February 7, 2014

Mr. Stanford K. McCoy  
Assistant United States Trade Representative  
for Intellectual Property and Innovation  
Office of the United States Trade Representative  
600 17th Street NW  
Washington, DC 20508

Dear Mr. McCoy:

On behalf of the US-China Business Council (USCBC) and our nearly 220 members doing business in China, I am pleased to submit comments and recommendations for this year’s Special 301 Review of global intellectual property rights protection.

Year in and year out, intellectual property rights (IPR) issues remain one of the top challenges that US companies face as they seek to expand their business and investment in China. In our most recent annual member company survey, IPR protection ranked fifth among issues of top concern. Ninety-eight percent of respondents in 2013 reported that they were “very concerned” or “somewhat concerned” about IPR protection in China, with a key focus on inadequate or inconsistent IP enforcement.

China’s current IPR environment continues to have a negative impact on the products and technologies that US firms are willing and able to research, manufacture, and sell in the China market. Nearly half of companies (49 percent) in our 2013 survey indicated that China’s level of IPR protection limits the products they are willing to manufacture in China, and more than 40 percent of companies indicated that it limits the product they are willing to license or the types of research and development (R&D) they are willing to undertake in China. It is notable that these numbers have increased compared to those in USCBC’s 2012 survey.

China has made incremental progress on IPR issues, both on its legal framework and on enforcement. Last year, for example, Chinese government agencies made progress in updating and revising many of their core intellectual property (IP) laws and regulations: finalizing an important round of revisions to the Trademark Law, releasing drafts of its Patent and Copyright Laws, and drafting or revising other key regulations and judicial interpretations. Chinese policymakers also appear to be increasingly aware of the benefits of promoting and protecting IP for building an innovative economy, which creates more opportunities for engagement and potential alignment on the importance of IPR protection.
As a result of these efforts, companies have noted some improvement in IPR enforcement, including increased activity during enforcement campaigns to battle counterfeiting and online piracy. In response to a survey question about how China’s protection of IPR had changed from the previous year, 41 percent of USCBC respondents indicated that it had “somewhat improved,” with an additional 54 percent saying that it had not changed. In contrast, only 4 percent said that IPR protection had deteriorated over the previous year.

Despite this progress, companies still face significant challenges and view additional progress as critical for the success of their business in China. These concerns cut across industry sectors, company size, and IP type, including patents, trademarks, copyrights, and trademarks. Additionally, our members have noted with concern Chinese official statements and policies that call for the development of domestic innovation and IP, creating the potential for discrimination against IP owned by foreign and foreign-invested companies. This has manifested itself in provisions that require domestic ownership or exclusive licensing of IP in a growing number of disparate policies, from accreditation rules for national and provincial catalogues of indigenous innovation products to criteria for awarding companies high- and new-technology enterprise (HNTE) status.

Given the above, USCBC recommends that USTR keep China on the Priority Watch List in 2014 and work with Chinese officials to make progress on the issues listed in this submission. In support of USTR’s efforts, we are attaching a set of documents to provide more detailed views of the IPR landscape in China. We list below several priority areas of concern where we would recommend that USTR and its counterpart US government agencies focus their efforts with China. We encourage the US government to pursue these issues through all existing bilateral dialogues and cooperative channels, including the Joint Commission on Commerce and Trade, the Strategic and Economic Dialogue and the US-China IPR Cooperation Agreement.

1) **Continue to strengthen enforcement of IPR in China**

Stronger IPR protection is in China’s own interest as it seeks to develop an innovative economy. It is also critically important to US companies that do business in China. The US government must continue to urge Chinese government agencies to expand efforts devoted to IPR enforcement, including steps to:

- Increase funding, personnel, and training devoted to IPR enforcement, including for local administrative agencies (particularly in trademarks and copyrights) and judicial bodies at multiple levels (particularly in patents and trade secrets);
- Upgrade and expand the work of the National IPR Leading Group to actively coordinate IP-related efforts of various government agencies through enforcement campaigns, work plans, and other means;
- Add benchmarks for IP protection to the process of regular performance evaluations of provincial and municipal government leaders;
- Strengthen internal monitoring and reporting mechanisms to control IP-infringing goods, including market surveillance, monitoring of exports, and internal mechanisms for communicating and responding to reports of IP theft;
• Expand work on non-traditional programs – such as credit systems and blacklists – that would make it more difficult for IP infringers to continue to act in bad faith;
• Broaden and encourage use of judicial procedures, such as preliminary injunctions and evidence preservation orders, to reduce the evidentiary burden plaintiffs face in IP court cases, while considering changes to judicial practice that would allow shifting the burden of proof from the plaintiff to the defendant and greater admissibility of evidence; and
• Increase its engagement with the US government and private sector on IP enforcement issues.

2) **Adopt stronger deterrents against IP infringement**

China should act on its 2012 Strategic & Economic Dialogue (S&ED) commitment to consider revising the Criminal Law to address IP-related concerns. Legal penalties that are currently available in IPR enforcement proceedings provide an insufficient deterrent to IPR infringement. Administrative penalties and judicial damages levied against offenders remain too low to deter infringement and are often viewed by the offender as merely a cost of doing business. Moreover, existing value-based thresholds to determine potential criminal penalties are too high, effectively limiting the number of criminal cases each year. To address this issue, we recommend that the US government work with relevant Chinese agencies and officials to:

- Eliminate value-based thresholds laid out in the Supreme People’s Court 2004 judicial interpretation that counterfeit goods must meet to qualify for criminal prosecution, and replace them with a system that applies criminal penalties for commercial-scale infringement in line with World Trade Organization (WTO) practices.
- Increase the effective level of penalties for IPR infringement – both judicial damages and administrative penalties – by instituting statutory minimums and raising or eliminating the statutory maximums on fines and damages. In addition, encourage local regulators and judicial officials to levy fines that will serve as more effective deterrents and reward those who do so.
- Revise existing standards for calculating the value of infringing goods so that standards are based on the market value of the infringed goods (i.e. what the original goods would sell for in the marketplace), rather than using the market value of the infringing goods (i.e. what the counterfeit goods would sell for in the same marketplace).

3) **Improve enforcement against online counterfeiting and piracy**

Internet platforms continue to be a growing means for counterfeiters to market and sell counterfeit goods and distribute pirated content, but present special challenges for rights-holders and enforcement officials alike. USTR should encourage China to increase its enforcement of Internet-related IPR by drafting and implementing regulations to govern areas such as use of trademarks on websites, trademark-related aspects of domain name registrations, and use of websites as platforms for counterfeit and pirated products. Such regulations and their enforcement should balance the needs of legitimate IPR holders and Internet intermediaries.

4) **Strengthen trade secrets protection**

Protection of trade secrets is an increasingly important issue in China and was the IP area of greatest concern in USCBC’s 2012 and 2013 member company surveys. USCBC and other...
industry organizations have continuously raised this issue with Chinese authorities, and Chinese
government agencies have begun to respond to such concerns by paying greater attention to this
issue. USCBC was pleased with the notable trade secrets-related deliverables at the 2013 Joint
Commission on Commerce and Trade (JCCT), which focused on revising China’s trade secrets
laws and increasing enforcement efforts. However, much still needs to be done, given that
insufficient trade secret protection hampers the growth and development of companies, products,
and technologies that use such trade secrets.

We recommend the US government expand its engagement with the Chinese government on
trade secrets concerns in 2014 and encourage China to:

- Launch substantive work to draft a unified Trade Secret Law that would incorporate and
  expand upon trade secret-related provisions in the Anti-Unfair Competition Law, Labor
  Contract Law, Company Law, Criminal Law, and other laws and regulations, and engage
  actively with government and industry through this process, as pledged at the 2013 JCCT.
- Move quickly to release a robust action plan for trade secret protection, in line with
  China’s commitment at the December 2013 JCCT, and consult with domestic and foreign
  companies to best ensure that government efforts address the practical business concerns
  that confront companies on these issues.
- Reduce the high evidentiary burdens that companies face during trade secrets cases,
  including expanded use of judicial procedures and changes to judicial practice in line
  with the recommendations listed above. These issues are particularly acute for trade
  secrets cases, given that trade secrets by definition depend on confidentiality.

More information and detailed recommendations for trade secrets are provided in USCBC’s
September 2013 Recommendations for Strengthening Trade Secret Protection in China, attached
to this submission.

5) Protect IPR and technology during government review processes
Chinese government agencies collect significant amounts of data from companies about their
business, operational practices, products, and services that may be sensitive as a part of
government approval processes, including patent reviews, investment approvals, product
registrations, environmental impact assessments, and business licensing. Such sensitive
information is often critical to company competitiveness; should this information fall into the
hands of their competitors, companies would be harmed both financially and competitively. Yet
in many cases, companies have little concrete evidence that the information being requested by
government agencies will be protected either during or after the government approval process.

China should ensure that its practices for collecting, accepting, reviewing, and protecting
sensitive company information, including both patent-related information and trade secrets, are
consistent with international regulatory practices. This includes a variety of more specific areas
where China should take action:

- Ensure that government reviews of patents under Article 26.3 of the Patent Law are
  consistent with international patent practice, do not require unnecessary examination
data, and do not unreasonably reject applications or revoke existing patents under
discriminatory criteria. In addition, the Chinese government must ensure that current judicial cases involving US companies are handled in line with these principles. These actions would be in line with China’s commitments made during Vice President Joseph Biden’s November 2013 visit.

- Adopt international best practices to reevaluate and assess new and existing regulations to ensure that any regulations that propose collecting information from companies fully consider whether such information is necessary to carry out the required regulatory goals and how collecting such information might impact companies. These types of regulatory impact assessments have been successfully used by the United Kingdom, New Zealand, Russia, and Mexico.
- Encourage government agencies at all levels to sign mutual non-disclosure agreements with licensing applicants. This will reinforce that both sides are committed to confidentiality in investment and licensing approval processes.
- Draft and enforce laws, regulations, and regulatory practices governing expert panels to require confidentiality for all data collected during and before these reviews, and to prevent those with a conflict of interest (such as competitors) from serving on these panels. These panels are a part of a number of government licensing and approval processes. For more details and specific recommendations in this area, see our January 2014 Licensing Challenges and Best Practices in China report (attached).

6) Ensure equal treatment for IP owned by foreign and domestic firms
China should promote a fair and open landscape for innovation and IP by setting and implementing regulations and policies in IP-related areas (such as standards, taxation, R&D, and government procurement) that treat foreign-invested enterprises (FIEs) equally with their domestic private and state-owned enterprises, to ensure that all IPR holders—foreign and domestic—receive equal legal protection for their IPR. The US government should continue to work closely with industry to identify and address policies that contain discriminatory IP provisions or that in practice discriminate against IP owned by US companies, in line with company concerns. Specific recommendations include encouraging China to:

- Fully implement former President Hu Jintao’s January 2011 commitment to break links between China’s innovation and government procurement policies. To do so, China should implement the State Council’s November 2011 notice requiring all provincial and local governments to halt implementation of provisions within regulatory documents that link innovation and government procurement, revise those provisions to eliminate such links, and publish the results.
- In line with China’s commitments at the 2013 Innovation Dialogue and JCCT, amend China’s HNTE accreditation program to eliminate current requirements that license rights held by the applicant must be global, exclusive rights (not merely the right to exploit the relevant IP in China) with a term of not less than five years. Options for such a change can be:
  - Eliminating the requirement for ownership of core proprietary IPR in China; or
  - Expanding the criteria to include legally-acquired, non-exclusive license or usage rights; or
  - Narrowing the criteria to be exclusive license rights in China only.
Clearly mandate the removal of IP ownership qualification criteria from all central and local government incentive programs related to Strategic Emerging Industries, or amend the requirement to allow for non-exclusive licenses to Chinese affiliates.

More information and detailed recommendations in this area are provided in various documents, including USCBC’s March 2013 China’s Strategic Emerging Industries: Policy, Implementation, Challenges, & Recommendations, September 2013 Recommendations for China’s High- and New-Technology Enterprise (HNTE) Program, and our May 2013 report on China’s Progress on Meeting Bilateral Commitments on Indigenous Innovation and Government Procurement at the Provincial and Local Level (attached).

**Other priority recommendations**

We also recommend that USTR and relevant US government agencies encourage the Chinese government to address additional areas, such as:

- **Uneven enforcement**: Encourage consistent IPR enforcement across regions and jurisdictions by providing clear guidance to local government agencies and fostering increased communication between central and local government agencies. This should include information sharing and dialogue between provincial and local IPR regulators to share experiences and best practices. Additionally, encourage provincial and local IPR enforcement officials to increase communication with US government and industry, both domestic and foreign, to discuss progress on enforcement and emerging issues.

- **Transparency in drafting laws and regulations**: Actively engage with foreign and domestic stakeholders in revising IP-related laws and regulations, including both core IP laws such as the Patent, Trademark, and Copyright Laws, and regulations such as the Measures for the Compulsory Licensing of Patents and the Provisional Administrative Measures for National Standards Involving Patents. Release such laws and regulations for multiple rounds of public comment for at least 30 days, if not 60 or 90 days. Such transparency will promote better, more widely accepted regulatory outcomes.

- **Inventor remuneration**: Further revise the draft Regulations on Service Inventions in close consultation with all stakeholders, including foreign businesses, to address concerns, including provisions that would override existing inventor-employer agreements, that inappropriately extend remuneration to cover “know-how” or trade secrets, and that set standards limiting the ability of inventors and companies to openly negotiate appropriate remuneration. For more detailed recommendations, see USCBC’s December 2012 comments to the Chinese government on the draft regulations (attached).

- **Patent quality issues**: Reform China’s patent system to address the number of patents that have questionable validity, notably utility-model patents (UMPs). Possible reforms include increasing the examination level for UMPs by requiring substantive examinations for both novelty and creativity, requiring evaluation reports for UMP applications, or allowing third parties to comment on UMPs or to request an evaluation report.

- **IP and competition issues**: Ensure that Chinese regulatory processes and investigations, including those related to competition, pricing, and standard-setting, are conducted in keeping with provisions in the Patent Law that permit the legitimate exercise of intellectual property rights. For competition and pricing-related investigations, interpret the Article 55 of
the Antimonopoly Law (which states that the law does not govern the legitimate exercise of IPR under other laws and regulations) in ways that best promote innovation and IP development and avoid undue use of compulsory licensing that hinder industry development.

- **Software legalization**: Promote the use of legal software, as agreed by China and the United States in multiple high-level dialogues, by fully implementing existing policies and regulations focused on boosting use of legal software, increasing funding to government agencies to purchase legal software, auditing use of legal software by government agencies, publishing the results of those audits broadly, and actively promoting the use of legal, licensed software in state-owned enterprises and private companies via various means, including software asset management programs.

- **Counterfeiting tools**: Revise existing laws and regulations, such as the Criminal and Trademark Laws, to mandate that infringing goods—and the equipment used to produce them—be destroyed upon seizure and not be permitted to re-enter the marketplace under any circumstances.

- **Copyright barriers**: Remove market access and distribution barriers for legitimate copyrighted products, such as imported feature films and television programs, to better meet domestic demand with legitimate products as opposed to pirated ones, in line with the 2009 WTO Dispute Settlement panel decision on this topic.

- **Scope of copyright protection**: Extend the scope of works eligible for copyright protection to include areas such as live television broadcasts (such as sporting events), as these telecasts include sufficient creative elements (including camerawork, editing, music, graphics, and commentary) to merit copyright protection.

- **Trademark opposition processes**: Take steps to ensure that, despite the elimination of the Trademark Review Adjudication Board (TRAB) appeals process for opposition hearings in the revised Trademark Law, the China Trademark Office (CTMO) more consistently rejects bad-faith trademark applications, and that CTMO’s opposition proceedings more consistently invalidate bad-faith trademark registrations.

- **Trademark laws and regulations**: Engage with China through the drafting of its Trademark Law Implementing Regulations to address continued trademark-related issues that companies face, including the elimination of TRAB appeals process for opposition hearings, short timelines for responding to requests for more information, inadequate enforcement of trademarks by local governments, and a lack of clarity on handling of bad-faith trademark applications.

We look forward to working with USTR and other US government agencies to promote an improved environment for IPR protection in China. Please do not hesitate to contact me or my colleague Ryan Ong (ryan.ong@uschina.org; 202-429-0340) with any questions or clarifications.

Sincerely,

Erin Ennis
Vice President
Attachments

- Appendix 1: USCBC Member Company Survey (October 2013)
- Appendix 2: USCBC Intellectual Property Rights Review and Recommendations (May 2013)
- Appendix 3: Trade Secrets Paper (September 2013)
- Appendix 4: USCBC Comments on Draft Regulations on Service Inventions (December 2012)
- Appendix 5: Licensing Challenges and Best Practices in China (January 2014)
- Appendix 6: Recommendations for China’s High- and New-Technology Enterprise (HNTE) Program (September 2013)
- Appendix 7: China’s Progress on Meeting Bilateral Commitments on Indigenous Innovation and Government Procurement at the Provincial and Local Level (May 2013)
- Appendix 8: China’s Strategic Emerging Industries: Policy, Implementation, Challenges, & Recommendations (March 2013)
USCBC 2013 China Business Environment Survey Results:
Tempered Optimism Continues amid Moderating Growth, Rising Costs, and Persistent Market Barriers
USCBC 2013 China Business Environment Survey Results:

Tempered Optimism Continues Amid Moderating Growth, Rising Costs, and Persistent Market Barriers

Executive Summary

» Slowing economic growth, rising costs, and persistent, unaddressed operating challenges in China continue to moderate corporate optimism toward the China market, though companies are decidedly not pessimistic. Fewer companies in this year’s survey report that their profit margins in China are better than that of their global rates, and fewer companies report double-digit revenue increases compared to previous years.

» Nonetheless, more than 90 percent of survey respondents report that their China operations are profitable, the highest percentage reported since the US-China Business Council (USCBC) began surveying its membership.

» While a growing number of companies place China as one of the top five global market priorities, the number of companies that cited China as the top priority declined. Just over half of survey respondents plan to commit more resources to China in the next year, down from 67 percent in the 2012 survey.

» Competition is intensifying. Most multinational companies in China contend with other foreign competitors as well as both state-owned and private Chinese companies. Survey respondents expressed concern over the benefits that Chinese companies (both state-owned and private) receive that are not available to foreign companies.

» Problems with licensing occur at the central, provincial, and local levels and affect almost every aspect of doing business in China. Licensing issues often overlap with other issues in the top 10, including uneven regulatory implementation, lack of national treatment, and insufficient transparency in government rule drafting and decision making.

» Investment and market access restrictions continue to be a priority concern for American companies operating in China, and one in which US and Chinese regulatory regimes diverge. Once a company invests and incorporates in the United States, it is treated as a US company under most laws and regulations. This is an approach that China should adopt as well.

» Lack of progress is a significant concern for a range of issues. Nine of the top 10 member company issues are characterized as “unchanged,” suggesting that companies feel that little is being done to address their concerns.

» This year’s survey also noted emerging challenges such as cybersecurity that affect a wide variety of companies. Progress on this issue will require government-to-government discussions and action.

» In order to be effective, government-to-government dialogue on any issue must focus on effective and practical solutions. The business community plays an important role in identifying the policies that are problematic and recommending ways to address them. USCBC has developed an array of recommendations to address concerns in the top 10 and beyond.

2013 Top 10 Challenges

1. Cost increases
2. Competition with Chinese companies in China
3. [Tie] Administrative licensing
3. [Tie] Human resources: Talent recruitment and retention
5. Intellectual property rights enforcement
6. Uneven enforcement or implementation of Chinese laws
7. Nondiscrimination/national treatment
8. Transparency
9. Standards and conformity assessment
10. Foreign investment restrictions
USCBC 2013 China Business Environment Survey Results:
Tempered Optimism Continues Amid Moderating Growth, Rising Costs, and Persistent Market Barriers

Table of Contents

Executive Summary ................................................................. 1
USCBC 2013 China Business Environment Survey Results ...................... 3
Challenge 1. Cost Increases ......................................................... 8
Challenge 2. Competition with Chinese Companies in China .................... 9
Challenge 3. [tie] Administrative Licensing .................................... 11
Challenge 3. [tie] Human Resources ........................................... 13
Challenge 5. Intellectual Property Rights Enforcement
(trademark, patent, copyright, trade secrets) ..................................... 15
Challenge 6. Uneven Enforcement or Implementation of Chinese Laws and Regulations .................................................. 17
Challenge 7. Nondiscrimination/National Treatment ........................... 17
Challenge 8. Transparency .......................................................... 19
Challenge 9. Standards and Conformity Assessment ............................... 20
Challenge 10. Foreign Investment Restrictions .................................... 20
Other Issues of Interest .................................................................. 21
Respondent Profile ...................................................................... 25
Tempered optimism” sums up corporate America’s view of the China business environment for the second year in a row. While most respondents to the US-China Business Council’s (USCBC) annual survey report that China remains among their company’s top five priorities, fewer respondents this year ranked China as their top priority. Moreover, for the second consecutive year respondents suggested that companies’ optimism about the prospects for the market in the next five years has moderated. Rising costs — particularly for labor — competition with Chinese companies, and challenges with the licensing and business approval process continue to rank as the top issues of concern to foreign companies doing business in China.

USCBC surveys its member companies each year to gauge the business climate in China and assess the top challenges of doing business there. As China’s economy has slowed over the past year — though still growing at strong rates compared to most other markets — USCBC’s survey results indicate that many companies face business and market access issues in a market that for the past five years has been a rare bright spot in a difficult global downturn.

Still a priority market, but profitability and optimism leveling off
While 96 percent of survey respondents reported that China is among their top five priority markets for their company’s strategic investment planning — the highest response to this question over the past five years — fewer respondents labeled China as their top priority (Fig. 1).

Other data indicate a similar tempering of expectations for the market compared to previous years:

> Just over half of respondents indicated that they will accelerate their resource commitment to China in the next year, reflecting a continued year-on-year decline since 2011 (Fig. 2).

> Fifteen percent of companies reported that they had reduced or stopped planned investments in the past year (Fig. 3). Of those that reduced or stopped their investments, nearly 40 percent cited overall global economic uncertainty as the primary driving factor rather than China concerns. But nearly a quarter cited market access restrictions.

Fig. 2
Resource commitment to China for the next 12 months

<table>
<thead>
<tr>
<th>Year</th>
<th>Will accelerate</th>
<th>Will be curtailed</th>
<th>Will remain unchanged</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>1%</td>
<td>2%</td>
<td>7%</td>
</tr>
<tr>
<td>2012</td>
<td>26%</td>
<td>31%</td>
<td>41%</td>
</tr>
<tr>
<td>2011</td>
<td>73%</td>
<td>67%</td>
<td>52%</td>
</tr>
</tbody>
</table>

Fig. 3
Did your company reduce or stop planned investment in China in the past year?

- Yes 15%
- No 85%

Fig. 1
How prominently does China currently figure in your company’s global strategic investment planning?

<table>
<thead>
<tr>
<th>Year</th>
<th>Top priority</th>
<th>Among top five priorities</th>
<th>One of many non-key priorities</th>
<th>Not a priority</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>23%</td>
<td>22%</td>
<td>23%</td>
<td>15%</td>
</tr>
<tr>
<td>2010</td>
<td>18%</td>
<td>23%</td>
<td>74%</td>
<td>6%</td>
</tr>
<tr>
<td>2011</td>
<td>4%</td>
<td>71%</td>
<td>71%</td>
<td>2%</td>
</tr>
<tr>
<td>2012</td>
<td>5%</td>
<td>72%</td>
<td>4%</td>
<td>1%</td>
</tr>
<tr>
<td>2013</td>
<td>3%</td>
<td>81%</td>
<td>10%</td>
<td>2%</td>
</tr>
</tbody>
</table>
Almost three-quarters reported that their revenue from China businesses increased in 2012, but explosive revenue growth has tapered off. Those reporting sales increases of 20 percent or more dropped from 30 percent in last year’s survey to just 12 percent this year. Moreover, while nearly half of respondents reported double-digit revenue growth, the number of companies seeing sales rise by 10 percent or more declined for the third year in a row (Fig. 4).

Profitability was another area of decline: less than one-third of respondents said their profitability increased from the previous year, while the number that reported decreased profitability doubled from 10 percent to 21 percent (Fig. 6).

Sixty-one percent of respondents report that their China operations have profit margins greater than or equal to their company’s global profit margins, down from 75 percent in the 2012 survey (Fig. 5).
These factors, along with the challenges discussed later in the top 10, are moderating companies’ assessments of the China market. Since 2007, around 90 percent of respondents consistently reported that they were optimistic or somewhat optimistic about China’s prospects for the next five years. While this year’s survey shows a similar but slightly lower response rate in those two categories (88 percent), this year’s results affirmed an important change that emerged in last year’s survey — a shift of nearly 20 percentage points from “optimistic” to “somewhat optimistic” over the past two years (Fig. 7).

Many companies have growing concerns about the business environment in China. As one respondent explained, “It is getting more and more difficult for foreign companies in China, with the cost hikes (both material and HR), with the economic downturn, overcapacity in China, and a gloomy global economy.”

Not all of the top issues reflect policy choices — but many of them do, as this report will describe. The active economic reform debate underway in China provides an opportunity for PRC policymakers to take positive steps to further remove discriminatory barriers and allow American companies to more fully support and participate in China’s economic transformation.

**Restraints on profitability: overlapping challenges to doing business in China**

The moderation of optimism is due to a combination of factors. Most prominently, greater competition, cost increases, and enduring problems with obtaining the variety of licenses necessary to do business in China are hindering investors’ abilities to access and compete fairly in the market. These three issues ranked highest as the primary restraints on increased profitability (Fig. 8).

In addition, signs of protectionism in China negatively impact companies’ views of the market. Respondents most frequently claimed to have experienced protectionism in licensing and regulatory approvals, while also noting discriminatory enforcement and preferential policies favoring domestic Chinese companies in many forms (Fig. 9).

Fundamentally, there continues to be a significant difference in how foreign companies are treated, both formally and informally, versus their domestic Chinese counterparts. As one respondent noted, “As long as the term ‘foreign-invested company’ exists [in Chinese policies and regulations], the competition will not be very fair and the discrimination will exist in some way.” In other words, there is an inherent element of bias in the system.
That bias shows up in numerous ways, many of them overlapping. While each of the top 10 challenges could stand on its own, these issues magnify each other and often make resolution of the problems more complicated:

» Competition with Chinese companies (#2), licensing and approvals (#3), uneven enforcement (#6), inadequate transparency (#8), standards and conformity assessment regimes (#9) and foreign investment restrictions (#10) are all channels through which companies may experience discrimination or unequal treatment (#7).

» While human resources challenges (#3) are a significant contributor to cost increases (#1), cost increases are also driven by other factors that can reflect discriminatory practices, including cumbersome or lengthy licensing processes (#3), uneven enforcement of laws and regulations (#6), and lack of transparency (#8).

» The absence of intellectual property rights (IPR) protection (#5) is often exacerbated by uneven regulatory implementation across jurisdictions (#6) and lack of transparency (#8).

