions |
| MAD | Mutual Acceptance of Data |
| MARA | Ministry of Agriculture and Rural Affairs |
| MED | Marine Equipment Directive |
| MEE | Ministry of Ecology and Environment |
| MEM | Ministry of Emergency Management |
| MEP | Ministry of Environmental Protection |
| MFA | Ministry of Foreign Affairs |
| MIIT | Ministry of Industry and Information Technology |
| MNC | Multinational Corporations |
| MNR | Ministry of Natural Resources |
| MOA | Ministry of Agriculture |
| MOC | Ministry of Construction |
| MOE | Ministry of Education |
| MOF | Ministry of Finance |
| MOFCOM | Ministry of Commerce |
| МОН | 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 |
| МОТ | Ministry of Transport |
| MOU | Memorandum of Understanding |
| MPA | Medical Products Administration |
| MPS | Ministry of Public Security |
| MRO | Maintenance, Repair and Operation |
| MRV | Monitoring, Reporting and Verification |
| MSA | China Marine Safety Administration |
| NBFI | Non-banking Financial Institution |
| NBS | National Bureau of Statistics |
| NDRC | National Development and Reform Commission |
| NEA | National Energy Administration |
| NEV | New Energy Vehicles |
| NG | Natural Gas |
| NGO | Non-governmental Organisation |
| NHC | National Health Committee |
| NHFPC | National Health and Family Planning Commission |
| NHSA | National Healthcare Security Administration |



| NIP | National Immunication Dragramma |
|-----------|---|
| NMPA | National Immunisation Programme National Medical Products Administration |
| NOX | National Medical Products Administration |
| NPC | |
| NPL | National People's Congress |
| NRCC | Non-performing Loan National Registration Centre for Chemicals |
| NRDL | National Reimbursement Drug List |
| NSR | - |
| | National Security Review |
| OCT | Off-cycle Technology |
| OE | Original Equipment |
| OECD | Organisation for Economic Co-operation and Development |
| OEM | Original Equipment Manufacturer |
| OMA | Oversea Marketing Authorisation |
| OOP | Out-of-pocket |
| OTC | Over-The-Counter |
| P&C | Property and Casualty Insurance |
| P2P | Peer-to-Peer |
| PBOC | People's Bank of China |
| PC | Passenger Car |
| PCR | Petrochemicals, Chemicals and Refining |
| PD | Primary Dealer |
| PDP | Pollution Discharge Permit |
| PET | Polyethylene Terephthalate |
| PHEV | Plug-in Hybrid Electric Vehicle |
| PIC | Prior Informed Consent |
| PICC | People's Insurance Company of China |
| PRB | Patent Re-examination Board |
| PRC | People's Republic of China |
| PSB | Public Security Bureau |
| PTE | Patent Term Extension |
| PV | Photovoltaic |
| PVP | Plant Variety Protection |
| QSS | Quality and Safety Services |
| R&D | Research and Development |
| RDP | Regulatory Data Protection |
| RE | Real Estate |
| RE | Renewable Energy |
| REACH | Registration, Evaluation, Authorisation and Restriction of Chemicals |
| RECs | Renewable Energy Certificates |
| RMB | Renminbi |
| RMOA | Risk Management Option Analysis |
| ROP | Refined Oil Products |
| rPET | Recycled Polyethylene Terephthalate |
| RPS | Reimbursement Payment Standard |
| S&T | Science and Technology |
| SaaS | Software as a Service |
| SCA | Standards and Conformity Assessment |
| SAFE | State Administration of Foreign Exchange |
| SAIC | State Administration of Industry and Commerce |
| SAMR | State Administration for Market Regulation |
| C/ 1011 1 | etate, tanimoration for market togulation |

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| SASAC | State Assets Supervision and Administration Commission of the State Council |
|--------|---|
| SAT | State Administration of Taxation |
| SCA | State Cryptography Administration |
| SCOPSR | State Commission Office for Public Sector Reform |
| SCS | Social Credit System |
| SDO | Standards Developing Organisations |
| SESEC | Seconded European Standardization Expert in China |
| SME | Small and Medium-sized Enterprises |
| SOE | State-Owned Enterprises |
| SPB | State Post Bureau |
| SPC | Single Pill Combination |
| SPC | Supreme People's Court |
| SPP | Supreme People's Procuratorate |
| SSE | Shanghai Shipping Exchange |
| STA | State Taxation Administration |
| SVHC | Substances of Very High Concern |
| SWIM | System Wide Information Management |
| TBL | Tender and Bidding Law |
| ТВТ | Technical Barriers to Trade |
| ТС | Technical Committee |
| TC260 | National Information Security Standardisation Technical Committee |
| TC485 | National Technical Committee on Communication |
| TFCD | Task Force on Climate-related Financial Disclosures |
| THC | Terminal Handling Charge |
| TIC | Testing, Inspection and Certification |
| TIER | Technology Import and Export Administrative Regulation |
| TP | Transfer Pricing |
| TRAB | Trademark Review and Adjudication Board |
| UAS | Unmanned Aircraft System |
| UAV | Unmanned Aerial Vehicle |
| UDI | Unique Device Identifier |
| UK | United Kingdom |
| UN | United Nations |
| UNCTAD | United Nations Conference on Trade and Development |
| UNICEF | United Nations International Children's Emergency Fund |
| UPOV | International Union for the Protection of New Varieties of Plants |
| US | United States |
| USD | United States Dollar |
| UTM | UAS Traffic Management |
| V2X | Vehicle to X |
| VAT | Value-Added Tax |
| VATS | Value-added Telecoms Services |
| VBP | Volume-Based Procurement |
| VPN | Virtual Private Network |
| VSME | Very Small and Micro-Sized Enterprise |
| WCO | World Customs Organization |
| WFOCE | wholly foreign-owned construction enterprise |
| WFOE | Wholly Foreign-Owned Enterprises |
| WHO | World Health Organization |
| WHT | Withholding Tax |



WIPOWorld Intellectual Property OrganizationWTOWorld Trade OrganizationWTO GPAWTO Government Procurement AgreementWTO/TBTWorld Trade Organization Agreement on Technical Barriers to TradeYRDYangtze River Delta



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