**Lack of movement on top issues a significant concern**

It is also worth noting that most respondents indicated that there had been no improvement on each of their top concerns. Nine of the top 10 member company issues are categorized as “unchanged.” This suggests an additional reason for companies’ tempered optimism: there is a general sense that while the rhetoric of Chinese policymakers regarding improving the investment environment for foreign firms has been positive, in recent years little has been done to address their major concerns.

Ultimately, the solution to these problems will have to include a change of approach by China’s government to foreign investment in its country. Companies incorporated in China should be treated equally, regardless of ownership. Once a foreign company invests and incorporates in the United States, for example, the resulting US entity is treated the same as any other US company under US laws and regulations. This approach is one that China should adopt as well.
What’s not in the top 10
It is useful to keep in mind the issues that did not make the list of top 10 challenges for companies doing business in China. Many of them are topics that frequently receive widespread media attention in the United States.

Cybersecurity moved up significantly in the overall rankings this year to 14th, up from 23rd in 2012. Challenges cited in this area include the impact of Chinese cybersecurity inspections, restrictions on the use of foreign computer security products in China, the risks of potential trade secrets theft, and the impact of political discussions about cybersecurity on the overall US-China bilateral relationship.

The inability of service sector companies to fully access the China market ranked 13th overall, but jumped to the #2 issue when answers were filtered to show responses only from services companies. Other top concerns of services companies mirror those of non-services respondents — licensing barriers, competition with Chinese companies, discriminatory treatment, and human resources.

At the bottom of the list again this year: China’s exchange rate. The impact of the renminbi (RMB) exchange rate on competitiveness and the political aspects of China’s currency value ranked 29th and 30th in this year’s survey — the lowest rankings possible. This strongly indicates that meaningful bilateral engagement to address concerns American companies face when doing business in China should focus on topics other than currency.

Pursuing solutions
USCBC estimates that China was roughly a $300 billion market for American companies in 2012 — and could have been much larger without the market access barriers. China is the third-largest market in the world for US exports. Companies with operations in China sell more than $130 billion in goods and services there. Those operations continue to support jobs for companies here in the United States. And despite China’s lower growth rate, its economy is still growing at more than 7 percent per year, with a middle class set to double to 600 million persons over the next decade. As a consequence, China is — and should continue to be — an increasingly important component of economic growth and jobs in the United States.

Those numbers underscore why reducing market access and other barriers in China is so important. Progress on the issues is often frustratingly slow. Nonetheless, the business community and policymakers must continue to seek practical solutions through expanded engagement.

Both the US and Chinese governments need to be involved in order to fully develop commercial ties, tackle unresolved problems, and bring greater benefit to each country’s economy, companies, employees, farmers, and consumers. This requires high-level engagement from both countries through the current dialogue structure, including the US-China Strategic and Economic Dialogue (S&ED), the US-China Joint Commission on Commerce and Trade (JCCT), and the US-China Investment Forum. Consistent engagement at the presidential level has also been beneficial to the relationship, and perhaps should be formalized into an annual summit.

The business community must play an important role in identifying the policies that are problematic and recommending specific ways to address them. USCBC has recommended steps that China can take to address the kinds of concerns in the top 10, including market access in legal services, improving enforcement of intellectual property rights (IPR), and increasing imports of foreign goods and services into China. In addition, USCBC’s board of directors’ statement of priorities provides additional recommendations on issues of importance to US companies. USCBC will continue to use this solutions-focused approach in its advocacy with both governments.

Beyond the specific problems on which foreign companies seek progress, China’s leaders should be concerned about the downturn in optimism and take steps to address the persistent concerns that recur in the top 10. These issues not only negatively impact companies’ business decisions about China, but they also dampen enthusiasm for supporting Chinese investment in the United States. As Chinese companies seek a greater role in the United States and globally, there should be an increasing appreciation of the need to reduce barriers. This year’s survey results and weakening foreign investment into China over the past two years should provide sufficient data to serve as a catalyst for new policy breakthroughs in China.

Rising costs have been a concern in China for many years, but this year’s survey suggests that the increases may have outpaced company expectations of tolerable expense increases. This is the first time rising costs have ranked number one in USCBC’s survey and it is the only issue characterized as having “deteriorated” over the last year.

As one company put it, “Costs, particularly in major metropolitan areas, are moving to a point that China is no longer world-competitive.”

The vast majority of respondents have expressed concern about rising costs since the question was first asked in 2007. Only in 2009 as the global recession was at its height and wage pressures eased did that number dip below 80 percent (Fig. 10).

Human resources costs have consistently been the specific cost of most concern, reaching 92 percent in this year’s survey; a further discussion of those issues can be found under human resources (#3). Concerns about materials and land costs also increased this year; concerns in all other areas decreased (Fig. 11).
As has been the case in past USCBC surveys, most companies report that they have a variety of competitors in China, including Chinese state-owned enterprises (75 percent), Chinese non-state-owned and private companies (86 percent), and US and other foreign companies (89 percent) (Fig. 12).

The soft global economy and slowing growth in China’s domestic economy has only served to make the competitive environment in China more intense. As one respondent said, “Local competition is gaining strength in the slower economy.” Chinese companies are certainly improving their product and service offerings as they gain more experience. However, a slower-growth economy with a more competitive landscape also shines a spotlight on practices that may place foreign companies at a disadvantage when compared with their domestic counterparts, such as opaque licensing procedures, discriminatory treatment, and restrictions on foreign investment.

As noted in last year’s survey supplement, most respondents feel that China’s SOEs receive benefits or other favorable treatment not available to foreign-invested companies. Only about one-third have concrete knowledge that such benefits are provided to SOE competitors, while nearly two-thirds suspect such benefits are provided—underscoring the transparency problem (Fig. 13).

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**Challenge #2**

**Competition with Chinese Companies in China**

**Progress on Issue in Past Year: Unchanged**

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<th>Year</th>
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<tr>
<td>2012</td>
<td>3</td>
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<td>2006</td>
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**Fig. 12**

Who are your competitors in China?

- Chinese state-owned enterprises (SOEs)
- Chinese non-state-owned & private companies
- US and other foreign companies

Multiple responses allowed.

**Fig. 13**

Are SOE competitors receiving tangible benefits?

- Yes, have concrete knowledge: 34%
- Suspect but not certain: 64%
- No: 2%
Also like last year, it is important to note that respondents believe their non-SOE competitors receive such benefits. Almost three-quarters of respondents reported that they know or suspect that their private Chinese competitors also receive benefits or subsidies that foreign firms are not able to receive (Fig. 14).

In short, the discriminatory treatment problem is not just an SOE problem. It is a problem of Chinese companies versus foreign and foreign-invested companies.

Over the past three years, survey respondents have consistently named preferential government financing and preferential licensing and approvals as the areas in which they are seeing Chinese companies—state-owned and private—receive benefits their companies cannot. In addition to preferential access to government contracts, also consistently cited by survey respondents, this year companies indicated that their Chinese competitors received tax benefits that they cannot (Fig. 15).

Possible solutions
Addressing concerns about an unlevel competitive playing field provides a good example of the vital importance of solutions that focus on the right problems. Focusing simply on state ownership misses the similar benefits that many non-SOE companies also receive.

Instead, comprehensively engaging the Chinese government on competition policy—regardless of SOE or non-SOE ownership—indispensable regulators, and improved corporate governance may be a more productive approach to level the playing field for American companies.
Administrative licensing—which refers to the array of licenses and government approvals required to do business in China—has been at or near the top of USCBC’s survey results for eight years, and it remains one of the most complex challenges to address.

Almost 70 percent of respondents in this year’s survey indicated they had experienced challenges with licensing in China. The most frequent problems came in getting approval for products to be sold in the market, expanding operations, and securing approvals of foreign investments more generally (Fig. 16, 17).

These problems are occurring not only at the central government level, but also at the provincial and municipal levels (Fig. 18).
Further complicating the possible solutions to these challenges, over half of respondents report that their domestic competitors are not facing the same licensing problems (Fig. 19). Of those respondents whose Chinese counterparts have an easier experience obtaining licenses, the vast majority report that the differential treatment is not based on laws or regulations that discriminate against foreign companies (Fig. 20). Instead, the differential treatment may be a combination of local companies having better access to information about the licensing and approval process and, as is often the case at the local level, regulator preference for domestic (and often local) companies. Indeed, administrative licensing was the most cited area in which respondents saw signs of protectionism.

China’s central government has begun an initiative to reduce the number of approvals necessary to do business in China. USCBC analysis of the changes through fall 2013 indicated that China’s central government did not make significant improvements in administrative licensing issues for foreign companies, but the initiative may signal a shift from central to local oversight and administration in areas related to manufacturing and transportation. It is an issue that should be monitored closely, particularly to determine if subsequent changes address the concerns of foreign companies.

**Possible solutions**

Recommendations discussed in detail in USCBC’s 2013 Board Priorities Statement to help address these issues include:

- Ensuring equal treatment in licensing for all companies regardless of ownership;
- Strengthening implementation of the Administrative Licensing Law; and
- Further improving rule-making transparency.

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Demand for qualified workers continues to outstrip availability, resulting in significant competition among companies—Chinese and foreign—for employees.

One way in which companies have usually sought to retain employees is by increasing wages and salaries. Survey data shows that companies appear to be adjusting their human resource strategies, however. In 2012, almost 30 percent of companies reported that they had increased wages between 10 to 15 percent in the past year. This year, only 18 percent of companies reported wage increases of 10 to 15 percent (Fig. 21). Respondents indicated the fastest increases in wages are for middle management and highly skilled technical workers, consistent with reporting in the 2012 survey (Fig. 22).
About 70 percent of companies anticipated increasing wages by 5 to 10 percent in 2014, and 19 percent predicted increases of less than 5 percent. Those numbers are up from last year, when nearly 60 percent planned increases of 5 to 10 percent and 14 percent expected to increase wages by less than 5 percent (Fig. 23).

Despite these still significant year-on-year wage increases, most companies report that they plan to expand head count for their China operations in 2014 and that hiring more staff is the top vehicle through which the company plans to expand their resource commitment in China. Only 8 percent of companies predict that they will reduce their number of employees in China next year (Fig. 24).
While the protection of intellectual property rights (IPR) has shown modest improvements in recent years, the vast majority of companies—98 percent—still say IPR enforcement is a concern for them. A shifting IPR landscape and continued issues with enforcement have led a majority of respondents to state that IPR protection has gone “unchanged” from a year ago (Fig. 25). Similar to last year’s survey, 41 percent said the IPR environment had “somewhat improved,” while only 4 percent cited deterioration.

The inadequate protection of IPR continues to have a tangible impact on companies’ willingness to expose technology in China through manufacturing, licensing, and research and development (R&D) activity. Only 22 percent of companies report that China’s IPR environment has no impact on their business operations there (Fig. 26).

### Challenge #5

**IPR Enforcement**

**Progress on Issue in Past Year: Unchanged**

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<td>Rank in 2007:</td>
<td>3</td>
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<td>Rank in 2006:</td>
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</table>

Over the past year, China’s protection of IP has...

| Greatly deteriorated | 0% |
| Somewhat deteriorated | 4% |
| Remained unchanged | 54% |
| Greatly improved | 1% |

**Impact of level of IPR enforcement on activities undertaken in China**

| Limits products sold in China | 24% |
| Limits products manufactured in China | 49% |
| Limits products co-manufactured or licensed in China | 41% |
| Limits R&D activities in China | 44% |
| No impact | 22% |

Multiple responses allowed.
For the second year, protecting trade secrets remained the top priority for companies, with a record high number of respondents—40 percent—citing trade secrets as the IP of greatest concern. Ensuring appropriate enforcement of trade secret rights is highly complex, however, and requires numerous protections and enforcement mechanisms that China’s legal system may still be in the process of fully developing. For example, over a third of respondents noted the difficulties in enforcing non-compete agreements, which are a primary tool companies use to protect their trade secrets. Over a quarter of respondents said that the legal framework remained insufficient to fully prosecute a trade secrets case (Fig. 27).

One company put these results in context, however, stating, “It is impossible to pick one [top concern with trade secrets]. They are all very significant concerns. There is an overall lack of acknowledgement of the value of trade secrets. The penalties associated with violations are minor slaps of the hand. If the entity that misappropriated the trade secret is a government entity or well-connected private entity, you have no chance at even minimal redress. With respect to cases specifically, the lack of discovery and the strict requirement that all evidence be notarized makes it very difficult to even bring a case.”

For IP enforcement more broadly, China’s courts continue to gain momentum as a viable channel for addressing problems, though not in all cases. More companies reported they have brought court cases in China, with increasingly successful outcomes: just over 20 percent of companies reported that they had brought a case with a successful outcome (Fig. 28). This figure is higher for the third year in a row, suggesting that in some jurisdictions, China’s court system is improving in its protection of IPR, albeit slowly.

**Possible solutions**

While there is no single fix to these problems, at a minimum China should adopt a tougher deterrent to IP theft, that is, the international standard of allowing criminal penalties (not just civil) in cases of IP theft on a commercial scale. Not only is this the global best practice, but it will also help Chinese companies protect IP as they expand into higher-value services and products. In addition, China should continue its work in this area by improving the protection of trade secrets, restricting the use of compulsory licenses, and removing market access barriers to products such as imported films so that the absence of legitimate products does not incentivize the production and sale of counterfeits.6

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Challenges #6 and #7 are closely related and deal with how foreign and foreign-invested companies are treated in China versus their domestic competitors. In essence, respondents have indicated that rules and regulations are not applied consistently or equitably in China, and that their companies often are not treated the same as Chinese companies with regard to regulation and implementation. In some cases, such uneven enforcement may be due to protectionism, but in others, it may spring from a lack of communication and coordination between government agencies in different regions or at different levels.

For example, foreign law firms operating in China pay higher taxes than their Chinese law firm competition and they are not able to join their clients in meetings with Chinese government officials although lawyers from Chinese firms can. Moreover, Chinese lawyers who come to work for a foreign firm must give up their domestic law licenses to do so. More details on these issues can be found in USCBC’s report on legal services.

In the retail sector, foreign companies seeking to expand in China encounter zoning and site-selection processes that are more cumbersome and time consuming than the processes their domestic competitors face, thus raising costs for the foreign retailer, delaying time to market, and putting the foreign retailer at a competitive disadvantage.

As noted in the introduction to this report, companies report seeing signs of protectionism in a variety of areas, including licensing and regulatory approvals; tighter enforcement of rules against foreign companies; government pressure to buy goods and services from Chinese companies; and direct benefits such as direct subsidies, preferential financing and better ability to sell products to the government (Fig. 29).

Possible solutions
There are many changes Chinese regulators can make to solve the problems created by uneven enforcement and unequal treatment. In its 2013 Statement of Priorities, USCBC’s Board of Directors recommends two important actions: ensuring equal treatment in licensing for all companies operating in China regardless of ownership, just as the United States does, and ensuring equal treatment in government procurement for all legal entities in China, regardless of ownership. An added benefit to China: addressing disparities in licensing and government procurement practices will go a long way toward restoring optimism in China’s market for the future, and creating goodwill for Chinese companies looking to expand abroad.

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Fig. 29  Signs of protectionism in China

Multiple responses allowed.
Challenge #8
Transparency

Progress on Issue in Past Year: Unchanged
Rank in 2012: .......................... 11
Rank in 2011: .......................... 9
Rank in 2010: .......................... 7
Rank in 2009: .......................... 8
Rank in 2008: .......................... 4
Rank in 2007: .......................... 5
Rank in 2006: .......................... 5

Transparency is a broad subject that ranges from the public release of draft laws and regulations for comment to fair and open government decision making. As such, it is a core element of a well-functioning licensing regime in that greater transparency increases understanding about the licensing process, reduces the potential for bureaucratic mismanagement and corruption, and speeds time to market for products and services. As one company noted, “With respect to licensing, i.e., permitting for site approvals, we have experienced constantly changing requirements, rules, and regulations that are subject to local and/or many times ‘personal’ interpretation. This dynamic results in loss of crucial time, increases costs, and [losses] of proprietary trade secret information.”

China’s central government has made inconsistent improvements in rule-making transparency over the past several years. USCBC’s report on China’s transparency efforts goes into further details about the transparency records of the key ministries and agencies in China affecting business operations. Among those findings:

» The National People’s Congress, the State Council, and other selected government agencies have varying levels of compliance with these transparency commitments, and all agencies need considerable improvement.

» The NPC continues to have a mixed record of posting draft laws and keeping them open for comment for a full 30-day period. Only 40 percent of laws passed over a recent eight-month period had been published to the NPC website for comment at some point during their drafting process.

» The State Council posted less than 15 percent of its own administrative regulations and departmental rules for public comment through the State Council Legislative Affairs Office (SCLAO).

» Other government agencies did no better. The National Development and Reform Commission (NDRC), Ministry of Commerce (MOFCOM), Ministry of Finance (MOF), Ministry of Industry and Information Technology (MIIT), General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), State Administration of Industry and Commerce (SAIC), and Ministry of Human Resources and Social Security (MOHRSS) all posted only a small fraction of relevant documents for comment on either the SCLAO or their respective agency websites. These agencies posted less than 10 percent of regulations to the SCLAO site and less than 17 percent of additional regulations to their agency sites.

» Among the small percentage of regulations that are being posted for public comment in line with the State Council’s commitments, however, the majority are being posted for at least the full 30-day period. The average comment period for administrative regulations and departmental rules posted for public comment on either the SCLAO or agency websites exceeded 25 days.

Possible solutions
China should fully implement its commitment to publish all draft trade and economic-related laws, administrative regulations, and departmental rules for a full 30-day period, but it should also consider going further by posting draft regulations on a designated website for a 60- or 90-day public comment period. In addition, China’s central government should ensure that laws and regulations, once finalized, are consistently interpreted and implemented nationwide.

Challenge #9: Standards and Conformity Assessment

China’s standards and conformity assessment regime raises concerns for companies in a variety of sectors—as they set the ground-rules that dictate if and how companies and products can enter new markets. This year’s survey shows that companies remain concerned with a number of long-standing issues, such as China’s use of unique standards for goods and services sold in its market and the inability of conformity assessment service providers to test goods for China’s market. Both challenges significantly raise costs for American companies trying to sell to China while also limiting the access that Chinese consumers have to the fullest possible range of the latest products and services. This year’s survey also sheds light on an aspect of standards and conformity regimes that sometimes gets lost in consideration of such a technical issue: the negative impact on companies’ abilities to get products certified and approved for sale in China. As noted in challenge #3, administrative licensing, over half of respondents that reported problems in licensing said they were related to the standards and conformity assessment system, be it China Compulsory Certification (CCC) approvals, import licenses, or others.

Possible solutions

As noted in the 2013 USCBC Board Statement of Priorities, China should use global standards as the basis for Chinese standards wherever practical and adopt a fairer, more equal, and transparent market-led approach to standards setting and development. The system should be open to all companies regardless of nationality, including domestic, foreign-invested, and foreign-based manufacturers.

Other ways that China could address concerns in this area are discussed in USCBC’s 2011 report, “Recommended Changes to the Development and Implementation of China’s Standards and Conformity Assessment Policies and Processes.”

Progress on Issue in Past Year: Unchanged
Rank in 2012: 10
Rank in 2011: 6
Rank in 2010: 10
Rank in 2009: 6
Rank in 2008: 14
Rank in 2007: 6
Rank in 2006: 6

Challenge #10: Foreign Investment Restrictions

China’s Catalogue Guiding Foreign Investment maintains foreign ownership restrictions in nearly 100 manufacturing and services sector categories in China. Additional restrictions on foreign investment appear in other policies and regulations. Key sectors for reduced foreign ownership restrictions include financial services, agriculture, cloud computing, data centers, health insurance, hospitals, refining, petrochemicals, audiovisual, and other media industries. Discriminatory restrictions on foreign investment have spillover consequences that negatively affect core Chinese government goals, such as creating a more innovative society or developing the services sector. Limiting competition and excluding internationally innovative companies hurt China’s ability to compete in these sectors.

Possible solutions

Another important component of investment liberalization would be for the United States and China to negotiate and finalize a meaningful bilateral investment treaty (BIT). A BIT provides one of the best opportunities to reduce investment barriers in both countries and improve protections for US and Chinese investors in each others’ markets. The most important elements of a strong BIT are national treatment provisions that apply to both new and existing investments (“pre-establishment”), and an approach that covers all investments except those specifically excluded in the agreement (“negative list”). The United States and China announced in 2013 they will use this approach. Both the Chinese and US governments should seek to conclude a BIT incorporating these elements as quickly as possible.

Progress on Issue in Past Year: Unchanged
Rank in 2012: 7
Rank in 2011: 7
Rank in 2010: 14
Rank in 2009: Not asked
Rank in 2008: Not asked
Rank in 2007: Not asked
Rank in 2006: Not asked

Strategic Emerging Industries

In 2010, China’s central government announced plans to promote the development of seven strategic emerging industries (SEIs): energy efficient and environmental technologies; next-generation information technology (IT); biotechnology; high-end equipment manufacturing; new energy; new materials; and new-energy vehicles.

As noted in USCBC’s report on SEIs, the most immediate impact of the central government’s announcement was to signal to Chinese government agencies at all levels that future government policies on issues such as taxation, human resources, and R&D must support SEI development. Implementation of those policies is occurring at the provincial and local levels, but foreign companies’ ability to get information on the programs and to participate remains uneven, a problem resulting from China’s transparency issues. USCBC’s report on SEI policies goes into greater detail about those specific challenges.

Most companies report that they have had some difficulty obtaining information about the specific industries being promoted and types of incentives offered, as well as having mixed experiences in turning information leads into business development opportunities. Only a third indicated that they have had good access to this type of information (Fig. 30).

As one company explained, “The information published is limited, the incentives offered are not known to the public, the process of application is unclear, and all provinces have their own regulations.”

The lack of published materials can be particularly problematic in the case of government-supported pilot projects in encouraged industries. Foreign companies often do not have any knowledge of these projects before they have been launched and the suppliers decided. This not only eliminates foreign companies’ abilities to compete in critical projects in innovative industries important to China, but it also appears to act as a marketing tool for domestic companies, a further advantage to building a customer base in nascent industries.

While foreign companies are closely watching SEI programs and policies, it is also unclear whether foreign companies are interested because they want to participate in SEI programs or because they are concerned about the advantages that SEI programs may provide to domestic competition. While 45 percent of respondents indicated their companies are very interested, just over half said participation is not a top company priority, with interest determined by whether SEIs sectors align with overall company priorities (Fig. 31). Most companies report they have not yet applied for an SEI incentive or project (Fig. 32).

Interestingly, the types of SEI benefits that are of most interest to companies are among those that would address some of the challenges they report seeing in China’s market overall: preferences in licensing and approvals, government subsidies, and procurement preferences (Fig. 33).

USCBC’s SEI report includes detailed recommendations on changes that China should implement in these programs to ensure equal treatment of foreign and domestic companies, including steps to address transparency, IP protections, and procurement concerns.

**Technology transfer**

Seventy percent of respondents report that they are concerned about transferring technology to China, generally because of concerns about IP protection and enforcing licensing agreements (Fig. 34).
The issue that gets the most attention in the United States—the active role of government in “forcing” technology transfer—was cited by only 28 percent of respondents (Fig. 35).

Of companies that have received requests for technology transfers, just over half said the request came from a company as part of a commercial negotiation and 48 percent reported that the request came from a central government entity (Fig. 36). Under those requests, most said that the technology would have been controlled by their company and a Chinese entity, though about a third said their own company would retain control. No respondents indicated they would fully give up control of the technology (Fig. 37).
Responses to these transfer requests varied. Equal numbers found the requests acceptable and proceeded as found the requests unacceptable and halted the proposed transactions. About 20 percent were able to simply avoid requests that they found unacceptable and a quarter of companies were able to mitigate the request and transfer only some technology, suggesting for both groups that commercial negotiation strategy was at the core of the original request. However, about 20 percent had to comply with the transfer requests in order to access the market despite their concerns (Fig. 38). Sectors in which this occurred included power generation, medical devices, and automotive, among others.

Of companies that transferred technology because of one of these requests, 60 percent reported that they were able to negotiate commercially acceptable payments for the technology. The remaining 40 percent received some payments, but below the amount that they considered acceptable. This was particularly true for companies that were required to transfer the technology in order to gain market access. No companies reported that they had to transfer technology at no cost (Fig. 39).
US- and China-based executives
USCBC’s survey incorporates a unique mix of US- and China-based executives. Just over half the respondents were based in China with an on-the-ground perspective, and 45 percent were based in the United States and view the China environment with a global perspective. The remainder were located elsewhere in Asia (Fig. 40).

In addition, respondents range from CEOs of global corporations to executives based in the field. Survey results incorporate both strategic and tactical perspectives.

Cross-sector representation
USCBC members who completed this year’s survey represented a cross-section of US companies doing business in China. Sixty-four percent of respondents represented manufacturing companies, and 40 percent represented service providers—and many respondents’ companies are active in both sectors. Nineteen percent worked for companies in primary industries, such as agriculture and oil and gas (Fig. 41).
Long experience in the China market
USCBC member companies have a long history of doing business in China: 57 percent of respondents’ companies have been in China for more than 20 years, and 29 percent have been in China for 11–20 years (Fig. 42).

In China to access Chinese customers
The overwhelming majority of USCBC member companies report that they are doing business in China to access China’s domestic market. Twenty-one percent use China as an export platform to reach other markets around the world, though only 8 percent use their China operations to produce products that are shipped back to the United States (Fig. 43).
USCBC Intellectual Property Rights Review and Recommendations
May 2013

Executive Summary

- China has made considerable progress in recent years in its efforts to boost innovation and intellectual property (IP), with an improved legal and regulatory framework, stronger efforts to enforce intellectual property rights (IPR), an expanding body of registered IP, and the growth of corporate research and development (R&D) activities.
- While domestic and foreign stakeholders recognize the value of these achievements, both remain concerned about their ability to protect their IPR. Many companies view IPR protection as an important priority for their operations in China.
- Stronger IPR enforcement could have a significant positive impact on the Chinese economy, and would boost domestic industry development, spur innovation, strengthen Chinese companies, and promote the interests of Chinese consumers.
- Based on regular communication with its members, the US-China Business Council (USCBC) has compiled a list of priority areas and suggestions to further strengthen Chinese government efforts to improve IPR protection.
- USCBC’s top concern remains that penalties imposed during IPR enforcement proceedings do not provide a sufficient deterrent to IPR infringement, and that existing value-based criminal thresholds effectively limit the number of criminal cases.
- Other priorities include further expanding the work of the State Council Leading Group on Combating IPR Infringement and Sales of Counterfeit Goods, increasing enforcement resources, ensuring equal treatment for foreign and domestic firms, addressing uneven enforcement of IPR, increasing enforcement of Internet-related IPR, and boosting trade secret protection.

Introduction

China has made considerable progress in recent years in its efforts to boost innovation and intellectual property (IP), with an improved legal and regulatory framework, stronger efforts to enforce intellectual property rights (IPR), an expanding body of registered IP, and the growth of corporate research and development (R&D) activities. The US-China Business Council (USCBC) and its members recognize these achievements as important steps towards China’s goal of building a robust environment for creating and protecting intellectual property in China. Such efforts are also directly in line with important Chinese framework documents like the 12th Five-Year Plan (2011-15) and the National IPR Strategy.
China Has Made Incremental Progress in Legal, Enforcement Environments

Chinese government agencies have made improvements to China’s legal and regulatory framework for IPR protection. For example, the Chinese government in recent years has actively sought to revise many of its core IP laws—including the Patent, Trademark, and Copyright Laws—to reflect emerging IP issues and evolving regulatory practices, and has drafted many other regulations, notices, and judicial interpretations that provide important clarification for regulators and industry representatives. These revisions have provided important opportunities for recommendations and feedback that improve the system of laws and regulations that govern IPR.

USCBC and its member companies also appreciate the Chinese government’s efforts to improve IPR enforcement. More than half (51 percent) of member companies surveyed in 2012 noted some progress on IP protection in the previous year (see Chart 1). China’s 2010-2011 IPR enforcement campaign provided a notable example of this progress, in which greater attention to intellectual property at all levels of government delivered measurable results for many companies. USCBC applauds the Chinese government’s efforts to institutionalize enforcement by creating the State Council Leading Group on Combating IPR Infringement and Sales of Counterfeit Goods to continue this work.

Chart 1: Over the past year, China’s protection of IPR has...

These efforts have yielded some positive results. For example, China’s invention patent filings have skyrocketed. In 2011, China’s State Intellectual Property Office (SIPO) received more than 526,000 invention patent applications and—for the first time—surpassed the United States as the world’s largest filing destination. The number of invention patents filed in China has only grown since then. Official Chinese statistics in January 2013 predicted that overall 2012 spending on R&D would exceed RMB 1 trillion ($160.8 billion), and Chinese companies increasingly rank among global leaders in important IP-intensive sectors.

IPR Protection Remains a Priority for Chinese, Foreign Companies

Despite such progress, enterprises – both Chinese and foreign – remain concerned about their ability to protect IP. Chinese companies are now more active than ever before in applying for patents at home and abroad, developing and commercializing new technologies, innovating new branded products, and developing movies and cultural products – all of which require IP that must be
protected. A 2013 survey of more than 1,100 Chinese and foreign businesses conducted by the China Europe International Business School showed that 64 percent of Chinese businesses believed that IP is “important” or “very important” to their business. In addition, IPR protection has ranked among the top 10 challenges facing USCBC members each year since 2003—ranking fifth in 2012. In that same survey, 95 percent of companies said they were either “very concerned” or “somewhat concerned” about intellectual property rights protection (see Chart 2).

**Strengthening IPR Protection Would Greatly Benefit the Chinese Economy**

Stronger IPR enforcement will benefit domestic industry development, support Chinese companies, and promote the interests of Chinese consumers. Ongoing IPR infringement harms both Chinese and foreign companies in a number of important ways. First, it limits their growth and development by limiting the economic benefits they derive from their present products and technologies. Both Chinese and foreign companies are negatively impacted by IPR infringement: well-known domestic companies such as ZTE, Moutai, Sany, and Baidu, as well as influential Chinese authors and sports figures, have all been involved in high-profile IPR infringement cases over the last year.
Ongoing infringement creates disincentives for companies to develop and commercialize further technology in China, thus hindering the Chinese government’s stated goal of promoting innovation. For example, IPR infringement narrows the types of products and technologies that US companies are willing and able to research, manufacture, and sell in the China market. In USCBC’s 2012 member company survey, for example, at least one-third of companies surveyed indicated that China’s level of IPR enforcement limits the types of products they are willing to co-manufacture or license in China (40 percent), the R&D that they conduct (40 percent), and the types of products they manufacture (36 percent) (see Chart 3). Such concerns about the level of IPR infringement lead foreign companies to avoid bringing many high-technology products and technologies to China.

These factors limit the products and technologies that Chinese consumers and businesses can access. This ultimately slows the development of many technology-driven industries, slowing economic growth and job creation in key sectors. These policies thus work counter to government goals for integrating advanced technology and improving innovation, and to government efforts to promote technology-incentive sectors such as China’s strategic and emerging industries.

Further steps to improve China’s intellectual property environment would promote the growth and success of enterprises in China and around the world. USCBC research illustrates the need to address IPR infringement and the value of continued reforms at both the national and local levels to tackle and prevent IPR infringement. While some of the reforms that would address these challenges are specific to one set of problems or one type of intellectual property, other recommendations cut across specific types of IP to address broader structural issues that limit the development of China’s IPR environment.

**USCBC IPR Recommendations**
USCBC is pleased to present suggestions designed to further strengthen Chinese government efforts to improve IPR protection. These recommendations are based on detailed USCBC conversations with member companies about their experience protecting IPR in China. We hope that this document is useful for both US and PRC stakeholders in discussions on IPR and related issues.

Although USCBC and its member companies have an interest in all types of IP protection, our members’ priority concerns are focused in a few specific areas, such as penalties and damages for IPR infringement and enforcement efforts of the State Council Leading Group on Combating IPR Infringement and Sales of Counterfeit Goods.

**Addressing Penalties and Damages for IPR Infringement**
Our member companies’ top concern remains that penalties imposed during IPR enforcement proceedings do not provide a sufficient disincentive to IPR infringement. Specifically, administrative penalties levied against infringers are often too low to deter infringement and are sometimes viewed by the infringer as the cost of doing business. Moreover, existing value-based thresholds to determine potential criminal penalties are too high and effectively limit the number of criminal cases that appear each year by eliminating the option of criminal penalties for many cases.

USCBC and its members applaud statements by senior Chinese leaders at the 2012 US-China Strategic and Economic Dialogue confirming that they are studying criminal liability for IPR infringement as a positive step. We encourage relevant Chinese government agencies to accelerate this process and to engage US companies along with other stakeholders as they consider potential revisions to the PRC Criminal Law and other laws and regulations.
To improve China’s system to deter IPR infringement, USCBC recommends that relevant Chinese government agencies:

- Eliminate value-based thresholds laid out in the Supreme People’s Court 2004 judicial interpretation that counterfeit goods must meet to qualify for criminal prosecution, replacing them with a system that applies criminal penalties for commercial-scale infringement in line with World Trade Organization (WTO) practices.
- Increase the effective level of penalties for IPR infringement—both judicial damages and administrative penalties for trademark and copyright infringement—by instituting statutory minimums and raising or eliminating the statutory maximums on fines and damages. In addition, encourage local regulators and judicial officials to levy fines that will serve as more effective deterrents and reward those who do so.
- Revise existing standards for calculating the value of infringing goods so that penalties are based on the market value of the infringed goods (i.e. what the original goods would sell for in the same marketplace), not the market value of the infringing goods (i.e. what the counterfeit goods would sell for in the marketplace).

**Expanding the Scope and Efforts of the State Council’s IPR-Focused Leading Group**

USCBC and its members appreciate the establishment and ongoing work of the State Council Leading Group on Combating IPR Infringement and Sales of Counterfeit Goods and view it as a positive sign of the Chinese government’s commitment to progress on these issues. To further strengthen and expand its efforts to coordinate a robust government effort to protect IPR, USCBC suggests that the Leading Group:

- Actively and visibly coordinate the IP-related efforts of various government agencies through regular releases of work plans, public meetings, and other means.
- Expand its efforts beyond counterfeiting to more actively address protection of other types of IPR, including patents, copyrights, and trade secrets, and to address emerging IPR issues such as compulsory licensing.
- Foster frequent collaboration between the Leading Group, its supporting office housed in the Ministry of Commerce, and US government and industry stakeholders to discuss progress on IP enforcement and emerging IP-related issues, such as hosting quarterly or biannual meetings with groups of stakeholders and open communication channels for smaller group meetings.

**Other Priority Issues**

USCBC suggests that Chinese government agencies may consider other important topics, such as:

**Cross-Cutting Areas**

- **Enforcement resources:** Equip regulators, enforcement agencies, and courts at all levels to enforce IPR by significantly increasing resources (both funding and personnel) for local administrative agencies that investigate IPR infringement, particularly of trademarks and copyrights; establishing benchmarks for IP protection in regular performance evaluations of relevant government officials; and conducting regular, targeted professional training for IPR personnel at all levels of government.
- **Equal treatment for foreign and domestic firms:** Promote a fair and open landscape for innovation and IPR by setting and implementing regulations and policies in IPR-related areas (such as standards, taxation, R&D, and government procurement) that treat foreign-invested enterprises (FIEs) equally with their domestic private and state-owned enterprises, to ensure that all IPR holders—foreign and domestic—receive equal legal protection for their IPR.
- **Uneven enforcement**: Encourage consistent IPR enforcement across regions and jurisdictions by providing clearer guidance to local government agencies and fostering increased communication between central and local government agencies, including information sharing and dialogue between provincial and local IPR regulators to share experiences and best practices.

- **Transparency in drafting laws and regulations**: Actively engage with foreign and domestic stakeholders in revising IP-related laws and regulations, including both core IP laws such as the Patent, Trademark, and Copyright Laws and regulations such as the Measures for the Compulsory Licensing of Patents and the Provisional Administrative Measures for National Standards Involving Patents. Release such laws and regulations for multiple rounds of public comment for at least 30 days, if not 60 or 90 days. Such transparency will promote better, more widely accepted regulatory outcomes.

**Specific Areas of IPR Protection**

- **Internet-based IPR infringement**: Increase enforcement of Internet-related IPR by drafting new regulations relevant to Internet-related trademarks and copyrights to cover issues such as use of trademarks on websites, trademark-related aspects of domain name registration, and use of websites as platforms for counterfeit and pirated products. In addition, boost resources and attention to monitoring and investigating Internet sales and distribution of infringing products.

- **Trade secret protection**: Expand government efforts to address trade secrets concerns, including expanding efforts by the State Council Leading Group on Combating IPR Infringement and Sales of Counterfeit Goods to enforce trade secrets in China, strengthening regulatory protections by drafting a unified Trade Secrets Law, and broadening judicial protections by addressing evidentiary concerns related to potential trade secrets cases.

- **Inventor remuneration**: Further revise the draft Regulations on Service Inventions in close consultation with all stakeholders, including foreign businesses, to ensure that efforts to boost innovation do not create significant administrative burdens for companies with active patent portfolios or drive up compensation costs above international norms.

- **Regulatory data protection**: Draft and enforce measures that require government officials to keep confidential all technology and IPR gathered during regulatory reviews and product approvals, with concrete penalties when such penalties for those who violate the measures. Relevant types of IPR include trade secrets, formulas, test data, and product information.

- **Software legalization**: Promote the use of legal software, as agreed by China and the United States in multiple high-level dialogues, through fully implementing existing policies and regulations focused on boosting use of legal software, increasing funding to government agencies to purchase legal software, auditing use of legal software by government agencies, publishing the results of those audits broadly, and actively promoting the use of legal, licensed software in state-owned enterprises and private companies via various means, including software asset management programs.

- **Counterfeiting tools**: Revise existing laws and regulations, such as the Criminal and Trademark Laws, to mandate that infringing goods — and the equipment used to produce them — be destroyed upon seizure and not be permitted to re-enter the marketplace under any circumstances.

- **Copyright barriers**: Remove market access and distribution barriers for legitimate copyrighted products, such as imported feature films and television programs, to better meet domestic demand with legitimate products as opposed to pirated ones.

USCBC is happy to engage further with government officials and other stakeholders to provide more detailed suggestions on specific IPR areas, including IPR infringement, trademarks, trade secrets, and judicial enforcement.
Recommendations for Strengthening Trade Secret Protection in China
September 2013

Executive Summary

- Trade secrets have increasingly become a critical component of companies’ intellectual property (IP) portfolios in China alongside more visible forms of intellectual property, such as patents and trademarks. According to respondents of the US-China Business Council (USCBC) 2013 member company survey, 40 percent of respondents selected trade secrets as the IP of most concern.
- In response to such views, Chinese government agencies have paid greater attention to trade secrets, gradually prioritizing trade secrets on the domestic IP agenda and increasing engagement with their international counterparts.
- But insufficient trade secret protection hampers the growth and development of companies, products, and technologies that use such trade secrets.
- Further progress can be made to increase the recognition by Chinese government agencies, companies, and citizens that trade secrets hold the same property rights as other forms of IP.
- Additional steps to improve China’s legal environment for, and protection of, trade secrets would promote the growth and success of enterprises in China and around the world.
- Based on ongoing conversations with members, USCBC has compiled a detailed summary of the trade secret-related challenges that companies face as well as constructive recommendations to improve trade secret protection.
- Some of the challenges that companies face in trade secrets parallel challenges that they face in other areas of IP, such as value thresholds that can inhibit companies from using criminal channels to pursue trade secret enforcement and low administrative fines and court damages that encourage IP-infringing behavior by companies and individuals.
- In this paper, USCBC focuses on six trade secret challenges with concrete recommendations to address each of the following areas of concern:
  - A fragmented legal framework;
  - Questions about trade secret disclosure during government licensing and regulatory processes;
  - Limited government and judicial experience;
  - The high evidentiary burden faced by plaintiffs in court cases;
  - Limited use of relevant and potentially useful judicial procedures; and
  - Insufficient information about relevant judicial procedures and practices.

Trade secrets—confidential technical or business information that is not known to the public and has economic benefits for the rights-holder—are an important piece of a company’s overall portfolio of proprietary technology and information. Strong recognition and protection of trade secrets can significantly benefit the development of both domestic and foreign companies operating in China.

Recognizing the value of stronger trade secret protection, the Chinese government has recently paid greater attention to trade secrets and increased their engagement with their international counterparts. The 2013 priorities for the high-level State Council Leading Group on Combating Intellectual Property Rights (IPR)
Infringement and Sales of Counterfeit Goods (IPR leading group), released in May 2013, specifically includes the need to strengthen trade secret enforcement. In May 2012, a group of leading Chinese judges—including current Supreme People’s Court IPR Tribunal Chief Judge Kong Xiangjun—published a book that discusses China’s efforts to promote judicial protection of trade secrets and Chinese views of the most significant challenges the country faces in boosting trade secret protection. The US-China Business Council (USCBC) recognizes and appreciates these important developments.

Such government actions reflect a growing understanding within the Chinese government about the negative consequences of insufficient trade secrets protection. If a company is unable to protect its trade secrets and thus cannot economically benefit from products and technologies that depend on them, it weakens the company’s incentive to develop and use new technologies in China. A lack of trade secret protection can also lead the company to withhold its latest, most advanced technologies from China. Both factors can severely limit the products and technologies available to Chinese consumers and businesses, thus hampering China’s innovation development.

In today’s increasingly competitive commercial landscape, companies are paying greater attention to trade secret protection. Trade secrets became the IP of greatest concern for the first time in the USCBC 2012 member company survey, and have only become more of a concern since then. According to respondents to the 2013 member company survey, 40 percent of respondents selected trade secrets as the intellectual property of most concern. Trade secrets ranked ahead of trademarks (27 percent), patents (20 percent), and copyrights (8 percent). As a result of this growing concern, trade secret protection has become an increasingly prominent part of bilateral discussions on IPR issues. For example, at the July 2013 Strategic and Economic Dialogue, the United States and China agreed to share information about trade secret enforcement—an important step forward for building a constructive dialogue.

Table 1: Type of IP Infringement of Greatest Concern

<table>
<thead>
<tr>
<th>Type of IP</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade secret</td>
<td>28%</td>
<td>29%</td>
<td>36%</td>
</tr>
<tr>
<td>Trademark</td>
<td>34%</td>
<td>27%</td>
<td>26%</td>
</tr>
<tr>
<td>Patent</td>
<td>26%</td>
<td>26%</td>
<td>20%</td>
</tr>
<tr>
<td>Copyright</td>
<td>10%</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>Other</td>
<td>2%</td>
<td>3%</td>
<td>5%</td>
</tr>
</tbody>
</table>

Source: USCBC member company surveys (2011, 2012, and 2013)

USCBC is pleased that there is greater interest in improving China’s legal framework and implementation of trade secret protection. Doing so would promote the growth and success of enterprises in China and around the world. Over the past eighteen months, USCBC has engaged in active conversations with companies from a variety of sectors on their views of trade secrets, including company views of the legal and enforcement environment and best practices that companies use to proactively protect trade secrets. This report is designed
to provide a detailed summary of the challenges that companies face on trade secret issues, as well as constructive recommendations for how to make concrete progress on protecting trade secrets.

**Challenges and Recommendations**

Companies appreciate the growing attention that the Chinese government is paying to trade secret protection, and look forward to progress on specific challenges they face in fully protecting their trade secrets, proprietary technology, and confidential information in China. In USCBC’s 2013 member company survey, the largest number of companies ranked “enforcing agreements” as their primary concern related to trade secret protection (38 percent). “Enforcing agreements” can include but is not limited to confidentiality, non-disclosure, and licensing agreements. Concerns were also raised about the legal framework (26 percent), a lack of regulatory clarity (12 percent), lack of employee understanding (6 percent), evidence-gathering for trade secret cases (3 percent), and getting evidence admitted in enforcement proceedings (an additional 3 percent). Companies noted that they typically face several of these concerns at the same time, with one company noting, “It is impossible to pick one [top concern with trade secrets]. These are all very significant concerns.”

<table>
<thead>
<tr>
<th>Table 2: What Aspect of Trade Secret Protection in China Is of Greatest Concern?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enforcing agreement</td>
</tr>
<tr>
<td>38%</td>
</tr>
<tr>
<td>Lack of employee understanding</td>
</tr>
<tr>
<td>6%</td>
</tr>
<tr>
<td>Other</td>
</tr>
</tbody>
</table>

*Source: USCBC 2013 Member Company Survey*

In this paper, USCBC will focus on six challenges that companies face specific to trade secrets: a fragmented legal framework for trade secrets, questions about protection of trade secrets collected during government regulatory processes, limited government experience with trade secrets, the high evidentiary burden that plaintiffs face during trade secret cases, limited use of judicial procedures that would promote trade secret protection, and insufficient information about judicial procedures and practices related to trade secret protection. For each of these challenges, this report describes not only what the challenge is and why it is problematic, but also makes concrete recommendations to address the challenges.

**Challenge 1: Fragmented legal framework for trade secrets**

Unlike many other countries, such as the United States, Russia, and South Korea, China lacks a national, unified trade secrets law and instead protects trade secrets through a series of laws and regulations. The most important trade secret-related regulatory document is the 1993 Anti-Unfair Competition Law (AUCL), but aspects of trade secret protection are included in laws such as the Contract Law, Labor Contract Law, Company Law, Labor Law, and the Criminal Law, as well as regulations such as the 1998 Provisions Regarding the Prohibition of Trade Secret Infringement and judicial documents such as the 2007 Interpretation on Certain Issues Related to the Application of Law in Trials of Civil Cases Involving Unfair Competition.
China’s fragmented legal framework creates challenges for all stakeholders in trying to protect trade secrets, making it difficult for regulators and companies alike to understand the scope of trade secret protection. Such a legal framework is also difficult to update easily, since a change to one aspect of trade secret regulation may require changes to several other laws and regulations. This creates disincentives for officials to update China’s trade secret regime despite the fact that trade secret enforcement is evolving rapidly, making it easier for the legal framework to become outdated.

Many Chinese and foreign experts have discussed the benefits of creating a unified trade secret law, and these calls have been increasing as Chinese government agencies and businesses have become more cognizant of the importance of trade secrets. For example, trade secret protection and the lack of a clear trade secret law were among topics discussed during the March 2013 meetings of the National People’s Congress (China’s national legislature) and the Chinese People’s Political Consultative Conference (CPPCC) (a high-level deliberative body that discusses social, economic, and legal issues). These meetings included a specific recommendation by Ying Yong, chief judge of the Shanghai Higher People’s Court, for a unified trade secret law and calls for improvements to trade secret regulations and enforcement by CPPCC delegates such as Zhu Jianmin and Wang Xin. However, there are currently no indications that Chinese officials plan to draft a unified trade secrets law, or even to revise China’s existing trade secrets laws, such as the 20-year-old AUCL.

**Recommendations**

- Launch substantive work to draft a unified Trade Secret Law that would incorporate and expand upon trade secret-related provisions in the AUCL, Labor Contract Law, Company Law, Criminal Law, and other laws and regulations (see also Challenge 5).
  - Actively consult with foreign and domestic stakeholders—including PRC government agencies, foreign and domestic companies, and foreign and domestic experts—through the drafting process to ensure the best possible law with the broadest support.
- As an interim option, prioritize revisions to the AUCL to improve China’s efforts to adequately and fully protect trade secrets. Ensure that provisions to fully protect trade secrets are included in efforts to revise other laws, such as the Criminal Law.

**Challenge 2: Questions about trade secret disclosure during government licensing and regulatory processes**

As a normal part of its regulatory responsibilities, Chinese government agencies collect significant amounts of data from companies about their business, operational practices, products, and services. Such data can be requested during a variety of government approval processes, including investment approvals, product registrations, environmental impact assessments, and business licensing. Requests can include information about company structure and operations, employee information and hiring practices, work safety procedures, manufacturing technologies and processes, product details and testing results. US companies recognize that government data collection is a necessary part of those agencies’ regulatory responsibilities, and generally seek to cooperate with government agencies wherever possible.

However, some of the information that government agencies request—such as company operating conditions, manufacturing process details, product formulas, or some types of product information—touches on trade secrets and other proprietary information that are core to the competitiveness of these companies and as such are carefully protected. Should this information fall into the hands of their competitors, companies would be harmed both financially and competitively. Company concerns about releasing this information are exacerbated by the expert panel review process that is required in some regulatory processes, as these expert panel reviews often expose a company’s trade secret information to individuals who are employees or former employees of competitors. While companies want to comply fully with local regulations, they are also careful about providing such sensitive information and seek to strike an appropriate balance to meet both goals.

In other jurisdictions, governments and businesses have engaged in constructive dialogue about this balance, leading many governments to institute procedures to increase transparency about the need and value of collecting company and product data. For example, many developed and developing countries—including the
United Kingdom, New Zealand, Russia, and Mexico—have adopted a regulatory impact analysis (RIA) approach that requires government agencies to analyze the impact of both proposed and existing regulations on various stakeholders (including companies). Many governments also provide clear and specific ramifications for government officials that purposefully or accidentally disclose sensitive regulatory data to best protect against trade secret leakage.

Such steps allow governments to collect the data they need while also ensuring the proper balance that encourages companies to provide necessary data and to plan for the data they need to provide. These reforms would also provide important assurances to both Chinese and foreign companies that the data they provide will be fully protected over the long term, enabling them to more easily and smoothly work with government regulators to promote optimal regulatory outcomes.

Recommendations

- Increase transparency in, and actively engage with government and industry stakeholders on, China’s current policies and practices to determine what regulatory data is collected, how it is used, and what steps are taken and implemented to protect that data after its collection. These dialogues can build on existing dialogues that touch on regulatory data protection in specific sectors.
- Exchange views with industry to arrive at a better understanding of and define what counts as “essential” information from both the regulator and company perspective. Consider adopting international best practices to assess new and existing regulations, such as RIAs, to ensure that any Chinese regulations that propose collecting information from companies fully consider whether such information is necessary to carry out the required regulatory goals, and how collecting such information might impact companies.
- Draft and consistently enforce State Council regulations that require government officials—and those acting in a government capacity, such as expert panelists—to keep confidential for a reasonable time period all data collected during regulatory reviews and product approvals and outline specific consequences when such provisions are violated.
- Continue and expand work proposed by Premier Li Keqiang and the State Council to simplify and streamline administrative licensing and approval processes to limit unnecessary administrative approvals and decrease opportunities for trade secrets leakage. In doing so, we encourage the Chinese government to limit agencies of jurisdiction to those that are absolutely essential, and require agencies to closely coordinate the information they collect and to limit it only to information that is truly necessary for project approval.

Challenge 3: Limited government and judicial experience with trade secrets

Despite the growing attention paid to trade secrets, Chinese government officials still have limited experience in dealing with these issues. Much of this is due to the small number of trade secrets cases that are brought to administrative and judicial bodies. Trade secret cases still represent a very small proportion of IP enforcement cases, giving officials fewer opportunities to become familiar with these types of cases. For example, according to the Supreme People’s Court 2012 White Paper on IPR protection (available online in English and Chinese), of the 7,684 criminal cases that found IP infringement in 2012, only 43 (less than 1 percent) were trade secret cases. The white paper did not report trade secret civil cases, but of the nearly 85,000 new civil cases accepted related to intellectual property, anti-unfair competition cases (a category that includes trade secrets as well as several other types of cases) numbered only 1,123 (just over 1 percent).

Trade secret cases present enforcement officials with particular challenges, as trade secrets differ significantly from other forms of IP. Unlike patents and trademarks, trade secrets are not formally registered with government authorities, meaning that officials dealing with trade secret cases do not have a formal written document to prove that a company holds a purported trade secret. Additionally, the legal definition of trade secrets in China (as in most jurisdictions) is written to cover a wide variety of possible information, including formulas, blueprints, product designs, manufacturing processes, customer lists, sales strategies, and management techniques. This adds considerable complexity to trade secret cases that may not exist for other types of IP cases.
These factors mean that Chinese officials are still actively learning how to effectively regulate trade secrets, and that many officials and judges do not yet have much experience with or a full understanding about how to handle trade secret cases. Further steps to elevate trade secrets on the domestic IP agenda and to help educate Chinese government officials and judges about trade secrets would greatly benefit China’s efforts to promote a robust trade secret enforcement environment.

**Recommendations**

- Make trade secrets a priority for the IPR Leading Group and its constituent agencies by formally adding trade secret protection as a consistent work item in the group’s quarterly workplans and encouraging agencies to prioritize trade secret education and protection in agency workplans, legislative agendas, and enforcement campaigns.
- Release judicial guidance from the Supreme People’s Court related to trade secrets, including:
  - A judicial interpretation specifically focused on trade secret cases, building on the broader 2007 Interpretation on Certain Issues Related to the Application of Law in Trials of Civil Cases Involving Unfair Competition, to educate provincial judges on the proper handling of trade secrets cases (see also Challenge 4 and 6); and
  - A set of model cases related to different aspects of trade secret protection for provincial courts to follow in adjudicating trade secret cases.
- Strengthen training and information-sharing on trade secrets through varying means, including workshops and training programs with national and local government and judicial agencies. Such workshops can include what types of information may constitute trade secrets, proper handling of trade secret cases, and international best practices for trade secret cases.
  - Consider working with outside stakeholders—including international organizations, foreign governments, industry associations, non-profit organizations, and companies—to implement such training programs.

**Challenge 4: High evidentiary burdens faced by plaintiffs in trade secret cases**

Companies seeking to protect their trade secrets in China often face a practical problem: collecting and using evidence to prove trade secret infringement. A potential plaintiff in a trade secret civil case must spend the time and resources to accomplish several tasks. The plaintiff must prove that the infringed information meets the definition of a trade secret; prove that the defendant is using information that is substantially similar to the trade secret; and be able to clearly document when and how that information was obtained illegally by the defendant using internal sources. Each of these steps requires significant time and resources.

In addition, this task is complicated by a number of important features of trade secret enforcement in China, including:

- *De facto* requirements for a company seeking police help to launch a trade secret criminal investigation to essentially prove the case by gathering and presenting a full set of evidence before approaching police, as local police are often reluctant to accept trade secrets cases without such clear evidence;
- Practices that limit a plaintiff’s ability to use evidence collected by private investigators in civil trials;
- Provisions that place the burden of proof in trade secret civil trials on the plaintiff and do not explicitly allow it to be shifted to the defendant, despite some judicial opinions (December 2011 Supreme People’s Court Opinions from the Supreme People’s Court of China on Giving Full Play to the Functional Role of Intellectual Property Trials) that appear open to the option of shifting the burden of proof to the defendant under specific circumstances;
- Regulations that require clear evidence of the instance of trade secret infringement, as opposed to “common sense” tests used in the United States and other countries that allow judges to find trade secret infringement when it is a reasonable inference based on other evidence;
- Judicial practices that limit the admissibility of non-documentary evidence such as witness testimony in trade secrets cases; and
- Civil procedures in some courts that require purported trade secrets to be first certified as such by outside expert panels.
These challenges often discourage companies from bringing trade secret enforcement cases in China, with a number of negative effects for China’s own economic and legal development. First, for those companies that decide to pursue trade secret enforcement in China, these challenges drastically increases the cost, leaving the company with fewer resources to devote to important tasks such as product development and process innovation. Second, they cut the number of trade secret cases that enforcement officials and courts see, which limits opportunities for these officials to learn the most effective means to manage these cases. Finally, these challenges foster a broad perception that trade secret enforcement is difficult in China, discouraging companies from bringing their products, services, and know-how to China, which prevents Chinese consumers and businesses from having access to the latest technologies.

Additionally, this evidentiary burden is complicated due to a lack of clear information about how such evidence will be protected during and after a judicial trial. Trade secrets, by their very definition, are information unknown to the public, yet must be proven (and thus revealed) in the context of a judicial trial. Yet there is little judicial guidance regarding the protection of trade secrets disclosed during civil trials. In 2010, the Jiangsu Higher People’s Court released the Trial Guidelines for Handling Trade Secret Infringement Cases stating that all parties involved in a trade secrets trial, including third-party expert panelists, must sign a guarantee letter to the court not to disclose or use trade secrets disclosed during the trial. However, there are no similar guidelines at the national level, and no clear obligations for courts to maintain confidentiality for confidential information disclosed during the trial unless the verdict is in favor of the plaintiff. Thus, unless a plaintiff is fairly sure that they will prevail in a trade secrets case, they often determine that the risk of further trade secret exposure outweighs the possible benefit of a favorable verdict.

Recommendations

- Release judicial guidance from the Supreme People’s Court (see Challenges 3 and 6) — building on language in Section 5 of the December 2011 Supreme People’s Court Opinions from the Supreme People's Court of China on Giving Full Play to the Functional Role of Intellectual Property Trials — that would categorically permit the plaintiff to shift the burden of proof to the defendant once the plaintiff can legally establish:
  - That it owns the trade secret in question;
  - That the defendant had access to that trade secret; and
  - That the defendant’s product, service, or internal operations are substantially similar to the plaintiff’s.
- Actively encourage judges handling trade secret cases to admit and consider a broader array of evidence in trade secret cases, specifically non-documentary evidence such as witness testimony, that would better allow plaintiffs to prove trade secret infringement. Offer guidance or education on best practices for admitting and using such evidence.
- Encourage courts to admit and consider evidence collected by qualified private investigators, including IP investigative firms and forensic computer experts, with appropriate procedures to ensure the validity of such information.
- Encourage judges at all levels to use greater leeway in applying “common sense” tests, such as the doctrine of “inevitable disclosure,” which allows courts to find trade secret infringement even in cases with limited documentary evidence based on the presumption that the defendant could not proceed with current actions or operations without having misappropriated the plaintiff’s trade secret. Such tests, which are in line with international judicial practices, would allow courts to find trade secret infringement even in cases where the direct act of trade secret infringement cannot be formally documented.
- Engage with judges and industry experts to understand the challenges that companies and courts face in protecting trade secrets and other confidential company information disclosed during civil trials to lower the risk of disclosure and to ensure that trade secrets holders have greater confidence in the courts as a viable channel for protecting trade secrets.
- Actively engage with stakeholders, including domestic and international legal and industry experts, to develop a set of rules to determine the credibility of non-documentary evidence in trade secrets and other types of IP cases.
Challenge 5: Limited use of relevant and potentially useful judicial procedures

China’s laws and regulations include a number of key judicial procedures that are relevant to potential trade secret cases and are used effectively in other jurisdictions. For example, preliminary injunctions in trade secret cases permit plaintiffs to prevent a defendant from further using or benefiting from a stolen trade secret before a final ruling is issued, based on a reasonable likelihood of finding trade secret misappropriation. Such injunctions can prevent further financial losses stemming from trade secret theft, but are particularly important in trade secret cases because they can limit the likelihood of further trade secret dissemination. The very definition of a trade secret depends on its secrecy: once a trade secret is publicly disclosed, it is no longer eligible to be considered a trade secret. Thus, preliminary injunctions could be particularly powerful in enforcing trade secrets rights.

Evidence preservation orders—court rulings that require a defendant to preserve and turn evidence over to the court—can also be an effective tool in trade secret cases. A plaintiff must apply to the court for such an order, and may be required to post a bond with the court. Though use of evidence preservation orders in trade secrets cases to date has been limited, this tool has been used increasingly for companies in other types of civil IP cases, and could alleviate the high evidentiary burden that companies face (see Challenge 4).

Unlike other forms of IP—such as patent, trademarks, and copyrights—there is no clear legal provision that explicitly gives plaintiffs in trade secrets cases the option of using such orders. However, recent developments indicate that preliminary injunctions may be a more viable option going forward. Article 100 of the revised Civil Procedure Law, which went into effect on January 1, 2013, permits plaintiffs in civil cases—including trade secrets cases—to apply for preliminary injunctions and evidence preservation orders. In August 2013, the Shanghai No. 1 Intermediate Court cited the Civil Procedure Law in granting US pharmaceutical company Eli Lilly and Co. a preliminary injunction in their trade secret case against a former employee. While this decision reflects judicial views in only one court and does not set any formal legal precedent for other jurisdictions, it points to the possibility of greater use of these tools for plaintiffs in trade secrets cases. Greater comfort with such orders, and increased use by Chinese courts at all levels, would tangibly contribute to China’s efforts to improve the environment for trade secret enforcement.

Recommendations

- Revise China’s current legal framework for trade secrets (see Challenge 1) to explicitly include evidence preservation orders and preliminary injunctions for trade secrets.
- Actively encourage courts at all levels to make greater use of evidence preservation orders and preliminary injunctions in trade secrets cases, when plaintiff applications meet appropriate requirements under Chinese law.
  - Consider using the August 2013 Shanghai case involving Eli Lilly as a model case, to be circulated to provincial courts as an example of a trade secrets case with a successful preliminary injunction.

Challenge 6: Insufficient information about relevant judicial procedures and practices

Many companies use agreements with their employees—including non-compete and non-disclosure agreements—as an important tool to protect against trade secret misappropriation or infringement. Recent changes to the legal framework governing such agreements, including the 2008 implementation of the new Labor Contract Law, have raised questions for many companies about how best to structure and implement such agreements to ensure their enforceability. While some companies have indicated that they expect no problems with their current agreements, others have reported inconsistencies between court rulings in different jurisdictions, and still have questions about their ability to enforce these agreements through Chinese courts. Providing further information and guidance to both courts and potential plaintiffs about the process and outcomes of such cases would considerably help to alleviate potential questions and would better ensure that companies drafting these agreements do so within the scope of the Labor Contract Law and other relevant regulations.
Companies also have questions in trying to understand another important piece of China’s trade secret regime: expert panels used in civil trade secrets cases. These experts often play an important role in trade secrets cases, assessing the technical aspects of trade secrets claims, but it is not always clear to the parties in a given case how these experts are qualified and selected. Questions also arise about potential conflicts of interest for experts, and what requirements and procedures might exist for experts to withdraw from a case due to a conflict of interest. Company experience indicates that the answers to these questions may differ from province to province. Providing more transparent information about the rules governing certification, selection, use, and operating conduct for these expert panels—and standardizing these rules between different local jurisdictions—would improve the quality and efficiency of trade secret cases.

**Recommendations**

- Release judicial guidance from the Supreme People’s Court (see Challenges 3 and 4) that would provide clear, useful information to court officials, plaintiffs, and defendants about the proper judicial handling of cases involving trade secrets disputes involving non-disclosure agreements and confidentiality agreements. Such guidance could include a judicial opinion, a batch of model cases, or both.
- Work with provincial courts to provide clear information to court officials, industry and the public via a judicial notice, public seminars, or other means about the rules governing certification, selection, use, and operating conduct for expert panels, including obligations for experts to withdraw from considering a particular case based on a conflict of interest.
  - Increase standardization of such rules across provinces through SPC guidance and promoting greater information sharing among provincial court officials.

**Conclusion**

Intellectual property protection is an important foundation of China’s efforts to upgrade its economy and promote the growth and development of innovative sectors. Recent reforms clearly show that the Chinese government is aware of this need, and has taken many of the necessary steps to improve the IP legal framework and boost intellectual property enforcement. Yet much of this progress has been targeted at traditional forms of IP—patents, trademarks, and copyrights.

Some of the challenges that companies face in protecting trade secrets parallel challenges that they face in protecting other types of IP, including low administrative fines and court damages, the challenge of persuading local enforcement officials to tackle difficult cases, judicial procedures that do not include a discovery process, and high criminal thresholds that can inhibit companies from using criminal channels to pursue trade secret enforcement. These areas present more general challenges to IP protection, and would require broader structural reforms that are addressed in other USCBC reports on China’s IPR environment (see, for example, USCBC’s May 2013 IPR Review and Recommendations). The recent surge in attention to trade secrets, nevertheless, shows the continuing challenge that companies face in trying to protect trade secrets.

The unique challenges that companies face in seeking to protect their trade secrets are wide-ranging—related to the legal framework, structural barriers to robust trade secret protection, and judicial practices. Many of these concerns require joint efforts by government agencies and companies. For example, a considerable amount of trade secrets theft stems from incidents of misappropriation caused by current or former employees. This can be addressed by companies, government agencies, and other stakeholders conducting educational initiatives to promote the importance of preserving the confidential nature of this type of information. Steps to address these challenges would thus necessitate a range of actions, including changes to existing laws and regulations, new policies and practices, and better information on a number of key topics. Such reforms would significantly advance China’s trade secrets regime and encourage more companies to develop, use, and protect trade secrets in China.
US-China Business Council Comments on Draft Regulations on Service Inventions

December 3, 2012

The US-China Business Council (USCBC) appreciates the opportunity to participate in the public comment solicitation process for the draft Regulations on Service Inventions (“draft Regulations”). This process reflects a continued positive effort on behalf of China’s State Intellectual Property Office (SIPO) to provide greater transparency in the formulation of policy and legislation. The comments contained in this submission represent the views of many leading US companies engaged in business across all industry sectors in China.

USCBC has approximately 230 member companies that include global leaders in innovation that hold thousands of patents in manufacturing, information technology, pharmaceuticals, services, and other areas. Our companies support China’s goals to foster innovation and the development of intellectual property in China. Developing laws and regulations to promote these goals is the foundation of a modern economy. USCBC companies have invested considerable time and resources in research and development (R&D) activities in China that have benefited both companies and individual inventors.

Recognizing inventors at the time of invention and providing appropriate incentives to reward their work is an important method of encouraging innovation. USCBC supports Chinese government efforts to foster a more innovative society and to protect the rights of inventors. At the same time, USCBC has concerns that the current draft Regulations may not be the most effective way to achieve the objectives stated in Article 1 of the draft Regulations: building an innovative and talent-rich country, improving innovation capabilities, promoting development and implementation of service inventions, and protecting the legal rights of both companies and individual investors.

Strong corporate investment in R&D – by both domestic and foreign firms – is a necessity for an innovative economy. Yet language in the draft Regulations would create an unreasonable cost burden on companies conducting R&D in China by driving up compensation levels well above international norms and creating significant administrative burdens for companies with active patent portfolios. These high costs and administrative burdens would make it difficult for domestic and foreign companies to invest in R&D in China, ultimately reducing the amount of innovation that occurs in China.

For the reasons above, if new regulations on inventor remuneration are deemed necessary, USCBC respectfully suggests SIPO take into consideration the following three principles, which would help to achieve goals stated in Article 1 while also better aligning these rules with international best practices for fostering innovation. Companies and associations from multiple countries agree that these principles would enable SIPO to develop a remuneration system that appropriately balances the rights and responsibilities of inventors and companies alike:

- Suspend final passage of the draft Regulations until thorough outreach to all interested stakeholders can be carried out.
• Engage in substantive bilateral consultations with other governments to determine global best practices in the area of inventor remuneration.
• Include in any final version of the draft Regulations language specifying the superseding nature of inventor-employer agreements, existing and future, over all provisions of this regulation.

Recognizing that there are many provisions on which to comment that may be addressed by other organizations, USCBC respectfully submits the following comments on selected provisions.

SCOPE OF LAW
USCBC and its members appreciate that the draft Regulations attempt to provide clarity in how inventor remuneration agreements should be understood and enforced. To further streamline the process and to ensure that regulators and companies fully understand and are able to comply with the regulations, we respectfully make the following suggestions:

Limit Scope to Patentable Matter Only
USCBC is pleased to see that SIPO continues to recognize that protecting trade secrets is an important part of a robust IPR regime. USCBC respectfully suggests that the extension of the draft Regulations to “know-how,” or trade secrets, is impractical for these regulations. Most trade secrets are not directly examined and approved by a government agency. As such, they are difficult to identify and measure, and it is exceedingly difficult for a company to formally track all trade secrets held by every employee. In addition, the vague definition of trade secrets – which allow companies flexibility in protecting key proprietary information – can lead employers and employees to different understandings of what constitutes a trade secret. These challenges are well-known internationally: it is worth noting that even countries with a long history of inventor remuneration-related laws, like Japan and Germany, limit the scope of their laws to patents.

As such, USCBC suggests that all references within the law to “know-how” be deleted, including in articles 4, 8, 14, and 25. USCBC further suggests that the scope of the draft Regulations be clarified as being limited to patentable inventions only.

Notification of Inventors of “Economic Benefit” of Invention
The second paragraph of Article 20 requires companies to inform all inventors of “the economic benefit earned by the entity by exploiting, assigning, or licensing of their invention.” In practice, hundreds or even thousands of patents or patent applications (or future patents or patent applications) are often cross-licensed in a single transaction, making it difficult for a company to calculate the precise economic benefit for each individual patent and inform each inventor. As a consequence, such provisions would be impractical to enforce and the increased administrative costs could lead companies to reconsider complex cross-licensing arrangements. This would decrease opportunities for the sharing of patented technology and information in China.

Additionally, the economic benefit of these transactions is very likely to be a trade secret of the entity, as it would contain confidential information about company financing and proprietary business transactions that would be damaging if it falls into the hands of competitors. Thus, it is inappropriate to inform all inventors of the economic benefit. Such a disclosure may lead to a breach of confidentiality agreements the entity entered into with the assignees or licensees, or even the invalidation of the trade secret itself due to disclosure. This is particularly dangerous if the entity has to notify a former employee that is now employed by a competitor.

For the reasons above, USCBC recommends that the second paragraph of Article 20 be deleted.
Right of First Refusal

Article 29 allows the inventor the right of first refusal (ROFR) on any IPR that the company may decide to assign. USCBC understands this article is meant to protect the rights an inventor has in creating IP, but USCBC also notes that ROFR would make it difficult for an employer to enter into reasonable business transactions.

As written, Article 29 may prove difficult for regulators to enforce due to how IP is managed in practice. First, joint inventions can lead to conflicting ROFR rights for each inventor involved. This could lead to complex legal proceedings involving regulators, companies, and inventors to determine the primary rights’ holder. Second, patents are often assigned in bundles (known as assignment “on a package basis”) as part of a company’s overall business strategy, often including the exchange of hundreds of patents in one deal. Article 29 would give any individual inventor the ability to block business deals much broader in scope than the original individual patent, thus impeding a company’s ability to disseminate and commercialize patents in line with China’s broader IP and technology development goals. Lastly, seeking opinions from each inventor before patent assignment may expose the entity to confidentiality leakage or breaches, hindering or undermining the patent transaction process.

For the above reasons, USCBC respectfully suggests that Article 29 be deleted.

AUTHORITY OF COMPANY POLICIES AND AGREEMENTS

USCBC respects the motivations behind the draft Regulations to protect the rights of inventors as a means to encourage innovation. USCBC supports inventors’ rights to proper rewards and remuneration as an important part of the innovation process. Based on company experience in China and other markets, the best means to ensure fair compensation for inventors is to allow open negotiations between inventors and entities.

Some provisions of the draft Regulations may unnecessarily disrupt the relationship between an entity and its employee, and could, in practice, question or even invalidate existing company policies or inventor-employee agreements. USCBC respectfully makes the following suggestions as a means to promote innovation in China while also ensuring stable relations between entities and employees:

Ownership Rights for Inventions in Company Policy

USCBC welcomes the draft Regulations’ reference to inventor-employer agreements in Articles 6, 9, and 19. In particular, Article 9 allows the entity and employee to make agreements regarding the ownership of inventions that are relevant to the business of the entity, while Articles 6 and 19 separately allow the company to establish company policy or enter into an agreement with inventors. To ensure consistency throughout the regulation, we recommend that Article 9 be amended and expanded to be consistent with Articles 6 and 19, clarifying that invention ownership can be established not only through an agreement entered into between inventors and the entity, but also through company policy established by the entity.

Validity of Agreements “Limiting” the Rights of Inventors

USCBC respects that Article 19 references inventor-employer agreements and attempts to protect inventors from unfair agreements. The second paragraph states that “any agreement or provisions eliminating or limiting the rights which the inventor is entitled to in accordance with these regulations are invalid.” The broad wording of the second paragraph of the Article appears to undercut the authority of other Articles in the draft Regulations, including Articles 6 and 9, and calls into question the validity of relevant company agreements. Determining what constitutes a “limit” on inventor rights is subjective, and may lead to differing interpretations by individual regulators, companies, and inventors. This clause would call into question the validity of existing and proposed company policies or contracts, which could
result in an excessive administrative burden on regulators to attempt to determine which policies or contracts might be limiting inventor rights.

USCBC strongly recommends that the phrase “or limiting” be deleted from the second paragraph of Article 19. The final draft should read, “Any agreement or provisions eliminating the rights which the inventor is entitled to in accordance with these regulations are invalid.”

**Individual Agreements to Override Timeframe Obligations**

Articles 10, 12, 13, 14, 16, and 24 enact obligations and time limits for certain operations to be completed between the entity and its employees. Currently, many companies already have existing programs and procedures for signing inventor-employer agreements that cover employment arrangements more comprehensively than the obligations put forth in these articles. At the same time, USCBC recognizes that some companies have yet to adopt this important practice. To avoid conflict while encouraging greater usage of agreements that protect inventor rights, USCBC recommends that the draft Regulations include specific language clearly stating that the timeframes in the draft Regulations would only apply in the case that no such inventor-employer agreement exists, and that company policies and agreements would supersede the draft Regulations.

**Determining Proper Economic Compensation**

Articles 21 and 22 are designed to set default remuneration levels for inventors of IPR. Such language, however, conflicts with Articles 77 and 78 of the Implementing Regulations of the Patent Law, which assumes either a formal agreement between employee and employer, or the existence of legally compliant company rules and regulations that address remuneration. Articles 77 and 78 also include default provisions covering compensation amounts and the timeframe for when patents are granted or exploited. Consequently, an existing, widely understood body of PRC law has already made adequate provision for determining minimum remuneration thresholds. To prevent significant regulatory confusion, USCBC recommends that direct references to remuneration levels be removed from the final version of the draft Regulations, and that Articles 77 and 78 of the Implementing Regulations of the Patent Law be referenced as the authority on default remuneration levels. Additionally, as market-based negotiations remain the best means to determine remuneration levels that are appropriate for the industry, invention, and inventor, USCBC further recommends that the draft Regulations stipulate that companies may sign separate inventor-employer agreements with remuneration provisions to supersede these default levels.

**Right of Disposal of IPR**

Article 16 appears to allow inventors to request assignment of IPR to themselves upon learning of an attempt to abandon it by the employer, stating “where the entity intends to stop the process of applying for intellectual property of a service invention, it shall inform the inventor one month in advance.” This prior notice obligation would bring an unreasonable administrative burden for companies, and lead to inconsistent implementation for regulator. For example, in the course of an annual maintenance review a company may decide to abandon 500 patents for strategic or financial reasons. Article 16 would require the company to notify all inventors of those 500 patents, which would likely be thousands of people. It would be especially difficult to notify inventors who had retired, resigned, or gone to work for a competitor. In the case of the latter, notification would also result in a breach of confidentiality.

USCBC strongly suggests that Article 16 be deleted, or modified to clearly specify that the entity may establish a policy or reach prior agreement with the inventor in dealing with matter related to the abandonment and assignment of IPR, as mentioned above.

**CONCLUSION**

USCBC thanks SIPO for providing this opportunity to comment on the draft Regulations. We hope that
these comments are constructive and useful to SIPO as it reviews the draft measures, and welcome any further discussion that SIPO may wish to provide on these comments.

—END—

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Executive Summary

- Licenses and approvals are essential to doing business in China, as in any other market, and present significant challenges for manufacturing and services providers operating there. For foreign companies invested in China, the process of expanding manufacturing operations remains particularly difficult. This report reviews companies’ experiences when expanding their operations in China.
- Members of the US-China Business Council (USCBC) have continually raised the issue of administrative licensing in USCBC’s annual membership survey. In USCBC’s 2013 survey, members ranked administrative licensing as their third most significant concern in the China market.
- Lack of transparency in the licensing process creates some of the most prevalent challenges in China’s licensing process, particularly in relation to documentation requirements, regulatory implementation, and procedural timelines.
- Requirements to disclose potentially sensitive company information in order to secure licenses—and the corresponding risk of intellectual property theft—are another notable concern. This concern was particularly strong for disclosure requirements during the course of expert panel reviews that take place at multiple stages in the licensing process.
- Throughout the licensing process, local governments frequently recommend domestic third-party firms to consult or manage different aspects of companies’ domestic licensing. Such recommendations often present compliance and approval challenges and can be difficult for companies to mitigate.
- To help manage the licensing process, interview respondents suggested that companies should establish strong relationships with local government officials involved in the licensing and approval process. Respondents also recommended that companies should make clear to officials at a project’s outset what information companies are—and are not—willing to disclose. To aid in this, companies may also consider creating internal decision-making structures to help manage requests for sensitive information when they arise. Other licensing best practices are detailed in the full report.

Introduction

For companies seeking to operate and expand in China, as in any market, numerous permits, approvals, and reviews are required before they can proceed. From selling products to creating new manufacturing facilities, these processes—often referred to generally as “administrative licensing”—are necessary steps to invest, expand and conduct commercial operations in China. While administrative licensing is a common process worldwide, China’s extensive, complex, and at times onerous licensing system at the central, provincial, and municipal government levels often results in significant delays, added costs, and lost revenue, while also creating reluctance among some foreign companies to increase investment in China.¹

According to the US-China Business Council’s (USCBC) annual member company survey, licensing remains a perennial problem in China. In USCBC’s 2013 survey, members ranked administrative licensing as their third most significant concern in the China market. Two notable concerns that this report highlights are the lack of transparency in the licensing process and the requirement to disclose potentially sensitive company information.

Licensing can include an array of approvals and processes, including product approvals, import licenses, operational licenses, and even residence permits. While application procedures, required documents, and timelines may differ somewhat from process-to-process and industry-to-industry, many of the challenges that companies face and the best practices to address these challenges and obtain the necessary licenses are similar. Thus, this report does not seek to document the problems and best practices for every licensing process that a company may face, but uses select processes and company examples to illustrate how companies might seek to overcome licensing hurdles.

To identify some of the most prevalent problems in China’s licensing system, USCBC interviewed 19 member companies in August 2013 to discuss their experiences with the licensing process when expanding their manufacturing operations in China. This report is based on those interviews.

China's Administrative Licensing System

China maintains an array of procedures and requirements that companies must meet before establishing or expanding their operations, or before selling their products in the market. Most, but not all, of the rules governing this process are laid out in various legal documents found at c processes. Beginning in 2013, the Chinese government announced 2,400 approvals would be cancelled or delegated to lower level authorities. The government has since indicated there will be additional work to decentralize and streamline existing administrative approvals as well as to limit new administrative approvals in the future. More recently, the State Administration of Industry and Commerce announced reforms to the business registration system by eliminating some capital requirements for establishing a new company. Central authorities have also indicated administrative reforms will continue and most investments not related to national security, the environment, strategic resources, and public interest will no longer need to undergo government approval. Though these

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changes have been welcomed by USCBC companies, some note that these decentralizations have primarily benefited domestic companies. Further, while these developments are important steps, depending on implementation, many significant challenges in the licensing process have yet to be addressed.

As an example, companies seeking to establish new or expand existing operations in China must go through a lengthy and complex system of approvals, permitting, and government engagement that requires extensive time and resource allocation. The process requires going through multiple agencies and bureaus, depending on the size, scope, and location of the project. The outline below represents the general process and time estimate for companies to establish and construct a wholly foreign-owned (WFOE) manufacturing company in China:

Source: Sidley Austin; Timelines are estimates

While the expansion process is similar from region-to-region in China, the majority of companies interviewed for this project said they found the process runs more smoothly in China’s more developed eastern provinces than in western provinces. Local officials in western China generally have less experience in dealing with licensing processes and with multinational corporations (MNCs) seeking to invest. As a consequence, companies said they prefer to invest in eastern China, where investment authorities are more experienced and generally have more sophisticated licensing and approval processes.
USCBC’s interviews revealed that during the expansion process, companies frequently encounter problems in five broad areas: Transparency, expert panel reviews, disclosure requirements, third-party consultant recommendations, and licensing associated with joint ventures.

**Transparency**

Transparency in administrative licensing – or applicants’ ability to easily apply, monitor, and determine the status of their application – frequently contributes to procedural delays and creates uncertainty for companies engaging in the licensing process. To complicate matters, transparency varies from region to region, and among different branches and levels of government, according to company interviews.

For USCBC companies, transparency has remained a top concern, both in the context of licensing as well as more broadly in regulatory development and enforcement. In USCBC’s 2013 member survey, companies ranked transparency their eighth most significant concern in the China market; transparency has remained one of USCBC companies’ top 10 concerns over the past seven years.

This section will review three key ways that lack of transparency is problematic for companies engaging in the licensing process: unclear documentation requirements, inconsistencies in regulatory implementation, extended approval timelines, and insufficient procedural transparency.

**Lack of Clarity in Documentation Requirements**

Companies seeking to expand their manufacturing operations in China are required by central and local governments to submit various legal and planning documents. The list of required documents typically varies by region, and companies typically have to carefully review local government websites to understand which documents different regional governments require in the licensing process.

Documentation and procedures for licensing and approval processes are often made available through public sources, such as government websites. However, companies noted that the information provided on these websites is often found to be inaccurate, vague, or incomplete. For example, several companies cited cases in which local government websites list a set of standard documents that companies are required to submit. The websites also specify a general requirement that companies submit “other” documents, but frequently do not clarify what comprises “other” documents. In such cases, companies had to engage directly with local governments to understand what documentation is required in the licensing process.

Companies also raised concerns about the lack of detail in disclosure requirements. In many licensing processes, companies said there are documented requirements to disclose certain information related to the new project, but the amount of detail required in the disclosure is vague. This makes it difficult for companies to know how much information is required to avoid lengthy delays caused by insufficient applications. Additionally, vague requirements lead to different regulator interpretations of the same requirements, at times making the application process different each time companies apply.

By not listing clearly or fully the documents required to invest in a locality, company representatives are required to engage with government officials to learn what is required in the licensing process and then take the time to prepare final documents for submission. This creates delays that cost both government officials and companies valuable time and resources. These delays can ultimately reduce valuable investment, jobs, and production in the region, as they hamper companies in their attempts to launch new operations and hire local employees.

**Inconsistencies in Regulatory Implementation**

There are also inconsistencies in local governments’ interpretation and implementation of regulations related to licensing. Even if there are clear rules in place at the national, provincial, and local levels, inconsistencies in implementing these rules within and between government agencies adds time and cost to the licensing process.
Companies described several instances in which differences in local governments’ interpretation of regulations created challenges in the licensing process.

As an example of such inconsistencies, one company interviewed was required to gain approval of its documents from the Ministry of Commerce (MOFCOM) and then take the approved documents to the local Administration of Industry and Commerce (AIC) for review. When the company approached the AIC, it was told it needed to amend one of the documents. The company was hesitant to change the document, which had already been approved by MOFCOM. The company believed that any changes made to the document would need to be reviewed again by MOFCOM under the law. The AIC insisted the company would not need to send the document back through MOFCOM for a second review. After repeated conversations with the AIC and MOFCOM, MOFCOM permitted the changes to be made and confirmed that the document would not need to go through a second review. The company was later informed by the AIC that it did not need the revised document after all.

This example indicates how insufficient transparency and inconsistent interpretation between and within government agencies can foster uncertainty and ambiguity for companies operating or expanding in China. Generally, companies interviewed said they were unaware of the reasons as to why local governments interpreted policies as they did, leaving the company struggling to quickly work with officials to mitigate differences between government interpretation and company strategy.

Extended Approval Timelines and Insufficient Procedural Transparency

While central and local government regulations provide official timeframes for various steps in the licensing process, the majority of companies found that those timelines differ greatly from what occurs in practice. Several companies said that their project timelines ran anywhere from four months to one year or more past the published, public timelines. One company remarked that making a project timeline is often futile, since projections are always wrong, no matter how prepared a company is. This overall lack of certainty creates an ambiguous investment environment that can cause significant revenue loss and project delays, and one that could, ultimately, inhibit foreign investment.

In addition to these problems, several companies also described a lack of transparency in the government’s review of their project-related applications. In some cases, companies that submitted all required documents to the local government for its review and approval and expected a relatively smooth licensing process, but still experienced delays. To try to mitigate these delays, some companies have resorted to developing their own methods to gain more insight into the status of an application. For example, one company that sought to find out the reason behind the delay in government review of an application dispatched an employee to wait outside the local government offices to try to locate key officials overseeing the review of their application during their break.

Still, another company suggested that government officials may be reluctant to disclose the reason for procedural delays because such transparency could give companies the ability to challenge those reasons. Instead, the government may be more likely to attribute delays to official vacations or misplacement of a company’s application.

Companies also raised similar concerns about the process at the national level. Projects over a given investment value threshold in some industries are required to be approved by central-level authorities.7 Despite challenges that exist at the local level, several companies noted that local authorities often appear more willing to help companies through the licensing and investment process, as they understand the direct benefits the project will have on a given region. Comparatively, central level authorities may have less motivation to help companies move through the licensing process. Due to such factors, one company remarked that it does everything possible to avoid seeking central government approval of a project and will keep projects under certain thresholds that automatically trigger central government-mandated review.

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As an example of the problems that can arise from such lack of clarity, one company noted that it experienced significant delays in the licensing process when it sought to change the company from a joint venture to a wholly-foreign owned entity. In the process, the company submitted its completed application to a central-level agency for its review and approval. However, the company waited more than six months to hear back from the agency on the status of the application; the reason for the delay was not explained. In order to make progress, the company sought meetings with the agency to engage them directly and gain approval for their application. The agency agreed and met with the company. In the meeting, the agency attributed the delay in approval to personnel changes. After the meeting, the agency quickly approved the application.

The lack of clarity about approval timelines routinely affects how US companies operate in China. When regulatory systems are unpredictable, companies are unable to develop accurate timelines or budgets for their new investment. In addition, if companies are unable determine the causes behind approval delays, they are less able to prevent such delays when investing in the future. Thus, companies and government both benefit when transparency is a fundamental component in the licensing process.

Managing Insufficient Transparency

To help manage the lack of transparency, companies emphasized the importance of building relationships with local governments officials overseeing licensing processes in the region in which they are seeking to invest. Establishing relationships with officials involved in the licensing process, as well as those in investment promotion departments, helps foster rapport before investments are made and allows companies time to clarify ambiguities in documentation requirements or licensing processes. As one company noted, it will share with local officials the planned project schedule and alert officials to any expected construction or customs issues that arise. Further, companies noted that it is important to develop relationships with each agency involved in the licensing process—while ensuring compliance with the Foreign Corrupt Practices Act and Anti-Bribery Law—as many agencies are reticent to answer companies’ questions unless they are specific to their jurisdiction. Maintaining close contact with local authorities also provides channels for staff to stay apprised of new or potential regulatory changes and respond or advocate accordingly.

One company noted that sharing information about a project’s expected economic, tax, and employment contributions can help underscore the benefits the project will introduce to the community, and may help to ensure a speedier and more transparent review. Overall, companies can present a compelling narrative about the new jobs and production their investments will bring, which may appeal to local officials and communities alike.

Companies also noted that they seek to provide input on regulations released for public comment to reduce potential conflicts between regulations. Companies are usually very familiar with existing regulations governing their operations or projects, and can help provide insights into how the regulations interact with others, or where clarification may be needed. Further, companies provide comments and feedback through both formal and informal channels, including solicitations for public comment, government meetings with industry groups, and individual meetings with government agencies.

Expert Panel Reviews

Many companies interviewed expressed concern over expert panel reviews and the potential for disclosure of sensitive information during the licensing process. Depending on the size, scope, and type of project, these reviews may occur at several steps in the licensing process, such as during review of a project’s energy conservation assessment, safety assessment, occupational health assessment, project approval, and environmental impact assessment (EIA) report. The panel is typically comprised randomly of five or more experts, who must meet academic and professional qualifications set out by the government.8

Expert panels are usually convened to review reports submitted in the course of a particular assessment, such as an EIA report. These reports may contain detailed information on companies’ proposed project, including

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project economics, major unit operations, equipment lists, equipment specifics, capacity, and raw material and energy use.\textsuperscript{9, 10} Members of expert panels are to be chosen randomly from a database of experts compiled by relevant authorities; in the case of an expert panel for review of an EIA report, the Environmental Protection Bureau would be the relevant authority. The expert panel examines the company’s report and submits a written opinion based upon its review. According to interview respondents, a company will likely exchange several rounds of comments with the panel to address any concerns that the panel may have over the company’s report.

Companies shared many concerns over the expert panel review process. While many of these concerns were raised in regards to the EIA, the concerns are germane to all types of expert panels reviews used in China. Several concerns that companies raised include:

- Nomination of competitors as experts and potential conflicts of interest on expert panels,
- Companies’ inability to suggest or dispute expert nominations, and
- The broad range of documents required for inclusion in the report and for consideration by the expert panel.

Problems with the Expert Panel Review Process

Companies expressed strong concerns about the government’s authority to nominate Chinese competitors as experts to the review panel. Reports submitted to review panels often include detailed documentation requirements about project costs and revenue, capacity and equipment information, raw material and energy requirements, and other sensitive details about the operations. Other types of licensing processes may contain similarly sensitive company, product, or process information. For companies, this information is sensitive in itself, and providing such information to anyone outside the company – including competitiors and government officials – is extremely problematic.

Foreign companies have no formal input on the composition of the expert panel, nor is there a method to dispute panelists. Furthermore, there is often very little room to negotiate what information is disclosed. Consequently companies frequently must make difficult decisions on how to address and mitigate the risks arising from experts’ requests for information, or even whether to proceed altogether. For more information on managing disclosure requests, see the “Disclosure” section in this report.

Companies also noted that competitors named to the expert panel may use their position to gain access to proprietary information from companies undergoing the review. Some companies said that competitors named to the panel may request companies’ trade secret information under the auspices of the review, even though the requested information may not be pertinent to the subject under consideration. Given that the scope of the panel’s review can be vague, experts have broad authority to request sensitive documents from companies. In this way, expert panel reviews introduce significant liability for companies seeking to safeguard their trade secrets. Further, as there are no clear requirements to destroy sensitive information disclosed in the review process, companies face the possibility that their trade secrets will be exposed long after the review is concluded.

Companies also noted a variety of other problems that arise in the expert review process. For example, companies are often required to pay travel expenses and per diem fees for experts involved in the review. Further, companies noted there are no clear guidelines as to what these travel costs should be. One company USCBC interviewed noted there are no regulations indicating what per diem fees should amount to; rather, the company based these fees on its own “common sense” estimates.

The requirement that companies pay for travel expenses not only raises costs for companies engaging in the licensing process, but it also presents challenges with internal compliance guidelines and puts member companies at risk with regards to regulations under the Foreign Corrupt Practices Act.

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Companies related several anecdotes illustrating the challenges presented in the expert panel review process. After one company submitted its EIA report, the local government named a competitor to the expert review panel reviewing its report. The expert was a vice president of a domestic company in the same sector as the company that was seeking approval. The competing executive made clear that he wanted a stake in the company’s new project. To try to persuade the company to agree to his demand, he began questioning different parts of the project from his position on the panel to prolong the process. The company was ultimately able to manage the expert’s request, though the project timeline was delayed in the process. This example suggests companies may often need to manage expert panelists’ requests, since there is no formal dispute process for individuals selected for the expert panel.

The liabilities introduced by expert panel reviews—ranging from information disclosure to compliance concerns—introduce serious risks for US companies seeking to invest in China, with implications for China’s longer term attractiveness as a place to invest. These panels require companies to turn over sensitive information—which may be unrelated to the issue under review—and may expose companies’ trade secrets to competitors. Further, these reviews may needlessly extend the licensing process, due to experts’ unfamiliarity with the process or for other motives, costing companies both time and resources and delaying the many economic and social benefits companies’ investments bring to local communities. While companies seek to comply fully with Chinese regulations and work with governments to provide necessary information, they are also committed to protecting sensitive business information. When companies determine that the risks introduced in the panel review process become too great, companies may refrain from bringing innovative technologies or operational processes to China.

Managing Expert Panel Reviews

Companies suggested that maintaining strong relationships with local governments could help influence which experts are nominated to the panel. Once panels are comprised, companies noted that identifying experts who are knowledgeable of the industry or sector and who have sound grasp of the processes or technology under review can help facilitate the review process by clarifying misunderstanding, maintaining the panel’s focus on the issues under consideration, and offsetting any negative views held by other experts towards the company. For example, one company noted that it was able to recommend an expert to the panel considering its EIA, which helped counter the influence of another expert who was openly hostile to the company. Such experts can also help reduce requests for sensitive information and information that is unrelated to the process or operation under consideration, while facilitating a more timely review.

Further, companies may also be able to work with local governments to clarify misunderstandings that may arise on the expert panel. As one company noted, the expert panel reviewing its energy-consumption assessment calculated energy utilization in a way that would make the company’s operations noncompliant with government energy quotas. To clarify the company was in compliance, it reached out to the local energy authority, which in turn drafted a letter to the panel stating that the company was in fact compliant with the requirements.

**IP and Disclosure Issues in the Licensing Process**

One of the many requirements for licensing approvals at various levels of government is that companies provide detailed product and process information. These information disclosures often put sensitive intellectual property (IP) at risk of leakage to third parties, competitors, or officials during the approval process. These concerns are not new, and have been a key issue for USCBC members over the years, including in USCBC’s recommendations for strengthening trade secret protection in China.\(^{11}\) Given the pervasiveness of IP theft, it is understandable, although perhaps unlikely, that some interviewees viewed the entire permitting and approval processes as being specifically tailored to obtain confidential details of proprietary processes.

Companies indicated that approval processes in China are significantly less clear and objective than they are in other markets, such as the United States. This leads to the disclosure of sensitive information that is typically not

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required in any other location where a company operates. One company said that in its application for a safety assessment it was required to provide specific temperature and pressure information of machinery used in the production process, which it considers to be trade secrets. In every other country where the company operates, it only needs to provide a range for pressure and temperature information.

Due to the amount of data companies are required to provide in the licensing process, it can be a significant time and cost burden simply to gather the information—and even more of a problem for staff to review potential submissions to discern how to ensure compliance while also minimizing the risk of providing sensitive information. This leaves companies to make difficult decisions as they have to manage applications submission-by-submission, at a sizable cost of time and resources.

China does not maintain requirements to destroy information that may be provided to the government once the information is no longer needed in the approval process. Other entities involved in the licensing process, such as local environmental or design institutes, are also required by the government to retain a version of the information in perpetuity. Further, regulations regarding the elimination of sensitive documents are very vague, and do not stipulate directly in what cases such documents should be safely destroyed.  

Managing Information Disclosure Requests

While companies may be required to provide information beyond what would be required in other markets, companies interviewed shared a number of practices they have incorporated to minimize disclosure of sensitive information while also respectful engaging with government authorities.

- **Selectively limiting decision-making authority**: One company said that it emphasized with local authorities that its China office was not permitted to disclose certain information it considers sensitive; only the company’s US corporate office is permitted to make such disclosures. Emphasizing this fact early and often in the licensing process helped to manage local officials’ expectations of what information the company could provide. Expressing this sentiment reinforced that the company was committed to working with the government agency, though it was restricted by internal guidance from sharing certain information. The company reported significantly reduced disclosure requirements once government officials understood that this was the company’s practice.

- **Negotiating what information is made publically available**: The Chinese government is obligated to make certain information in the licensing process publically available at Chinese citizens’ request. One company recommended negotiating with the government what information would be publically available from the documents it was required to submit. In negotiations, the local authorities agreed that the company could highlight small portions of the most sensitive information and the government would redact that information from public disclosures. The government was very clear, however, that only a small portion—two to three sentences per page—could be excluded.

- **Signing non-disclosure agreements with local administrative committees**: One company requests that administrative committees within local industry parks sign non-disclosure agreements (NDAs) with the company in preparation for launching new investment projects in the region. By signing NDAs with administrative committees rather than investment promotion bureaus, the NDA has a wider scope of coverage. This conveys the company’s commitment to protecting its trade secrets, while helping institute protections to lessen the risk of exposure.

**Third-Party Consultant Recommendations**

Companies in all industries work with tax, environmental, legal, and many other third-party consultants and agents throughout the licensing process. Depending on the approval being sought, companies interviewed for this project said that local government regulators often recommend or mandate the use of specific third-party consultants. Many companies stated that they had received these types of recommendations when engaging

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with local authorities in the licensing process. These recommendations can arise at any stage in the licensing process, including for the EIA report, certain product approvals, and to ensure paperwork complies with local government requirements.

Though companies agreed that they prefer to utilize trusted third parties over government-recommended parties, many companies felt a great deal of pressure to use government-recommended service providers. Several companies noted that if they choose not to use a government-approved entity recommended to them, they run the risk of extended lead times and strained government relations. In the course of USCBC interviews, companies raised a number of concerns associated with hiring government-recommended or mandated third parties, including:

- **Limited vendor selection**: A reoccurring problem raised by companies interviewed was that government regulators do not provide enough third parties from which the company could choose. In one company example the government recommended only one third party for the foreign company to consider, raising red flags for the company.

- **Required use of local vendors**: In some cases, a company may be strongly discouraged from or not allowed to use their preferred vendor. In one case, a local government official informed the company that their preferred supplier “lacked local experience and presence.” While not outright forbidding the company from utilizing their preferred service provider, the foreign company felt that if it did not use a government-approved vendor, the licensing process would not proceed smoothly.

- **Inadequate skills for recommended third parties**: Recommended third parties may not possess the necessary knowledge or technical skills to satisfy the standards of the foreign company. One company shared the example of an agent they employed to obtain a manufacturing license. When the company provided the agent with technical information to formulate the appropriate application documents, the agent indicated he was primarily there to ensure interaction with the government went smoothly and would have limited engagement on technical details.

One company shared that – despite its years of experience in China – it was required by the local government to employ a recommended agent to assist in paperwork preparation. However, the company discovered that the agent acted primarily as a courier; once a company prepared its paperwork, the agent then provided it to the government. The local government refused to accept submissions from the company directly, adding additional costs for the company.

Overall, these types of recommendations create added costs and delays for companies engaging in the licensing process. Companies that feel they must hire recommended firms must budget added time and resources for due diligence investigations. Further, as several companies interviewed for this project found, local consultants may not actually be familiar with the type of licensing process in which the company is engaging. Finally, these recommendations inhibit capable international firms from contributing knowledge and skills in China’s market, and from facilitating timely licensing reviews for both Chinese and domestic companies.

**Managing Third-Party Recommendations**

Third-party recommendations create significant challenges for companies engaging in the licensing process. For example, many foreign companies require strict due diligence review before working with any third party with which they have not worked previously. These firms also observe a variety of practices to ensure the third party is compliant with international regulations. Risk assessments, background checks, and audits are all methods a company can use to evaluate the risk posed by partnership with a third party. Some companies expressed concern that carrying out due diligence on a government-recommended third party might offend government officials. This risk can be minimized by stressing early and often that the company is obligated by global best practices to conduct due diligence on any new third party with which it works.

While some companies felt they had to work with the third party, at least one company chose to use its preferred firm to conduct the majority of the consulting work, and then have the local entity submit the final documents to the government. For companies who did not take issue in working with local partners but wanted the government to recommend more than one entity, several companies negotiated with the authorities to share
additional local entities that could assist in the licensing process. These types of solutions helped companies appropriately respond to requests to use recommended third-party service providers while maintaining their relationships with local authorities.

Licensing Challenges in Joint Ventures

Joint ventures (JVs)—either majority- or minority-owned—add a layer of complexity to company licensing and approvals in China. Companies operating in industries—such as the automotive industry—are required to operate in JVs to sell products in China. While companies are familiar with the challenges of operating in a JV, one of the benefits companies cite is the close government connections a Chinese partner may enjoy. This relationship can prove valuable in the licensing process; companies said their Chinese partners can leverage their relationships with local government to clarify procedural issues and work directly with officials when problems arise. However, some companies noted that this relationship can also give Chinese partners significant leeway to ask their US partners for more information than is necessary in the licensing process.

Some companies noted that their Chinese partners are either unwilling to include and often resist including the foreign partner in licensing discussions with government regulators. For example, the partner may assert their relationship with government officials is sufficient to move the licensing process forward or the process is easier if the partner deals with officials directly. As a result, a JV partner may request extensive information from its foreign partner, some of which is considered sensitive, stating that it needs to share the information with the local government to move forward in the licensing process. When asked to see the requirements requiring excessive disclosure, the Chinese partner is occasionally unable to provide written evidence or refer the company to publically-available requirements. One company stated that in one instance their Chinese partner said the JV was “behind in the approval process” and that it required additional, sensitive information to move forward in resolving the licensing delays—information which the company did not consider necessary to advance in the licensing process.

While JV relationships are often unique to the partners and industry, companies will benefit from being aware of common challenges other JVs have faced prior to engaging in the licensing process with their Chinese partner. Understanding challenges shared by companies in similar arrangements may help companies negotiate strategy internally, while making them more familiar with the disclosure requirements in the licensing process. In doing this, companies will gain better understanding of the common hurdles and requirements stipulated in the regulations guiding the licensing process, and become more capable of negotiating information requests from JV partners as they arise.

Managing Disclosures in Joint Ventures

Though there is no guarantee a JV partner will protect the information supplied to them in the licensing process, companies shared practices that can be utilized to limit IP risk after information has been disclosed.

- **Contractually limit the geography where certain technology can be used:** Companies should clearly define that technology used in the production of any final product can only be sold in certain markets. China and Africa were mentioned by companies as examples. One company noted that if their agreements had not laid out these restrictions in the early stages of the relationship, their partner would likely now be a direct competitor in the developed markets key to the foreign company’s business.

- **Source some products internally:** In the China Compulsory Certification process, a company will normally provide a detailed technical documentation list that includes all components included in the final product. One way to protect this information is to split sourcing of the most technologically sensitive information between the JV and the company. The company is still required to disclose the technical information; however, by ensuring the most sensitive information is sourced from a trusted supplier the company can minimize risk of unexpected trade secret disclosure.
Conclusion

Foreign and domestic companies must negotiate a complex and opaque licensing system that often requires the disclosure of sensitive information or trade secrets, potentially to competitors. While there are steps companies can take to lessen risks in the licensing process, many of the problems addressed in this paper cannot be solved sufficiently through company best practices. Instead, the issues described in this paper should be addressed by the PRC government to create a more transparent, fair, and timely licensing process for foreign and domestic companies.

To strengthen China’s operating environment and attract foreign investment, the PRC government should consider reinforcing its commitments to transparency and reducing disclosure risks introduced in the licensing process. USCBC is developing specific recommendations to this end for Chinese policymakers to consider as they seek to improve their licensing and investment regimes and strengthen foreign investment. In considering these recommendations, Chinese leadership will help improve the operating environment in China for industries across all sectors, while helping to strengthen overall investment in its market.

US companies seeking to invest or expand in China can mitigate risks and facilitate the licensing process by establishing strong relationships with local government officials, as doing so may help improve transparency and minimize disclosure requests. Further, companies should seek to make clear to officials what information they are— and are not— willing to disclose in the licensing process and create internal decision-making structures to help local branch offices manage officials’ expectations. These strategies, along with those described previously, may help companies manage challenges in China’s administrative licensing system.
China has made notable advances in recent years in technology innovation. For example, in 2012, China’s State Intellectual Property Office (SIPO) received more than 650,000 applicants for invention patents, an increase of more than 26 percent from 2011 and the largest number received by any patent office in the world. Investment in research and development (R&D) activities is also growing, with spending on R&D in 2012 growing more than 17 percent, according to official Chinese statistics.

As a part of these efforts, Chinese authorities have recognized that nondiscriminatory tax policies and a robust legal and regulatory system for protecting intellectual property rights (IPR) play a vital role in fostering innovation. The US-China Business Council (USCBC) acknowledges the efforts of Chinese central and local government agencies to set fiscal and IPR protection policies and programs that advance innovation. USCBC also appreciates the ongoing dialogue between USCBC and various central government agencies to discuss the value of tax and IP protection policies that align with international best practices and the realities of corporate structures. Through this submission, USCBC hopes to continue this constructive conversation about best practices for tax and IP policies that benefit all stakeholders to promote China’s development as an advanced, high-tech industrial economy.

One of China’s core innovation tax policies, the High- and New-Technology Enterprise (HNTE) program, offers qualified company locations a 15 percent tax rate regardless of the company’s investment type and where the company is headquartered. HNTE status is granted by provincial tax authorities for company facilities located within their jurisdictions. To qualify a facility for HNTE status, companies are required to own the proprietary IPR of the core technology used in their products and services in China, or they must give their Chinese subsidiaries a global exclusive license for that IP for at least five years.

While China’s current HNTE program allows both domestic and foreign companies to apply for HNTE status, the structure of the HNTE program presents innovative global companies with three particular challenges, discussed below. These challenges limit the ability of these companies to participate in the HNTE program. The end result is that the innovative companies that officials aim to attract cannot fully contribute to China’s efforts to promote innovation. In addition to discussing these three challenges in greater detail, USCBC recommends potential solutions to address these challenges.

Challenge: HNTE Criteria Deviate from International Norms and Best Practices

Most foreign companies manage their IP portfolios globally based on commercial considerations, the legal environment, and accessing top talent and resources where they may be found, rather than on national borders. The result is a dynamic, globally integrated IP development structure, uniquely suited to each company’s needs and promoting innovation and technology development to the benefit of both businesses and consumers.

By contrast, China’s HNTE program requires companies to own or hold an exclusive global license for their IP in China to qualify for the preferential tax rate. Such a requirement prevents companies from fully utilizing their own IP throughout their company and in the most appropriate location for their business goals. As a consequence, companies must choose between benefits they can receive under HNTE by bringing IP to China and the benefit they may receive by using that IP in other markets. Faced with that choice, some companies may choose not to bring the IP to China, limiting their ability to innovate in China. Consequently, Chinese companies are closed off from the global innovation network. Both of these dynamics ultimately hinder central government innovation goals.
Recommendations

- Modify the current HNTE requirement that license rights held by the applicant must be global, exclusive rights (not merely the right to exploit the relevant IP in China) with a term of not less than 5 years. Options for such a change can be:
  - Eliminating the requirement for ownership of core proprietary IPR in China; or
  - Expanding the criteria to include legally acquired, non-exclusive licensee or usage rights; or
  - Narrowing the criteria to be exclusive license rights in China only.

Challenge: Limited Applicability of HNTE Incentives

Under existing HNTE rules, legal entities must have both a manufacturing and an R&D component and generate revenue to qualify for HNTE status, since eligibility criteria focus on sales of high-tech products and services as well as on R&D spending and employment of technical personnel. These requirements do not take into account modern international corporate structures that manage and promote joint corporate R&D activity, often by using single R&D centers to support multiple corporate units.

Under China’s framework, many entities that carry out innovative and high-tech activities are ineligible for HNTE. This includes R&D centers without manufacturing capabilities, manufacturing entities that use R&D innovations generated elsewhere in the products they sell, and companies whose innovative products are manufactured in China but not sold through their manufacturing entities. China’s government should allow all legal entities that develop, use and commercialize R&D, technology, IP, or high-tech products to qualify for the tax incentive.

Recommendations

- Revise existing HNTE rules—such as the Management Rules of High- and New-Technology Enterprises—to allow all legal entities that develop, use and commercialize R&D, technology, IP, and high-tech products to qualify. All entities that do so – including R&D centers without manufacturing capabilities, manufacturing entities selling products are commercialized using innovation generated elsewhere, and manufacturing entities that do not themselves sell in China the innovative products that they produce (e.g. a foreign-invested manufacturing enterprise whose products are sold by a separate foreign-invested commercial enterprise) – should qualify for HNTE status based on innovation and commercialization they are conducting.
- Review and revise other tax-related laws and regulations to eliminate location-specific IP ownership and registration requirements that hinder innovation.

Challenge: High Risk of Trade Secret Theft

The HNTE application process requires companies to disclose a significant amount of information that may be considered to be trade secrets or highly sensitive. These disclosures include the number of R&D projects a company is undertaking, names of personnel who work on them, types of activities taking place on the projects, and other confidential business information. The amount of information required by provincial authorities for these applications has been increasing. Fearing loss of trade secrets and other IP, qualified companies often do not apply for HNTE status because of these invasive procedures that put their IP at risk due to the lack of clarity about how such information will be protected.

Recommendations

- Revise existing HNTE rules, including the Management Rules of High- and New-Technology Enterprises, to limit the amount of sensitive company information that companies are required to compile and submit with their application, including project details and personal information about employees. Officials should work with companies to limit required information disclosures to that which is truly necessary to evaluate a company’s high- and new-technology activities such as supporting evidence of R&D expenditure.
- Release specific guidelines outlining the responsibilities of officials involved with HNTE certification to protect confidential business data gathered during the application process, including ramifications for officials that fail to protect such data.

Conclusion

Innovation that happens in China benefits China, regardless of the nationality of the company that does it and regardless of where the company registers the IP connected to it. To that end, China can best advance its innovation and industrial modernization goals by adopting tax policies and programs to promote innovation that align with international best practices, including policies that do not explicitly or implicitly
link the location of IP ownership to incentives. Improving the HNTE program and similar tax programs that reward innovative activities regardless of the location of IP ownership would be an important step in that direction.
Status Report: China’s Innovation and Government Procurement Policies

May 1, 2013

Executive Summary

PRC officials made a series of commitments in 2011 to break existing links between indigenous innovation and government procurement preferences – a significant concern for the US-China Business Council and its member companies. These included a State Council notice, issued in November, requiring provincial and local governments to halt implementation of any measures that link innovation and government procurement within regulatory documents, to review existing regulatory documents for provisions that may need to be eliminated, and to report results to the State Council before the end of December 2011.

Not all such sub-national governments have yet announced their compliance with these requirements. To facilitate continued discussion on China’s full implementation of its pledges, USCBC is regularly updating a report covering the central, provincial, and local policy changes on indigenous innovation. This report is designed to ensure full implementation of China’s commitments at the provincial and local level since January 2011, with a particular focus on those documents released since the November 2011 notice.

- As of May 2013, 18 provinces have released notices and announcements to comply with central government requirements. Fourteen provinces – Anhui, Beijing, Chongqing, Guangdong, Guizhou, Hebei, Hunan, Inner Mongolia, Jiangsu, Jiangxi, Liaoning, Tianjin, Xinjiang, and Yunnan – have complied to some degree after the November State Council notice was issued. An additional 4 provinces – Fujian, Gansu, Shandong, and Shanghai – did so before the notice.
- An additional 38 sub-provincial units – ranging from Chengdu, Sichuan to Wuxi, Jiangsu – have issued notices and announcements to comply with central government requirements.
- USCBC has found only three local regulations formally linking indigenous innovation and government procurement released since the State Council’s November 17 notice, suggesting that the central government’s efforts have seen a measure of success but that further vigilance is needed.
- However, significant work still remains: 13 provinces have not released any measures since January 2011 to implement central-level pledges, including some notable locations where foreign companies have investment such as Sichuan and Zhejiang provinces.
- USCBC recommends that US government officials continue to raise this issue to ensure full and consistent compliance, including raising this issue at the 2013 Strategic & Economic Dialogue, Joint Commission on Commerce and Trade and other relevant bilateral meetings.

In January 2011, PRC President Hu Jintao committed his administration to breaking links between China’s innovation and government procurement policies, including removing government procurement preferences for products on “indigenous innovation” catalogues. This was followed by subsequent commitments at the May 2011 Strategic and Economic Dialogue and the November 2011 Joint Commission on Commerce and Trade to eliminate regulations and policies linking innovation and government procurement. The US-China Business Council (USCBC) has prioritized the elimination of discriminatory innovation-related procurement rules at all government levels in its advocacy work and has provided various PRC government agencies with a list of rules and policies that need to be revised or revoked.
In the intervening months, central and provincial governments have taken specific steps toward implementing these commitments. In June the PRC Ministry of Finance (MOF) and other agencies published notices invalidating three regulations linking indigenous innovation and government procurement and removed the draft accreditation rules for indigenous innovation products in July. These national regulations had composed important parts of the PRC regulatory framework promoting government procurement of indigenous innovation products and had spurred national, provincial, and local government agencies to release similar policies.

Such discriminatory links, however, remained at the sub-national level, with policies and regulations such as the accreditation rules for indigenous innovation products and catalogues for those products. As confirmed at the JCCT, the State Council on November 17, 2011 released a notice stating that sub-national governments at all levels must halt implementation of any measures that link innovation and government procurement within regulatory documents by December 1, 2011. The notice also requires these governments to announce to the public which regulatory documents remain in effect, which are eliminated and which are suspended, and to report progress to the State Council by the end of December 2011. (For a copy of the notice, see zfxx.cq.gov.cn/zfxgk/jsp/view/infoview.jsp?xbid=59679).

Recent government actions to amend or eliminate some of these regulations and catalogues demonstrate that the government is keeping its commitments. Based upon publicly available information, 22 of China’s provinces and provincial-level cities can show some kind of specific, concrete action since early 2011 to implement pledges at the provincial or local level, with many of those doing so in direct response to the November 2011 circular.

Not all provincial and municipal governments, however, have publicly announced the results of their work, and USCBC and other industry groups will continue to watch for new local policies and regulations where such links between indigenous innovation and government procurement persist. To date, USCBC has uncovered only new policies released since the November 2011 State Council notice requiring provincial and local governments to halt implementation of any such measures.

- **Rules to support local enterprises** released in June 2012 by the local government in Zhenjiang, Jiangsu, that encourage use of the indigenous innovation product catalogue and government procurement to support local enterprises.
- **A notice reviewing 2012 government procurement work** released in December 2012 by the local government in Yantai, Shandong that listed a scoring mechanism to evaluate government agencies’ procurement work with points given for their procurement of indigenous innovation products.
- **A notice announcing 2013-2014 government procurement work** released in February 2013 by the Hangmianhouqi county government (Inner Mongolia) claiming that the government should “actively support” indigenous innovation products through government procurement, and should give prior consideration of procurement for domestic indigenous innovation companies, if they have the same quality or price conditions.

In addition, despite the central government push to delink indigenous innovation and government procurement, data from USCBC’s 2012 member company survey reveals that 85 percent of companies surveyed said they had seen no positive change in sales opportunities to PRC government entities at the national, provincial, or local levels since the 2011 release of the State Council notice, implying that the delink effort on paper has yet to translate into real change. In direct advocacy with the PRC government and in government-to-government meetings and dialogues, USCBC will continue to ensure that resolution of this issue remains a priority.

To facilitate continued discussion on China’s full implementation of its pledges, USCBC has compiled—and is regularly updating—the following report covering the central, provincial, and local policy changes designed to ensure full implementation of China’s commitments at the provincial and local level since January 2011, with a particular focus on those documents released since the November 2011 notice.
I. Provincial- and Local-Level Government Actions Designed to “Delink” Indigenous Innovation and Government Procurement

Anhui

- On July 8, 2011, the Anhui Finance Bureau announced that it would suspend the implementation of 2007 provincial rules that regulate government procurement of indigenous innovation products, including provisions that cover drafting and use of provincial catalogues.
  www.ahcz.gov.cn/portal/zwgk/zbcg/1321546398264922.htm

- In late November or early December 2011, the Anhui provincial government issued a circular that is believed to order all government and agencies at or below the provincial level to halt implementation of any measures that link innovation and government procurement within regulatory documents no later than December 1, 2011. (Full text unavailable; referenced in www.czzwgk.gov.cn/XxgkNewsHtml/MA001/201112/MA001020503201112004.html

  www.ahzwgk.gov.cn/xxgkweb/showGKcontent.aspx?xxnr_id=95297

- On December 8, 2011, the Chuzhou municipal government released a circular announcing the launch of its work to eliminate measures linking innovation and government procurement. The notice required relevant departments to draft a list specifying which regulatory documents would remain in effect, and which would be discarded or suspended. Departments should eliminate such documents by December 12, 2011, and should report results to the public and to the Anhui provincial government.

Beijing

  www.bjsjs.gov.cn/zfcg/zdztg/8a8481d2345a594701355ba4a2e028c.html

- On December 1, 2011, the Beijing municipal government released a circular announcing that it would suspend the implementation of some related measures linking innovation and government procurement, including specific provisions in the 2006 Opinions on Strengthening Indigenous Innovation Capacity and Building an Innovative City, the 2008 Opinions on Pilot Work to Develop Government Procurement of Indigenous Innovation Products in Zhongguancun Science & Technology Park, the 2009 Opinions on Scientific Promotion of Industry Development in Ecological Conservation Development Zones, and the 2010 Opinions on Promoting the Establishment of Industry Development Guidance in Beijing.
  cwc.bjedu.gov.cn/publish/portal13/tab784/info18781.htm
On April 17, 2012, the Shunyi district Government under Beijing city released a circular, announcing that it would halt the implementation of any measures that link innovation and government procurement, including specific provisions in the 2009 Circular on Helping Enterprises Deal with the International Financial Crisis and the 2010 Circular on Boosting the Development of Cultural and Creative Industries.

www.bjshy.gov.cn/Item/48041.aspx

Chongqing

On July 14, 2011, the Chongqing Finance Bureau announced that it would no longer award extra points for indigenous innovation products in the Chongqing municipal government procurement process. The bureau also said it would eliminate such points from the 2010 standard text for tendering documents.


On November 29, 2011, the Chongqing municipal government released a circular announcing that all government entities at or below the municipal level must halt implementation of any measures that link innovation and government procurement within regulatory documents no later than December 1, 2011. Agencies and district governments must submit lists of regulations that will remain in effect, as well as those that will be eliminated or suspended, to the city government by December 15. The Chongqing Legislative Office will summarize progress reports and submit its final report to the State Council by December 25.


On December 5, 2011, the Banan district government under Chongqing city released a circular announcing that government entities within the district must halt implementation of any regulations linking innovation and government procurement by December 1, 2011, and must also halt implementation of any regulations based on related regulations now invalidated by NDRC, MOST, and MOF. Agencies must submit suggested regulations to eliminate to the Banan Legislative Office by December 12, which must then report the results of such work to the Chongqing Legislative Office by December 15.

zfxx.cq.gov.cn/zfxxgk/jsp/view/infoview.jsp?xxbid=59679

On January 17, 2012, the Chongqing municipal government announced the results of its round of regulatory changes, stating that county governments had eliminated five regulatory documents linking innovation and government procurement and had revised two others. Chongqing’s government is also currently revising Article 8 of the 2008 Opinions on Encouraging Enterprises to Expand Research & Development Investments to Increase Indigenous Innovation Capabilities.

zfxx.cq.gov.cn/zfxxgk/jsp/view/infoview.jsp?xxbid=58948

Fujian

On July 11, 2011, the Fujian Finance Bureau announced that it would suspend implementation of 2007 provincial rules regulating government procurement of indigenous innovation products, as well as all policies on government procurement preferences for indigenous innovation products.

www.fjicpa.org.cn/article.cfm?f_cd=56&s_cd=404&id=82FB052A-D605-5850-CBD6FFA4714C7316

On July 11, 2011, the Xiamen Bureau of Science and Technology released a circular announcing that the city would “temporarily suspend” its 2011 work on accrediting indigenous innovation products in light of the July central-level interagency circular. Xiamen’s circular made no reference to existing catalogues in Xiamen.

www.xminfo.net.cn/index.php?m=content&c=index&a=show&catid=12&id=17176

On July 20, 2011, the Zhangzhou Government Procurement Center released a circular announcing that it would suspend implementation of any policies providing preferences in government procurement to indigenous innovation products that appear in the center’s bidding documents.

www.zzzfcg.gov.cn/viewbody.cfm?id=9078
On August 24, 2011, the Fujian Finance Bureau announced that it would suspend implementation of the 2007 Fujian Trial Administrative Measures on the Accreditation of Provincial Indigenous Innovation Products.

www.shanghang.gov.cn/dzzw/dwzw/gfxwj/sjwj/201108/t20110829_97301.htm

Gansu

On July 6, 2011, the Gansu Finance Bureau announced that it would suspend implementation of indigenous innovation-related provisions included in broader provincial measures on procurement of energy saving, environmental, and indigenous innovation products.

www.gszfcg.gansu.gov.cn/web/147/110287.html

Guangdong

On August 2, 2011, the Guangdong Finance Bureau announced that it would suspend implementation of the 2009 guidance on government procurement of indigenous innovation products starting on August 1, 2011.


On August 16, 2011, the Qingyuan municipal government released a circular referencing the August 2011 Guangdong Finance Bureau circular and requesting relevant government agencies, including finance and science & technology bureaus at the city, district, and county level, to comply.

qingyuan.gdgpo.com/gdpmPortal/sp/article_content.jsp?articleId=4028708332b5d20e0132f752fde0c92

In late 2011, the Guangdong provincial government released a circular that is believed to order all government and agencies at or below the provincial level to halt implementation of any measures that link innovation and government procurement within regulatory documents. (Full link not available, but referenced in zwgk.gd.gov.cn/007335807/201204/t20120405_311243.html)

On January 9, 2012, the Chaozhou municipal government released a circular calling for governments at or below the municipal level to eliminate or revise regulatory documents linking innovation and government procurement. Such regulatory changes must be completed and reported to the Chaozhou Finance Bureau by February 15, 2012.

zwgk.gd.gov.cn/007335807/201204/t20120405_311243.html

On January 9, 2012, the Xinhui district government under Jiangmen city released a circular calling on governments and agencies at or below the district level to eliminate or revise regulatory documents linking innovation and government procurement. Such regulatory changes must be completed and reported to the Xinhui Legislative Office by February 15, 2012.

www.xinhui.gov.cn/zwgk/GBYTJ/QZFGB/201205/P020120524638115803821.doc

On March 8, 2012, six Jiangmen municipal government agencies, including the Jiangmen Science and Technology Bureau and the Jiangmen Finance Bureau, released a circular announcing revisions to the 2009 Jiangmen Provisional Management Rules for Indigenous Innovation Product Accreditation, including the elimination of Article 10, which had called for advantages in government procurement for indigenous innovation products.

fzj.jiangmen.gov.cn/FileDiscuss.aspx?Id=639

On March 13, 2012, the Zhuhai municipal government released a circular calling for all relevant government agencies to eliminate or revise regulatory documents linking innovation and government procurement. Such regulatory changes must be completed before December 1, 2011, and must be posted for the public on the municipal government website as well as reported to the Zhuhai Finance Bureau and the Zhuhai Legislative Office.

www.zhczy.gov.cn/ljcz/gzdt/201203/t20120313_279376.html
• On April 17, 2012, the Guangzhou municipal government released a circular announcing that the city would immediately halt the implementation of Guangzhou Management Rules for Indigenous Innovation Product Accreditation.
sfzb.gzlo.gov.cn/sfzb/file.do?fileId=2C9089253734F024013739EB5CC90000

Guangxi
• On January 5, 2012, the Liuzhou municipal government autonomous region released a circular announcing that the city would start cleaning up regulatory documents linking innovation and government procurement. The notice stated that the municipal government would halt implementation of any such regulatory documents by December 1, 2011. Agencies must submit suggested regulations to eliminate to the Liuzhou Legislative Office by January 20; that office must then report the results of such work to the municipal government by January 16.
www.liuzhou.gov.cn/zwgk/fggw/ysq/lzf/201202/t20120223_519915.htm

• On January 9, 2012, the Liunan district government under Liuzhou city released a circular announcing that the district would start cleaning up regulatory documents linking innovation and government procurement. The notice stated that the district government would halt implementation of any such regulatory documents by December 1, 2011.
www.liuzhou.gov.cn/lzgovpub/lzszf/gqzf/A090/201203/t20120331_523792.html

• On February 13, 2012, the Fangchenggang municipal government announced the results of its work to clean up regulatory documents linking innovation and government procurement released before December 20, 2011. According to its report, the review included five documents released by the municipal government, all of which remain in effect, and four departmental documents, of which one remains in effect and three have been suspended.
www.gx-law.gov.cn/old/news_show.asp?id=14540

Guizhou
• On November 29, 2011, the Guizhou provincial government released a circular announcing that it would halt implementation of any measures linking innovation and government procurement included in the 2008 Implementing Opinions for Guizhou Government Procurement of Energy-saving and Environmental Protection Products to Promote Indigenous Innovation and the 2008 Provisional Rules of Conduct for Government Procurement by Guizhou Provincial-Level Units.

Hebei
• On December 22, 2011, the Hebei Finance Bureau released a circular referencing the June 2011 State Council and requesting relevant government agencies at all levels to comply.
www.hebgp.gov.cn/upnews/upfiles/zfcg_zcfg/TS_LX20111222162415jg@ng.htm

• In early February 2012, the Hebei Finance Bureau issued a circular calling on all government entities at or below the provincial level to halt implementation of the 2011 Hebei Indigenous Innovation Product Government Procurement Catalogue. (Full link not available, but referenced in www.hebgp.gov.cn/upnews/upfiles/zfcg_zcfg/LF2012314152831jg_rf.htm)

Hunan
• On December 1, 2011, the Hunan provincial government released a circular announcing that all government entities at or below the municipal level must halt implementation of any measures that link innovation and government procurement within regulatory documents no later than December 1, 2011. Government entities must complete this work by December 31, 2011 and report results.
www.yylq.gov.cn/html/zhengwugongkai/zwgkzczwj/11216.html

• On December 14, 2011, the Yueyanglou district government under Yueyang city released a circular announcing that government entities, in accordance with Hunan provincial measures, must eliminate
or revise any regulatory documents linking innovation and government procurement and announce which documents remain in effect, and which are eliminated or suspended. The notice called on all relevant departments to submit results of removal work by December 20, 2011.

www.yylq.gov.cn/html/zhengwugongkai/zwgkzcwj/11216.html

- On December 19, 2011, the Hengyang municipal government released a circular announcing that it would halt implementation of any measures that link innovation and government procurement within regulatory documents no later than December 1, 2011. Agencies must submit suggested regulations to eliminate to the Hengyang Legislative Office by December 20. Regulatory changes must be completed by December 25, 2011.

www.hengyang.gov.cn/main%5Chyzw/zfxxgk/fggw/szfbgswj/1_17888/default.shtml

- On December 19, 2011, the Beihu county government (Chenzhou city) released a circular announcing that it would halt implementation of any measures that link innovation and government procurement within regulatory documents no later than December 1, 2011. Regulatory changes must be completed by December 20, 2011.

www.czbeihu.gov.cn/dtxx/tzgg/content_61384.html

- On December 31, 2011, the Taoyuan municipal government released a circular announcing that it had completed the required document removal work, confirming that the two existing regulations dealing with government procurement were both valid and that there were no documents that required elimination or suspension.


www.hnfgw.gov.cn/xzgk/sdxfxg/27119.html


www.xiangtan.gov.cn/new/wszf/wjgz/zfwj/szfgfxwj/content_26596.html

**Inner Mongolia**

- On December 21, 2011, the Inner Mongolia autonomous regional government issued a circular referencing the November 17 State Council notice and calling on governments below the provincial level to implement the policy and submit progress reports to the Inner Mongolia Legislative Office by January 31, 2012.

(Link inactive, but formerly available at www.nmfzb.gov.cn/information/fzb17/msg548586222.html)

- On February 24, 2012, the Inner Mongolia Health Department announcing that it would halt implementation of a 2007 notice aimed at implementing the spirit of MOF rules on indigenous innovation and government procurement.

Jiangsu

- In November 2011, the Jiangsu provincial government released a circular that is believed to order all government and agencies at or below the provincial level to halt implementation of any measures that link innovation and government procurement within regulatory documents no later than December 1, 2011. (Full link not available, but referenced in www.jscz.gov.cn/pub/jscz/zfxxgk/zfxxgkml/zfcg/11/201112/t20111231_22292.html)

- On November 25, 2011, the Changzhou Municipal Working Group for Comprehensive Promotion of Legal Administration Work released a circular announcing that implementation of any measures that link innovation and government procurement within regulatory documents should be halted no later than December 1, 2011, and that all government agencies at or below the Changzhou municipal level should review existing regulations for compliance. The municipal committee, city government, and directly administered offices should report initial results of their review and recommended changes to the Changzhou Legislative Office by December 5, 2011, while all municipal-level government organs, district governments, and governments of other directly administered cities should report to the same office by December 10, 2011. mail.changzhou.gov.cn/gi_news/133994310012279

- On November 29, 2011, the Qidong municipal government released a circular announcing that any measures that link innovation and government procurement within regulatory documents should be eliminated and implementation halted no later than December 1, 2011. Regulatory changes should be completed by December 10, 2011, with progress reports given to the Qidong Legislative Office the same day. www.qidong.gov.cn/art/2011/11/30/art_1768_125686.html

- On December 6, 2011, the Wuxi municipal government released a circular announcing that it would halt implementation of any measures that link innovation and government procurement within regulatory documents no later than December 1, 2011. Relevant departments and agencies should submit progress reports to the Wuxi Legislative Office by December 10, 2011. That office will summarize and submit a final report to the municipal government by December 15, 2011. www.wuxi.gov.cn/zfxxgk/szfxxgkml/zcfg/szfbgswj/5969581.shtml

- On December 8, 2011, the Donghai municipal government released a circular announcing that government entities, in accordance with Jiangsu provincial measures, must eliminate or revise any regulatory documents linking innovation and government procurement and announce which documents remain in effect, and which are eliminated or suspended. The notice called on all relevant departments to submit results of removal work by December 20, 2011. xxgk.jsdh.gov.cn/zhengfuxinxigongkai/xianzhengfubangongshi/2011-12-31/2583.html


- On January 10, 2012, the Nanjing municipal government issued a decision announcing the elimination and revision of a broad mix of documents – including some of those related to innovation and government procurement. These changes include the elimination of 2008 measures to promote innovation in enterprises and revisions to 2009 measures on promoting enterprise growth and stable, rapid development and to 2010 policies for promoting the software and information service industries. While revisions removed explicit ties between government procurement and innovation, the notices
do still call for government support and promotion of indigenous innovation software products and services.
www.js.gov.cn/xgk/bmhsxwj/sxwj/201201/t20120119_712053.html

- On February 3, 2012, the Xuzhou municipal government announced the results of its round of regulatory changes designed to eliminate or revise regulatory documents linking innovation and government procurement, stating that city government agencies had eliminated specific provisions in the 2006 Circular on Encouraging and Promoting Scientific and Technological Innovation and Start-ups and the 2009 Outline of Xuzhou’s Intellectual Property Strategy. (Link inactive, but formerly available at xgk.xz.gov.cn/xzxxgk/nrglIndex.action?catalogID=ba5a42a118c5c8140118c5ef68980046&type=2&messageID=ff80808135a7cddd0135ebc1c7f604a2)

**Jiangxi**
www.ncinfo.gov.cn/Newsite/content_detail.asp?id=40904

**Liaoning**
www.fd.ln.gov.cn/web/detail.jsp?id=8a98819d34cfac22013540d6d25b02d1

- On January 11, 2012, the Shenyang Finance Bureau released a circular announcing that it would halt implementation of 2009 implementing measures to promote model government procurement bidding activities no later than January 1, 2012.

**Ningxia**
- On December 21, 2011, the Yanchi county government released a circular calling for governments at or below the county level to eliminate or revise regulatory documents linking innovation and government procurement. All departments and agencies should report suggestions for regulatory changes or results of such work to the Yanchi county government by December 25, 2011. (Link inactive, but formerly available at xgk.yanchi.gov.cn/detail.asp?id=1592)

- On January 18, 2012, the Dawukou autonomous regional government announced that it would halt the implementation of the Administrative Regulations for Dawukou Government Procurement.
govinfo.nlc.gov.cn/nxfz/xgk/dwkqrmzfzwgk/201201/t20120119_1309802.html?classid=363

- On February 17, 2012, the Wuzhong Legislative Office released a review of its 2011 work and its direction for 2012. This report notes that it had completed a review of local regulations to ensure compliance with requirements not to link innovation policies and government procurement, and had not found any regulations that were out of compliance.
xn--xrtji123e.xn--fqs8s/article/dfxx/dffzx/nx/201202/2012020360611.shtml
Shandong

• On July 4, 2011, the Shandong Finance Bureau released a circular, which referenced the June MOF circular, calling on provincial government agencies to implement MOF government procurement policies.
  www.ccgp-shandong.gov.cn/fin_info/servlet/attach?type=site&id=832

Shanxi

• On December 13, 2011, the Anze county government called for governments at all levels to eliminate or revise regulatory documents linking innovation and government procurement in line with China’s external commitments. Such regulatory changes must be completed by December 25, 2011, and should post online a list of which documents are still in effect and which have been eliminated or suspended. Regulatory documents that are not listed online in this manner should cease implementation after January 1, 2012.

• On February 12, 2012, the Gujiao municipal government released a circular announcing that all government entities at or below the municipal level must halt implementation of any measures that link innovation and government procurement within regulatory documents, and must begin work to eliminate or revise regulatory documents linking innovation and government procurement. Results of the work must be reported to the Gujiao Legislative Office by February 20, 2012.

Shanghai

• On July 1, 2011, the Shanghai branches of MOST and MOF announced the immediate invalidation of Shanghai’s catalogue of indigenous innovation products.
  www.czj.sh.gov.cn/zcfg/gfxwj/zfcg/201107/t20110708_128211.html

Sichuan

• On July 11, 2011, the Chengdu Government Procurement Service Center announced that it would no longer award extra points for indigenous innovation products during the evaluation process for five specific municipal-level government procurement projects as of July 1.

Tianjin

• On July 1, 2011, the Tianjin Finance Bureau announced that it would no longer award extra points for nationally and locally accredited indigenous innovation products in the evaluation process for government procurement programs starting July 1, and released a list of bidding projects prior to July 1 that would need to be reviewed for compliance with the new notice.

  www.tjjj.gov.cn/upload/File/20111215160915059.pdf

• On June 26, 2012, Tianjin municipal government released a circular, announcing that the city would halt implementation of the 2009 Tianjin Provisional Management Rules for Indigenous Innovation Product Accreditation Management Rules.
  www.tjzfxxgk.gov.cn/tjep/ConInfoParticular.jsp?id=33352
**Xinjiang**


- On December 8, 2011, the Hutubi county government released a circular announcing that it would halt implementation of any measures that link innovation and government procurement within regulatory documents no later than December 1, 2011. Relevant departments and agencies should complete regulatory changes and report to the Hutubi Legislative Office by December 10, 2011. (Link inactive, but formerly available at [www.htb.gov.cn/10016/10016/00012/2011/34896.htm](http://www.htb.gov.cn/10016/10016/00012/2011/34896.htm))

**Yunnan**

- On August 16, 2011, the Yunnan Finance Bureau released a circular referencing the June 2011 State Council and requesting relevant government agencies at all levels to comply. [www.ynwscz.gov.cn/show.asp?id=1925](http://www.ynwscz.gov.cn/show.asp?id=1925)

- On September 20, 2011, the Wenshan municipal government released a circular referencing the August 2011 Yunnan Finance Bureau circular and requesting relevant government agencies, including finance bureaus at the city, district, and county level, to comply. [www.ynwscz.gov.cn/show.asp?id=1925](http://www.ynwscz.gov.cn/show.asp?id=1925)

- In late November or early December 2011, the Yunnan Legislative Office released a circular that is believed to call on all government and agencies at or below the provincial level to halt implementation of any measures that link innovation and government procurement within regulatory documents no later than December 1, 2011. (Full link not available, but referenced in [www.cxlaw.gov.cn/show.asp?id=4674](http://www.cxlaw.gov.cn/show.asp?id=4674))

- On December 8, 2011, the Chuxiong Yi autonomous prefectural government issued a circular, referencing a similar notice from the Yunnan provincial government, calling on that government entities to carry out regulatory changes and should submit progress reports to the Chuxiong Legislative Office by December 16, 2011. [www.cxlaw.gov.cn/show.asp?id=4674](http://www.cxlaw.gov.cn/show.asp?id=4674)

- On December 20, 2011, the Qujing municipal government in a report released on its performance in 2011 stated that it had begun the work of eliminating or revising documents that link innovation and government procurement measures. [qj.xxgk.yn.gov.cn/canton_model25/newsview.aspx?id=1645716](http://qj.xxgk.yn.gov.cn/canton_model25/newsview.aspx?id=1645716)

- On January 17, 2012, the Yongshan county government released a notice, soliciting comments on the results of work to eliminate or revise regulatory documents linking innovation and government procurement. The government asked for comments on elimination or revision of eleven relevant documents. Comments and recommended changes are due to the government by February 20, 2012. [zt.xxgk.yn.gov.cn/ztmode/newsview.aspx?id=1666995](http://zt.xxgk.yn.gov.cn/ztmode/newsview.aspx?id=1666995)
The US-China Business Council

China’s Strategic Emerging Industries: Policy, Implementation, Challenges, & Recommendations
March 2013

Executive Summary

- China’s central government has identified seven “strategic emerging industries” (SEIs) that officials hope will become the backbone of China’s next phase of industrial modernization and technological development.
- Many of these policies are still being drafted or are in the early stages of implementation. Foreign companies have increasingly sought to understand how these policies may affect them and what market opportunities may exist within these sectors.
- Senior leaders have noted on several occasions that foreign-invested enterprises should enjoy equal treatment in regards to all SEI policies. However, past experience with central government industrial plans that have placed limits on foreign companies’ opportunities to participate in key markets has led companies to be cautious about current opportunities.
- While central and local governments will both play important roles in developing SEI policies, provincial and municipal governments will be the primary drivers of SEI implementation nationwide and have significant authority to draft plans, funding schemes, preferred technology catalogues, and pilot projects.
- Local government transparency about local implementation strategies varies greatly by province or municipality. Most provinces appear to lack coordination with regard to implementing SEI development policies, and only limited government information is publicly available, making information gathering difficult.
- Local government financial subsidies will be a primary incentive for companies to develop new products and technologies in SEI sectors. Access to special funding in certain localities seems to favor domestic enterprises by requiring locally owned and registered intellectual property (IP).
- US-China Business Council (USCBC) members indicate that current SEI-related incentives and programs do not drive their strategy and investment decisions and are not vital to their business development. At the same time, USCBC members would like to see current and future SEI incentives and programs offered on a non-discriminatory basis, to ensure that foreign companies are not unfairly disadvantaged and can participate if they choose to do so.
- USCBC recommends that SEIs policies and projects be open to both domestic and foreign-invested enterprises – both in policy and in practice – at both the central and local level. We also encourage SEI policymakers to ensure that these policies do not violate international trade rules on national treatment or use discriminatory tools such as local IP requirements.
Introduction
Cloud computing. Electric vehicles. Gene-based drug therapies. The list of industries that China’s central government planners aim to develop over the next decade is as impressive as the technologies are modern. In the mid-2000s, the central government began to repeatedly and publicly declare its intent to upgrade the economy away from traditional industries reliant on low-skilled labor. Since then, central government policy, funding, tax, and innovation efforts have consistently emphasized one goal: to develop a more advanced and technology-driven economy.

To accomplish this goal, Chinese policymakers created the concept of the strategic emerging industries (SEIs): seven innovative industries just beginning to develop in China, whose expansion could drive China’s broader growth as an internationally competitive economy.¹

The State Council – a government body equivalent to the United States’ Cabinet – codified the importance of these industries in an October 2010 policy document. This document, the Decision on Accelerating the Development of Strategic Emerging Industries (”decision”), not only identified the specific industries the central government would target, but also established a quantitative target for SEIs to account for eight percent of GDP by 2015 and 15 percent by 2020.

The decision’s most immediate impact was to signal to Chinese government agencies at all levels that future government policies on issues as broad ranging as taxation, human resources, and research and development (R&D) must support SEI development. Subsequent industrial policies at the central and local government levels have frequently referenced or target development of these designated industries.


China’s 7 Strategic Emerging Industries

1. Energy efficient and environmental technologies
2. Next generation information technology (IT)
3. Biotechnology
4. High-end equipment manufacturing
5. New energy
6. New materials
7. New-energy vehicles (NEVs)

*See Appendix I for additional specifics

Foreign companies have increasingly sought to understand how their business might align with market opportunities presented within the sectors slated for special government attention. However, companies have faced significant challenges in finding reliable information on SEI policies and implementation. This is often due to the opaque manner in which policies are being developed and the lack of explanations for how policies relate to each other.

SEI policy development has also been marked by a lack of coordination between government agencies, differing interpretations of central government directives, and varied implementation methods among localities. These factors, coupled with foreign companies’ past experience with central government policies to promote innovative technologies, have raised some concern regarding the extent to which they will actually be allowed to take advantage of SEI-related market opportunities.

This paper provides a snapshot of SEI policies and practices in China, covering:
- Select central and local government policies that support the SEIs
- Specific examples of SEI implementation in different localities
- Central and local government policy tools to support the SEIs
- Challenges to foreign participation in the SEIs
- Recommendations to ensure full participation for foreign-invested companies in China’s industrial modernization
Central Government Policies to Promote SEIs

SEI policy creation and implementation has followed a similar pattern to other broad policy plans in China, where the central government drafts general guidelines and principles and local governments handle direct implementation.

Combining knowledge of the top-down guidelines with an understanding of local conditions can help companies understand local government SEI implementation, and help to frame policy discussions with central and local officials.

Key Agencies
While a number of government agencies participate in the development of SEI policies, a handful of agencies play a lead role in overseeing and regulating the SEIs. The 12th Five Year Plan (FYP) on the Development of the Strategic Emerging Industries calls for the establishment of an inter-ministerial coordination group headed by the National Development and Reform Commission (NDRC). Additional members of the group include the ministries of Commerce (MOFCOM), Science and Technology (MOST), and Industry and Information Technology (MIIT). The purpose of this group is to coordinate, analyze, and track SEI policy implementation across relevant agencies. Some of the agencies that make up the group also have authority to approve projects at the municipal, provincial, and national level.

Overview of Selected Agencies involved in SEI Policy Creation

<table>
<thead>
<tr>
<th>Central-Level Agency</th>
<th>Provincial-Level Equivalent</th>
<th>General Responsibilities</th>
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| National Development and Reform Commission (NDRC) | Local-level NDRC offices are called “development and reform commissions” (DRCs) | • Leads central government coordination of SEI interagency work  
• Guides overall SEI policy development  
• Formulates core and follow-up SEI documents such as key SEI products and services catalogue |
| Ministry of Industry and Information Technology (MIIT) | Local-level MIIT offices are often referred to as “economic and information technology commissions” (EITCs) | • Plays significant role in developing specific plans for four of the seven SEIs: advanced equipment manufacturing; new materials; next generation information technology; and energy efficient technologies  
• Participates in SEI policy formulation within the interagency process and also develops its own SEI catalogues |
| Ministry of Commerce (MOFCOM) | Local-level MOFCOM offices are often referred to as “commerce commissions” (CCs) or “departments of commerce” | • Coordinates with other agencies to support SEI policy development and implementation |
| Ministry of Science and Technology (MOST) | Local-level MOST offices are called “science and technology commissions” (STCs) | • Coordinates with other agencies in SEI policy development with a particular focus on fostering domestic innovation and technology development  
• Supports SEI basic R&D  
• Administers national science & technology (S&T) grant funding programs |
Within the government agencies that are broadly involved with SEI planning and implementation, various bureaus and departments have defined responsibilities, both for specific industries that fall under the SEI framework and for different elements of SEI implementation. Different agencies assign SEI-related responsibilities in different ways. For example, NDRC assigns much of its SEI-related oversight to the Department of High-Tech Industry, which maintains general oversight for promotion of all SEI industries based on its oversight of the IT, biotechnology, aerospace, new materials, new energy, marine, and high-tech services industries. Two other NDRC departments—the Department of Resource Conservation and Environmental Protection and the Department of Basic Industries—handle specialized pieces of the SEI landscape: energy efficiency and environmental protection, and high-end manufacturing related to transportation. In contrast, MIIT is more compartmentalized, with several separate departments responsible for planning, policy, and standards within their respective SEI sectors, such as the Department of Equipment Industry and the Department of Software Services.

**Key Government Policies**

Since 2010, various agencies have published SEI-related policy guidance:

- **State Council Decision on Accelerating the Development of Strategic Emerging Industries** ([http://www.gov.cn/zwgk/2010-10/18/content_1724848.htm](http://www.gov.cn/zwgk/2010-10/18/content_1724848.htm)), October 2010
  - Identifies the seven specific strategic emerging industries (see Appendix 1 for more details on industry breakdown)
  - Establishes a quantitative target for SEIs to account for 8 percent of GDP by 2015 and 15 percent by 2020
  - Stresses that R&D and indigenous innovation are core features of SEI development

  - Policy framework governing private company participation in China’s seven SEIs
  - Requires that future policies remove any existing market-entry thresholds—such as those governing registered capital, total investment, and land supply—that apply specifically to private companies
  - Requires that private companies have equal access to public financing and other government funds earmarked for SEI projects
  - Requires local officials and other relevant regulators to solicit comments from private enterprises on future policies and must take comments and recommendations “seriously”
  - Chinese term for “private” industry does not include foreign investment

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**Overview of Selected Agencies involved in Strategic Emerging Industries**

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<tr>
<th>Central-Level Agency</th>
<th>Provincial Level Equivalent</th>
<th>General Responsibilities</th>
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<tbody>
<tr>
<td>Ministry of Finance (MOF)</td>
<td>Local MOF offices are referred to as “departments of finance”</td>
<td>• Serves as the primary agency managing available funds for SEI development</td>
</tr>
<tr>
<td>State Intellectual Property Office (SIPO)</td>
<td>Local SIPO can be referred to as “intellectual property bureau” (IPB) or “intellectual property administration” (IPA)</td>
<td>• Focuses on emphasizing protecting intellectual property rights (IPR) within the SEIs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Coordinates with other agencies to protect IPR in SEI policy implementation</td>
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</table>
• State Council 12th Five Year Plan (FYP) on Development of Strategic Emerging Industries (http://www.gov.cn/zwgk/2012-07/20/content_2187770.htm), July 2012
  o Taps NDRC as the leader of an interagency central government taskforce to develop national SEI plans and policies
  o Lays out detailed goals, sub-industry priorities, key projects, and supportive policies
  o Lists large projects the government wants to promote during the 12th FYP period (2011-15)

• MIIT Notice on the First Batch of Key SEI Technologies and Products for Targeted Promotion (also known as Notice 318, http://www.miit.gov.cn/n11293472/n11293832/n12843926/n13917012/14713132.html), July 2012
  o Contains two appended catalogues, one of SEI technologies and one of SEI products that potentially could be used as reference in SEI policy implementation (see Appendix 2 for more details)

• MIIT Classification Catalogue of Strategic Emerging Industries (http://www.miit.gov.cn/n11293472/n11293832/n12845605/n13916913/14990105.html), November 2012
  o Provides systematic identification of specific industries to be considered for SEI-related policy implementation

• MOF and NDRC Interim Measures for the Administration of Special Funds for Strategic Emerging Industries (http://jjs.mof.gov.cn/zhengwuxinxi/zhengcefagui/201301/120130124_729883.html), December 2012
  o Manages and standardizes SEI funding allocation across central government agencies
  o Lays out principles to guide funding, stating that funding should be market-driven
  o Specifies that funding should facilitate significant technology breakthroughs, the industrialization of critical sectors, the establishment of industry value chains, and innovation-oriented development

• NDRC Guiding Catalogue for Strategic Emerging Industries’ Key Products and Services (http://www.ndrc.gov.cn/zcfb/zcfbgg/2013gg/t20130307_531611.htm), February 2013
  o Provides detailed list of technologies and products under each SEI and its sub-sectors
  o Does not include specific policies, funding, additional investment incentives for companies or technologies, or any criteria or other information about how either foreign-invested or Chinese companies might be able to participate in the development of these products and services
  o Provides cover note to encourage investment in these sectors, and as a baseline for provinces and ministries to develop their own specific lists of SEI products and services

Provincial and municipal governments also have their own policies and regulations designed to promote the SEIs, including local catalogues, funding plans, project announcements, and regulations. To better understand local policies and implementation USCBC interviewed local government agencies and analyzed local SEI-related policies and regulations across 12 cities and provinces. Appendix 3 provides examples of SEI policies, funding, and implementation plans in these select provinces and cities.
Central and Local-Level Funding Tools to Promote the SEIs

The State Council’s 2010 decision outlines broad measures to encourage SEI development and establishes the principle that financial subsidies will be a primary incentive to help companies conduct R&D and commercialize new technologies and products. Fiscal policy – particularly tax policy – will be a primary tool to support industry innovation and technology commercialization. Taken together, tax rebates and financial subsidies could be a significant boon to companies seeking to invest in SEI product development.

At the same time, central government officials have repeatedly made clear that most SEI support funding will not come from central government coffers. Ren Zhiwu, deputy director general of NDRC’s High Technology Division, the department responsible for drafting NDRC’s SEI catalogue, stressed in a speech to USCBC member companies in October 2012 that only about 25 percent of funding would come through the central government. The Interim Measures for the Administration of Special Funds for Strategic Emerging Industries, for example, emphasizes a combination of funding from various funding sources – including central government, local government, and private enterprises – to promote SEI technology and product development.

As a consequence, local governments will shoulder most of the financial responsibility to develop the SEIs in their region. In fact, the SEI 12th FYP requires each province to create its own special funding pool to promote SEI development. Local governments determine where subsidies will go according to local SEI supportive policies. Some provinces have already established their funds while others are still being formed.

Many provinces that may lack a specific SEI funding pool already offer local grants and subsidies through other programs that can be also used for SEI products or technologies. For example, the Hubei Special Fund for Major Science and Technology Projects; the Shanghai Special Fund for the Development of Major Projects of Indigenous Innovation and High & New Technology Industries; and the Jiangsu Special Fund for Software and Integrated Circuit Industries are examples of pre-existing local funding mechanisms that could also support SEI-related technology development.

Localities will decide their own methods for allocating funding, but past experience suggests many will likely use a combination of product catalogues and specific project proposals, as well as a competitive funding application process and other incentive programs such as High & New Technology Enterprises (HNTEs), to provide incentives.

USCBC interviews and research uncovered the following examples of local funding plans:
- Shanxi aims to set aside RMB 500 million ($80 million) annually as an SEI development fund.
- Tianjin aims to set up RMB 970 million ($156 million) fund to support commercialization of indigenous innovation and high-tech projects.
- Fujian plans to create a RMB 1 billion ($161 million) SEI venture capital fund.

Please refer to Appendix 3 for additional examples from USCBC interviews and research of local SEI policies, funding, and implementation plans across select provinces and cities.

Foreign Company Interest in Accessing SEI Funding
In USCBC’s 2012 member survey, companies reported mixed ability to participate in China’s SEI programs. Most respondents, 57 percent, reported that they have only been moderately successful in doing so. Just over a quarter indicated that they had good success and the remaining respondents, 17 percent, reported they had poor access.
Over several months in 2012, USCBC followed up with a number of companies to determine their views about and general experiences with local funding opportunities. Of the 23 companies interviewed, only about one-third of companies—eight of 23—indicated that they had applied for or had interest in applying for an SEI funding program. However, even among interested companies, half (four of eight) indicated that the local funds do not drive their strategy or investment decisions and are not vital to their business. Instead, companies viewed these funds as supplemental or as a means of countering competitors’ use of local funds.

In comparison, nearly half of companies—11 of 23—indicated clearly that they have not applied for and have little interest in the financial incentives at all. Respondents indicated that this is based purely on business considerations and not out of concern that they lack information or may face discrimination. This includes companies that have mature investments and so are less influenced by new preferential policies or are uninterested in making new investments.

The remaining four companies indicated they were not interested in SEI financial incentives because the amounts involved were too small to justify the effort required (two cases) or the likelihood of successful qualification versus local competition was too low (two cases).

**Foreign Participation in SEIs: Challenges and Recommendations**

Senior central government leaders have made a number of high-profile public statements declaring that the SEIs are open to foreign participation. For example, Premier Wen Jiabao replied to a question during the Summer Davos Forum in September 2012 that foreign-invested enterprises (FIEs) operating in the SEIs will be treated the same as Chinese companies. NDRC Vice Chair Zhang Xiaojiang echoed these comments in July 2012 interview when explaining that the 12th FYP on SEIs allows for a level playing field for both Chinese and foreign companies. NDRC’s Ren Zhiwu told USCBC member companies in October 2012 that SEI policies would not discriminate against foreign-invested companies or the products they produce.

Despite these statements, past experience with Chinese tax, innovation, and government procurement-related policies has led companies to be concerned about the possibility that these new SEI policies may in practice create an uneven playing field by potentially giving preferences to Chinese companies.

Many USCBC companies argue that any benefits that are in practice available only to Chinese companies have long-term negative consequences for fair competition and the development of market-based economics—both in China and increasingly in third markets around the world—by giving Chinese companies a competitive edge over their foreign-invested counterparts.

USCBC member company concerns center on a number of topics, including the continued role of SEI product and technology catalogues, use of discriminatory intellectual property-based qualification criteria, links to government procurement incentives, lack of transparency in policy drafting and implementation, and localization requirements that would exclude branch entities. One step local governments can take to mitigate general concerns about preferences is to mandate—in writing—that incentives be granted in a non-discriminatory manner and to establish an independent appeals process to review claims of bias. Local governments can also expand upon central government commitments to increase transparency and publicize more information about what incentives are available and the qualification criteria used to determine accessibility.
The Role of Catalogues
Catalogues are a central feature of China’s industrial planning system, outlining business and investment opportunities across all parts of the economy. Chinese government agencies at all levels have used catalogues for decades as a means to indicate what products and technologies are permitted, encouraged, or restricted for investment or purchase. For example, central and local governments update annual catalogues of products meeting energy efficiency requirements. These products may receive preference in government procurement or qualify the purchaser for a tax rebate.

The SEIs are no different, and both central and local agencies are developing product and technology catalogues. NDRC, for example, has the lead role in developing an SEI product catalogue, but MIIT has also been aggressive in publishing its own SEI-related catalogues. Local governments are also currently creating their own catalogues for industries in their region, which adds to the confusion for companies. While these catalogues are beginning to trickle out, it remains unclear what specific policies might be used to promote the technologies and products in these and other catalogues. For example, the catalogues do not indicate what benefits listed products receive. It is also unclear how the catalogues relate to each other and to other SEI-related policies, both at the national and at the local level. See Appendix 2 for a discussion of MIIT Notice 318 as an example of a catalogue.

Concerns and challenges that companies have raised about catalogues include:
- Lack of information about how the catalogues will be used.
- Lack of publicly available, clear, non-discriminatory criteria for how companies can get their products and technologies into a catalogue and how frequently catalogues will be updated.
- Whether a listing in a catalogue denotes preferential treatment for companies and their products. These concerns are bolstered by the fact that almost all companies listed are Chinese enterprises or Chinese-invested joint ventures.
- What special funding, if any, is provided to listed products. Conversations with local government officials indicate that locally developed SEI catalogues may be used as a reference for allocating special funding. Only companies that produce products and technologies that are described in the local SEI catalogue will be accredited and have access to these subsidies.

USCBC Recommendations
- USCBC recommends a long-term solution of eliminating the use of catalogues. Catalogues are no longer consistent with China’s development toward a market-based economy, nor in line with international best practices. Catalogues are difficult to maintain and are quickly outdated, thus reducing their effectiveness of promoting innovative products and technologies.

- If catalogues are to continue to be used, USCBC recommends that central and local government agencies:
  - Provide a cover letter for each catalogue, similar to those often provided for new legislation, explaining how the catalogue was drafted and how companies may be able to suggest new technologies and products for future catalogues;
  - Specify the types of policies and incentives that would be available for products and technologies included in the catalogue and how companies may apply for those benefits;
  - Include information regarding the specific government agencies or representatives that may be contacted to address company questions or concerns; and
  - Specify the applicability of central government catalogues to local catalogues (and vice versa) along with instructions on how local governments should use central government catalogues in their own SEI efforts, especially as it relates to the selection of products or technologies for preferential treatment.
Local Government Use of Discriminatory IP Qualification Criteria

Though local government officials have affirmed in conversations with USCBC that they adhere to policies of equal treatment and a level playing field for foreign-invested enterprises, they also indicated that the central government has given clear instructions that the cultivation of locally developed and locally owned intellectual property rights (IPR) is a core component of SEI development. Put another way, promoting the SEIs is linked with promoting indigenous IP creation. As one municipal government official said, because it is the central government’s clear intention to develop China’s IP capabilities, IP requirements are not negotiable.

This has raised the prospect that access to SEI-related incentives, financial subsidies or otherwise, may be conditioned on the possession of intellectual property developed and/or owned in China, and would not permit companies to qualify based on possession and use of intellectual property developed and/or owned in other locations. As noted in USCBC’s 2010 innovation incentive best practices report, neither the US nor any of the other nine top global innovative countries and regions are known to base participation in innovation incentive programs on domestic ownership of intellectual property rights or trademarks. Yet such requirements already exist as a part of China’s HNTE tax program. Companies may qualify for a reduced corporate tax rate of 15 percent if they engage in certain advanced production, high-tech activities and own the IP in China. While some foreign companies have chosen to structure their operations so they can own IP in China and qualify for the reduced tax rate, government requirements to own IP in a certain jurisdiction go against international best practices for IP creation and management.

Because local governments must establish their own plans and funding pools to develop the SEIs in their region, evidence suggests that many local SEI promotion policies may ultimately include IP requirements. For example:

- Shanghai’s SEI fund is a carve-out of a larger indigenous innovation and high-tech special fund, which requires local IP ownership and local legal presence to qualify for funding. In addition, wholly foreign-owned R&D centers may not be approved for SEI research projects unless they independently own the IP.

- Sichuan local agencies expressed differing opinions on the question of IP criteria. According to the Sichuan economic and information technology commission, there are IP requirements in Sichuan for SEI project applications. However, the Sichuan development and reform commission indicated that any company applying for SEI special funding only needs to be legally registered and pay taxes in Sichuan. Development and reform commission officials emphasized, however, that for SEI special funds, the goal is to develop independent IP to replace imported equipment and create capacity for Chinese companies in those areas.

USCBC Recommendations

- Central government agencies should mandate the removal of IP ownership qualification criteria from all central and local government incentive programs, including the HNTE tax program and SEI promotion policies. Short of this, the requirement should be amended to allow for non-exclusive licenses to Chinese affiliates.

- Companies should evaluate carefully the value in developing IP in China and/or transferring to China the license for their IP.

Transparency

The lack of publicly available, consistent information about SEI plans, catalogues, and projects has made it difficult for interested parties to gain a deeper understanding of what the government is doing and how to take advantage of available commercial opportunities. Slightly more than half of respondents to
USCBC’s annual survey, conducted in the summer of 2012, indicated that they had some difficulty getting information about the industries being promoted and the types of incentives offered and had mixed experiences in turning information leads into business development opportunities. This situation means that companies must expend significant time and personnel resources to understand disparate local implementation methods.

There are three transparency challenges of particular concern:

- **Lack of online documentation** When USCBC spoke with local officials to assess SEI implementation strategies, the majority said relevant SEI documents had been put online. Generally speaking, a more robust and transparent web presence often indicated a greater willingness among local officials to discuss policies. However, after navigating provincial government websites, USCBC found that locating these documents was extremely challenging, and in many cases policies could not be found at all. Some websites had no documentation, or documents that were months out of date. Some websites lacked basic search functions, further inhibiting information access. It was not unusual to find relevant provincial SEI documents from lower level government websites that were not posted on the websites of the upper-level issuing agencies, thus creating confusion about the validity of various policies.

- **Lack of clear authority structure for implementation agencies** At the national level, NDRC leads SEI policy development, with other agencies such as MIIT and MOST playing supporting, albeit important, roles. However, local implementation largely depends on each agency’s initiative and authority. This decentralization of SEI implementation responsibilities has made it very confusing for companies to know with whom they must talk in order to learn about SEI plans for that area. In some localities, such as Shanghai, the economic and information technology commission has taken the leadership role in SEI policy development and implementation, while other regions, such as Shandong, the science and technology commission is driving local policy development and implementation.

When formulating plans to implement national policy, local governments often set up interagency “leading groups” that gather senior officials from agencies that might have significant involvement in that topic. These leading groups do not deal with substantive implementation questions; rather, they serve as a platform for involved agencies to coordinate their work, leaving specific implementation work details up to the individual agencies in question. Because each province operates largely independently, interagency communication and coordination varies significantly among provinces. Moreover, local departments are often in competition with each other over final authority to implement SEI plans. Additionally, in some localities, only one person in a particular department handles questions related to SEI implementation, while other departments may be unaware of the process. In other cases, different departments oversee SEI development for industries that otherwise come under their jurisdiction, such as new energy, which usually falls to the local development and reform commission. Funding management also varies by locality: in Anhui, for example, the local development and reform commission works with the finance department to coordinate the management of funds while in Jiangsu, each relevant department takes charge of its own funds.

- **Officials’ willingness to discuss policies** Local officials’ willingness to discuss SEI policies for their jurisdictions varied greatly, reflecting everything from a lack of awareness of the plans in their region to concern about disclosing potentially sensitive information, even if it was posted publicly on a government website. Officials across multiple agencies in some locations, such as Beijing and Zhejiang, were unwilling to share information and refused to discuss SEI plans. Conversely, Hubei showed a strong willingness to answer questions about local SEI plans, as was also the case in Shanghai, which is frequently cited for a high level of transparency and cooperation with foreign enterprises.
Central government policy planners have used access to China’s lucrative government procurement market as a means to promote certain technologies or brands. Some of these programs are well-established and are generally considered non-discriminatory. For example, central and local governments maintain lists of products that have met certain energy-efficient and environmentally friendly criteria. Some foreign companies have been able to get their products on these lists via foreign-invested subsidiaries. On the other hand, certain government procurement requirements disadvantage foreign companies, such as the announcement in 2012 that government agencies must only purchase domestic Chinese auto brands for their office fleet. That notice also prompted several municipal and provincial governments to issue their own notices mandating the purchase of Chinese brands, rather than brands produced by foreign joint ventures – thus compounding the situation.2

While the central government has made general public statements about the important role of market forces within government procurement to promote new technologies, there is still concern that government procurement will benefit Chinese companies operating in SEI industries, particularly at the local level. For example, when responding to USCBC questions about local SEI development, Jiangsu provincial officials emphasized that they view government procurement as playing an important role in promoting SEI products and technologies. They argued that SEI products and services are new innovations that do not yet have an established market in China. Consequently, such procurement is a necessary tool to promote SEI growth. Nevertheless, without more details on how the procurement will be managed and what criteria will be required to qualify, it remains unclear whether local procurement will give more preferences to Chinese companies over foreign-invested companies.

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**USCBC Recommendations**

- Local governments should provide more information about their procurement practices and actively promote the long-term benefits of an open, transparent, market-based procurement system by mandating the removal of unwritten quotas that require local government agencies to purchase brands that are majority or wholly Chinese-owned.

- Local governments should continue work to improve the independence and effectiveness of the local appeals process for government procurement.

- Companies should actively seek out and engage stakeholders, both to educate them on product specifications and to gain leads on possible upcoming bids.

**Local Registration Requirements**

Many local regulations require applicants for funding to be registered as legal entities in the province, thus excluding branch offices. While it is not surprising from a tax perspective that local governments would give preference to full legal entities rather than branches, most companies, regardless of nationality, prefer to minimize the creation of duplicative legal and financial entities by using branch offices of one legally-registered entity. Local requirements to be a legal entity may have an especially negative influence on the development of R&D capabilities in a municipality — even though fostering more R&D is a key priority of the SEI plans — because R&D centers are often established as branches of an existing entity.

**USCBC Recommendation**

- Local governments should amend provisions to allow branches of existing legal entities to qualify for any local incentives.

**Conclusion**

SEIs will remain a centerpiece of China’s industrial development plans for many years to come. Given the relative newness of the overall SEI policies central and local governments are still exploring ways to implement SEI development policies, which may likely result in some confusion and potential implementation bottlenecks as localities put plans into action and clarify policies. At the same time, China’s dynamic market is such that companies interested in capitalizing on selling into the market risk losing opportunities if they wait until the path is clearly defined.

China’s local governments have long utilized different strategies to implement central policy goals and therefore a reasonable degree of difference among local plans is to be expected. Nevertheless, USCBC recommends that SEI policies should be open to both Chinese and foreign-invested enterprises at both the central and local level, should not violate trade rules vis-à-vis offshore foreign companies, and should not use discriminatory tools such as local IP requirements. Non-discriminatory policies would benefit China by making the most advanced and efficient technologies available in SEI sectors at the most reasonable prices. Pursuing these recommendations will address the broader need to create an open, non-discriminatory business environment in China that does not favor one group of companies over another. USCBC will continue to monitor SEI implementation plans and report information to its member companies.
APPENDIX 1: Outline of the Seven Strategic Emerging Industries and Selected Subsectors

Energy efficiency and environmental conservation
- Research, develop, and promote energy-efficient technology products in order to make technology breakthroughs and raise overall energy efficiency;
- Accelerate the R&D and production of broadly applicable technology that can be used for resource recycling and remanufacturing industrialization;
- Test and promote advanced environmental technologies and products;
- Promote a market-oriented service system for environmental protection and energy efficiency;
- Employ advanced technology to create a recycling system for waste commodities; and
- Promote clean coal and seawater use.

Next generation information technology
- Accelerate the construction of vast, integrated, and safe information network facilities, promote the R&D and production of new-generation mobile communication, as well as core equipment and intelligent terminals for next-generation Internet;
- Accelerate the convergence of telecom, broadcasting, and Internet networks; promote R&D in the "Internet of things" and cloud computing;
- Focus on developing core and basic sectors such as integrated circuits, new-mode displays, high-end software, and high-end servers;
- Upgrade software and value-added Internet services; promote smart renovation of infrastructure; and
- Develop digital and virtual technologies to promote creative industries.

Biotechnology
- Develop biotech-derived pharmaceuticals, new vaccines, diagnostic reagents, chemical drugs, modern Chinese medicine, and innovative drugs that prevent major critical diseases;
- Accelerate the R&D, production, and large-scale development of biological and medical engineering products such as medical equipment and medical materials;
- Promote bio-agriculture development, including the biological breeding industry, green agriculture, and biological production;
- Advance the exploration, demonstration, and application of core technologies in biological manufacturing; and
- Accelerate the R&D and production of marine biology technologies and products.

High-end equipment manufacturing
- Strengthen and expand the aviation industry, focusing on the development of key aviation equipment for trunk line and regional flights as well as utility aircraft;
- Promote aerospace infrastructure construction to develop satellites and related industries;
- Develop rail equipment used during the construction of passenger lines and urban metro systems;
- Develop marine engineering equipment to develop marine resources; and
- Develop intelligent manufacturing equipment with digitally-integrated systems as core components.
<table>
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<tr>
<th>New energy</th>
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<tbody>
<tr>
<td>• Research and develop new-generation nuclear power technology and advanced reactors;</td>
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<td>• Accelerate the application of solar-power technologies and explore diversified power-generation markets of solar photovoltaic and photo-thermal energy;</td>
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<tr>
<td>• Improve wind-power technology equipment to promote large-scale development of wind power and to develop an intelligent grid as well as new-energy systems; and</td>
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<tr>
<td>• Explore and use biomass energy according to local conditions.</td>
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<tr>
<th>New materials</th>
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<tbody>
<tr>
<td>• Develop new materials such as rare earths, high-performance membrane materials, special glass, functional ceramics, and semiconductor lighting materials;</td>
</tr>
<tr>
<td>• Develop advanced structural materials, such as high-quality special steel, new-mode alloy material, and engineering plastics;</td>
</tr>
<tr>
<td>• Develop high-performance fiber and composite materials, such as carbon fiber, aramid fiber, and ultra-high molecular weight polyethylene; and</td>
</tr>
<tr>
<td>• Research general and basic materials such as nano-, super-conductor, and intelligent materials.</td>
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<th>New-energy vehicles</th>
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<tr>
<td>• Make core technology breakthroughs in motor batteries, drive motors, and electronic controls to promote the application and commercialization of plug-in hybrid and pure electric vehicles; and</td>
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<tr>
<td>• Research leading and core technologies for fuel-cell vehicles; and vigorously promote low-emissions, energy-efficient vehicles.</td>
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APPENDIX 2: Catalogue Example, MIIT Notice 318

MIIT Notice 318 attracted attention in 2012 because of its focus on SEIs, but in actuality provided limited information about what its purpose and function. The notice appears to provide guidance to provinces and local governments on how to promote SEIs, and its catalogues list existing policies and programs that appear to support the development of certain SEI technologies and products. However, the notice provided little context for these policies or how they would be used. Additionally, the catalogues listed specific companies, universities, and R&D centers that presumably would be involved with SEI development, but included no information about how these companies were selected and what their listing meant in terms of incentives.

To better assess how the notice will be used, USCBC reviewed several of the policies listed in the notice’s catalogues. These policies were issued by a variety of agencies, including local-level branches of NDRC, MIIT, MOF, and the Ministry of Science and Technology (MOST), suggesting that local agencies each have their own industry promotion mechanisms. Most of these programs appear to be grant or funding programs. Many of the documents contained qualification requirements that could discriminate against foreign-invested enterprises seeking funding: requirements that companies have locally owned or registered IP and/or requirements that eligible companies must be a locally-incorporated company, not a branch. This latter criterion would not only discriminate against some foreign-invested companies, but also Chinese companies from other provinces.

Concerns about discrimination were also raised by the inclusion of companies in the catalogues themselves, and in the lack of transparency about how foreign companies might be considered for the catalogue. USCBC research indicates that only a small portion of the approximately 900 companies listed in the notice’s two catalogues are foreign-invested enterprises, and the vast majority of these are joint ventures. Further, it appears that there was no public notice about the drafting of this catalogue, nor were opportunities provided to companies to apply for inclusion in the product and technology catalogues appended to the notice. While some conversations with local officials indicated that MIIT may have created this list of companies based on companies already participating in existing programs such as High and New-Technology Enterprise (HNTE) certification, R&D grant and funding programs, and earlier local technology catalogues, there is no clear information about how decisions were made to include companies (or universities and research institutions) in that list.

Because the notice contains only these lists of policies and companies, companies must still review the specific policies for their locality and their products to determine whether these policies contain programs, such as grants, tax incentives, government procurement preferences, or subsidies that are open to foreign-invested enterprises.
APPENDIX 3: SEI Implementation in Selected Provinces and Cities

Chinese local governments seldom move at the same pace as the national government, and the opinions of local senior provincial-level leaders often are the most important determining factor in shaping local SEI promotion. Consequently, SEI implementation varies significantly across China. To better understand local policies and implementation, USCBC interviewed local government agencies and analyzed local SEI-related policies and regulations in 12 cities and provinces throughout late 2012. Findings about which industries are promoted, agencies involved, funding amounts, and use of catalogues, are described here and listed in the attached chart.

In general, the types of documents guiding local implementation might include local 12th FYPs, industry-specific SEI promotion plans, and catalogues. For example:

- Localities like Shanghai have released an overarching 12th FYP on Strategic Emerging Industries, while localities like Jiangxi, only released individual plans for each of their selected SEIs.
- Hunan published the General Outline on Accelerating SEI Development rather than an FYP. The outline provides general macro-guidance on implementation. The Hunan provincial government has also made individual plans for each targeted industry.

Local governments are setting their own categories of SEIs depending on local industry characteristics and existing industry plans. The variations reveal local preferences about future economic development and perceived competitive advantages for the market. For example, Hunan, known for its entertainment industry, replaced NEVs with “cultural innovation” (such as cartoon digitalization) in its selection of SEIs.

In addition, some localities have made priority distinctions even among the seven SEIs, with those on the preferred list receiving more funding. Among Sichuan’s six SEIs, next-generation information technology holds the top priority and is expected to receive upwards of 25 percent of Sichuan’s specially designated SEI funding.

Many localities have noted that there are a variety of incentives available to potential investors. These include priority land use (especially in eastern regions where land is in short supply); expedited licensing approvals; reduced costs for and preferential access to public utilities; and “talent support” policies, such as housing subsidies. All local officials stressed that local preferential policies are decided case-by-case, and expressed a strong willingness to work with companies individually to explore incentive and funding opportunities; therefore, companies should pay close attention to local policy documents, catalogues, and funding notices, and they should actively meet with local officials to determine what opportunities might be available. Local officials also stressed, however, that industries in which foreign investment is restricted or prohibited will not be more open due to SEI development. Foreign investment will still be regulated primarily by policies like the Catalogue Guiding Foreign Investment, to which SEI policies are subordinate.

The following chart details SEI implementation in selected provinces and municipalities.
<table>
<thead>
<tr>
<th>Provinces/Cities</th>
<th>Number of SEIs</th>
<th>Variations on Centrally Targeted SEIs</th>
<th>Key Agencies</th>
<th>Funding</th>
<th>Use of Catalogues</th>
<th>Other Features</th>
</tr>
</thead>
</table>
| Beijing          | 8              | Stronger focus on aviation industry    | DRC takes the leading role in SEI development, but specific responsibilities for each agency are not clearly defined | • RMB 40 billion ($6.4 billion) financial support  
• Will establish a “Guiding Fund for SEI Venture Capital investment” | N/A            | N/A          |
| Fujian           | 7              | - Does not include new-energy vehicles  
- Combines biology with new medicine  
- Adds the high and new technology marine industry | Fujian EITC, DRC, STC, commerce, finance, transportation, and environment departments share responsibilities as assigned by Fujian provincial government:  
- Next generation IT - EITC  
- New materials – DRC, STC, EITC  
- Advanced equipment manufacturing – CC  
- Energy efficiency and environment protection – CC, EITC  
- New energy – EITC, DRC, STC, CC, transportation bureau  
- Biology with new medicine – STC, DRC, CC  
- High and new-technology marine industry – CC, STC, department of marine and fishery | • RMB 500 million ($80.4 million) for SEI guiding funds  
• RMB 1 billion ($160.7 million) SEI venture capital fund  
• Fujian will invest more than RMB 128 billion ($20.6 billion) on over 100 major SEI programs | Fujian DRC and EITC developed an SEI key products and services guiding catalogue. | Developed an SEI Key Project List, selecting 100 key SEI projects. |
| Hubei            | 7              | Same as the central government’s list  | Established an SEI development leading group to guide and coordinate implementation | N/A            | The Hubei Statistics Department and DRC are drafting a local SEI products and services catalogue, according to one local official. The catalogue is still under review as of March 2013, and it is unclear to what extent it will mimic the national SEI catalogue. | Hubei DRC is building an SEI project pool, a database of qualified SEI projects that will be used for SEI policy reference and as a fund allocation mechanism. Companies are encouraged to apply directly to the relevant district or city level agencies |
### SEI Policies and Actions in Select Provinces/Cities

<table>
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<tr>
<th>Provinces/Cities</th>
<th>Number of SEIs</th>
<th>Variations on Centrally Targeted SEIs</th>
<th>Key Agencies</th>
<th>Funding</th>
<th>Use of Catalogues</th>
<th>Other Features</th>
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<tr>
<td>Hubei</td>
<td>7</td>
<td>Replaces new-energy vehicles with cultural innovation</td>
<td>Hunan’s SEIs are coordinated by local EITC, DRC, STC, and the local commission governing state-owned enterprises • EITC and the provincial finance bureau have responsibility for compiling projects, planning, arranging, and coordinating funds management • All special funds, regardless of industry, are managed by Hunan EITC • DRC has the lead on certain SEIs, such as new materials and new energy</td>
<td>Aims to allocate RMB 500 million (USD $80.4 million) annually.</td>
<td>Hunan has released several catalogues, including the SEI Key Technologies Catalogue, Key Products Catalogue (not available online), and the Top 100 SEI Companies List. According to one local official, companies will not be allowed to apply to be listed in the catalogue; instead lower-level governments (city or district) will collect all information based on companies’ output value and technology level and submit the information to the provincial level, which will select companies for inclusion in the catalogue. It is still unclear how these catalogues are linked with SEI supporting policies, since much information is not publicly available and local departments couldn’t clarify.</td>
<td>N/A</td>
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<tr>
<td>Provinces/Cities</td>
<td>Number of SEIs</td>
<td>Variations on Centrally Targeted SEIs</td>
<td>Key Agencies</td>
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<tr>
<td>Jiangsu</td>
<td>10</td>
<td>• Adds new medicine to biotechnology</td>
<td>• Jiangsu DRC coordinates new energy, smart grid, and new-energy vehicles</td>
<td>Current fund was established in 2012 with RMB 380 million ($61.1 million).</td>
<td>According to provincial development and reform officials, Jiangsu has already issued 10 individual SEI promotion action plans and is in the process of developing Jiangsu SEI guidelines. These guidelines will not be mandatory and will be used only for guidance for relevant industries. Jiangsu’s SEI action plans identify several key enterprises that may be eligible for SEI preferential policies, as these companies’ names appear in the action plans. Local officials explained that the key enterprise list will be used as a guide when companies apply for production expansion, in order to reduce the risk of overcapacity in a particular industry. However, according to government officials, there are no financial subsidies available for industries included in this list.</td>
<td>As Jiangsu is a province with varying levels of economic development, implementation plans are segregated by region. These distinctions may cause policies to be implemented differently across the province, according to local development needs. For example, northern Jiangsu is less developed, so there may be more opportunity to negotiate with local governments on requirements in that region. Moreover, local government support could also differ according to municipal capability.</td>
</tr>
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</table>
| Jiangxi          | 10            | • Re-divides SEIs into:  
  o Photovoltaic cells  
  o New-energy vehicles and batteries  
  o Energy efficiency lights and photoelectricity  
  o New materials: metals  
  o New materials: non-metals  
  o Biomedicine and new medicine  
  o Wind power and energy saving technology  
  o Aviation manufacturing  
  • Adds “green” food and agriculture, as well as the cultural and creative industries  | • Jiangxi EITC, DRC, and STC have various roles in SEI promotion  
  • New energy is supervised by Jiangxi DRC  
  • Jiangxi EITC administers the remaining SEIs and established a new internal division – “emerging industry division” – to manage SEI work  
  • The Jiangxi Culture Department oversees the cultural and creative industries | Established a RMB 400 million ($64.3 million) venture capital fund to be used for major projects, overseen by a management commission created to guide fund disbursement. | Conversations with Jiangxi local government officials indicated that except for the local 12th FYPs, all other policies are still under draft and are open for comments. No catalogue, direct subsidies, or pilot programs have yet been developed. | Discussions with Jiangxi DRC officials indicated that foreign-invested companies may participate in some SEI projects but will be ineligible for subsidies, which are set aside for Chinese companies. Subsidy provisions will not be written formally into any policy. |
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<tr>
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<tr>
<td>Shandong</td>
<td>6</td>
<td>• Does not include new-energy vehicles</td>
<td>Established an SEI special working commission in order to push forward SEI development.</td>
<td>Aims to invest no less than RMB 1 billion ($160.7 million).</td>
<td>Shandong DRC released the first “SEI Major Programs Catalogue” in 2010 detailing 10 methods to encourage private sectors to develop SEI.</td>
<td>Shandong’s 12th FYP on SEIs identifies priorities for each SEI.</td>
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<td>Shanghai</td>
<td>7</td>
<td>Same as the central government</td>
<td>Shanghai EITC is the primary agency driving local SEI implementation. Shanghai DRC manages and creates local SEI policies, approves large scale SEI projects, and coordinates with other government agencies for six of the seven SEIs. The only exception is the pharmaceuticals and biotechnologies sector, which is handled by Shanghai STC.</td>
<td>Set up a “special fund for technological transformation” to encourage companies to update equipment and facilities. Companies that are approved for funding can obtain a maximum of RMB 50 million ($7.9 million) in subsidies for this “technological transformation.”</td>
<td>Shanghai EITC officials indicate that they are drafting plans for 15 specific policies, including a specific guiding catalogue on each SEI as well as other implementing policies. The catalogue will be revised every 2-3 years and may only be used as a minimum technology reference standard for SEIs. Companies will have an opportunity to recommend additional advanced technologies or products to be listed in the subsequent revisions of the catalogue. Even if some products are not included in the initial catalogue, companies may still have the opportunity to have access to preferential policies if they can persuade local government officials that their products exceed minimum technical standards laid out in the catalogue. Shanghai EITC created a “green channel” to expedite SEI project approvals. The municipal government is also experimenting with new ways to attract foreign investment. For example, if an SEI project is established but does not qualify as “encouraged” in the Catalogue Guiding Foreign Investment, it may be permitted to benefit from preferential policies that technically may only be available those investments listed as encouraged. Preferential access to land is another benefit.</td>
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<td>Shanxi</td>
<td>9</td>
<td>Adds coalbed methane and modern coal-to-chemicals</td>
<td>Shanxi DRC leads the SEI interagency coordination working group.</td>
<td>Aims to set aside RMB 500 million ($80.4 million) annually as an industry development fund. Will use the existing Shanxi “Energy Industry Investment” fund to support energy-related new technology development and investment. That fund has around RMB 10 billion ($1.6 billion)</td>
<td>N/A</td>
<td>SEI development is closely related to the Shanxi government’s strategy of developing the energy sector, especially coal.</td>
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| Sichuan          | 6              | Does not include new-energy vehicles   | • Sichuan EITC manages next-generation information technology, high-end equipment manufacturing, and new materials  
• Sichuan DRC supervises the new energy industry as well as energy efficiency and environmental conservation  
• Sichuan STC is in charge of biotechnology | • Plans to invest RMB 2 billion ($321.5 million)  
  - IT will receive 25 percent of funding  
  - High-end equipment manufacturing and new materials industries should each receive 20 percent of funding  
  - New energy should receive 15 percent of funding  
  - Energy conservation and environmental protection, and pharmaceuticals and biotechnologies should receive about 10 percent each | Sichuan EITC released a local SEI Key Products and Services Catalogue, which covers approximately 100 products. (In contrast, the NDRC Catalogue contains about 4,000 products.) The catalogue is supposed to be reviewed every year, but according to media reports, it was not discussed in 2012.  
Sichuan also released the Work Plan on SEI Promotion and Administrative Measures on Use of SEI Special Funds in 2012. | Sichuan gives SEI projects priority in land use, energy, transportation, and financing. Sichuan EITC established the SEI Promotion Association to inform companies of SEI preferential policies available in Sichuan. The group also trains companies on how to apply for such policies. However, companies are only eligible for membership if their products are listed in Sichuan’s SEI Catalogue. |
| Tianjin          | 7              | Official list is same as the central government, though local government will promote the aerospace and aviation industry rather than NEVs.  
• Departments maintain responsibility for the industries under their current purview  
• An interagency leading group is under formation | • Tianjin’s Binhai New Area pledged RMB 50 million ($8 million) to support SEI projects  
• Aims to set up RMB 970 million ($156 million) fund to support commercialization of indigenous innovation and high-tech projects | The Tianjin municipal government completed a draft of the 12th FYP on Strategic Emerging Industries, but it has not yet been publicly released. According to local officials, there are only minor differences between the municipality’s SEI priorities and national ones. | In May 2012, Tianjin signed a cooperative framework agreement with MIIT to support Tianjin’s SEIs. According to this agreement, Tianjin and MIIT will work together to cultivate a competitive SEI cluster. This ministry-municipal cooperation is expected to provide special support in local development, which suggests more support could come from the ministry to Tianjin’s SEIs. Currently it appears Tianjin is the only municipality with such an agreement with MIIT. |
| Zhejiang         | 9              | Adds Internet of Things and the marine industry as full SEIs  
• The Zhejiang SEI Promotion Leading Group was set up in 2012 | • Set up a RMB 500 million ($80.4 million) SEI special fund | Zhejiang EITC issued local SEI catalogue in November 2011. This catalogue identified 40 key areas in nine SEIs for government support. | N/A |
## SEI Policies and Actions in Select Provinces/Cities

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<td>Zhejiang</td>
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<td>• Zhejiang DRC leads interagency coordination</td>
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<td>• Provincial finance bureau and EITC are in charge of subsidy funds for technology innovation pilot projects</td>
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### ACRONYMS

CC: commerce commission  
DRC: development and reform commission  
EITC: economic and information technology commission  
STC: science and technology commission

### Local policy documents:

1. Beijing Implementation Opinions for Accelerating Development of Strategic Emerging Industries  
2. Beijing Interim Measures on the Administration of Strategic Emerging Industries Venture Capital Guidance Funds  
3. Fujian Implementation Plan for Accelerating Strategic Emerging Industry Development  
4. Hubei Special Funds for Major Science and Technology Projects  
5. Hubei Opinions on Accelerating Strategic Emerging Industries Development  
6. Hubei 12th FYP on Strategic Emerging Industries Development  
7. Hubei Development and Reform Commission Announcement of Applying for 2013 Strategic Emerging Industries Projects and Important Early Stage Projects  
8. Hunan Strategic Emerging Industries Special Plan for New Materials Industry  
9. Hunan Decision on Accelerating Strategic Emerging Industries Development
10. Hunan General Outline for Accelerating Strategic Emerging Industries Development
   http://www.hnfgw.gov.cn/hghz/zdxzgh/12493.html
11. Jiangsu Province 12th FYP to Develop Strategic Emerging Industries
    http://www.ydfgw.gov.cn/Article/ShowArticle.asp?ArticleID=392
12. Jiangsu Special Funds on Software and Integrate Circuit Industries
    http://www.taiwan.cn/flfg/dffgdfgz/js/201112/t201111215_2214969.htm?randid=0.5482974260321047
13. Jiangsu Interim Measures on the Administration of Strategic Emerging Industries Development Special Funds
14. Jiangsu 12th FYP on Strategic Emerging Industries
    http://guoqing.china.com.cn/gbbg/2012-07/06/content_25837900.htm
15. Jiangsu 12th FYP for Electronic Information Industry
16. Jiangsu 12th FYP for Internet of Things Industry
17. Jiangxi Provincial Notice on Ten Strategic Emerging Industries Development Plans
    http://www.doc88.com/p-895572504877.html
18. Jiangxi Interim Measures on the Administration of Strategic Emerging Industries Venture Capital Guidance Funds
    http://www.jiangxi.gov.cn/zfgz/wjfg/szfbgtwj/201206/t20120617_741004.htm
19. Shandong 12th FYP for Strategic Emerging Industries Development
    http://www2.shandong.gov.cn/art/2012/11/15/art_3883_3118.html
20. Shandong Implementation Opinions on Accelerating Development of Strategic Emerging Industries and First Batch of Strategic Emerging Industries Projects
21. Shandong Third Batch of Strategic Emerging Industries Projects List
    http://www.sdjw.gov.cn/art/2013/1/14/art_148_152061.html
22. Shanghai Special Funds on the Development of Major Projects of Indigenous Innovation and High & New Technology Industries
    http://www.sheitc.gov.cn/0105021602/656936.htm
23. Shanghai Strategic Emerging Industries Development Special Funds Administrative Measures
    http://www.shanghai.gov.cn/shanghai/node2314/node2319/node12344/u26ai33090.html
24. Shanghai 12th FYP on Strategic Emerging Industries
    http://www.shanghai.gov.cn/shanghai/node2314/node2319/node2404/node29352/node29353/u26ai30764.html
25. Shanxi 12th FYP on Strategic Emerging Industries
    http://giss.ndrc.gov.cn/zcggh/dfghzc/gdxzgh/l20120328_471645.htm
26. Shanxi 2011 High-tech Industries Development Special Funds Application Guidelines
    http://www.sndrc.gov.cn/showfileOld.jsp?ID=12838
27. Sichuan 12th FYP for Strategic Emerging Industries Development
28. Sichuan Administrative Measures for the Use of Strategic Emerging Industries Special Funds  


30. Zhejiang Interim Measures for the Administration of Strategic Emerging Industries Special Funds  