September 25, 2014

Trade Policy Staff Committee
Office of the US Trade Representative
600 17th Street NW
Washington, DC  20510

Re: China’s WTO Compliance, FR Doc. 2014-19310

To the members of the TPSC:

The US-China Business Council (USCBC) is pleased to submit its analysis of China’s compliance with its World Trade Organization (WTO) commitments for your October 1, 2014 hearing.

USCBC is in regular contact with your agencies regarding the concerns our members have about the business operating environment in China. This submission is a summary of key WTO-related issues US companies face in China. Also attached are recent USCBC reports on several of the issues:

- Competition Policy and Enforcement in China, September 2014
- USCBC Economic Reform Scorecard, June 2014
- China Regulatory Transparency Scorecard, March 2014
- USCBC Special 301 Submission, February 2014
- Licensing Challenges and Best Practices in China, January 2014
- USCBC Board Priorities Statement, January 2014

USCBC will soon release its annual member survey on the China business environment, which provides additional analysis of how American companies view the China market. A copy of the survey report (embargoed until 2:00 p.m. EST on September 26) is attached.

China has long been an essential market for USCBC companies, and is one that American companies continue to name as a top priority. By USCBC calculations, China is at least a $300 billion market for American companies, but it should be even bigger. American companies with operations in China sell more than $170 billion in goods and services there—sales that in turn support jobs and economic activity that benefit both China and the United States. Eighty-three
percent of USCBC members report that their operations in China are profitable. Taken together, these statistics show that China continues to be a strong contributor to US economic and job growth.

While China presents growing opportunities for American companies, the market is not without its challenges. USCBC has reported in the past that China is often in compliance with the letter of its WTO commitments, but not the spirit. American companies face many challenges in China as a result, from unfair treatment in administrative licensing to concerns about the lack of transparency and due process in competition-related investigations.

To address the challenges American companies face in China, it is imperative that the United States continue and deepen its robust, high-level engagement with China. Through 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, we have seen steady progress on a number of issues. As the United States and China continue their work through these forums—and through negotiations on a Bilateral Investment Treaty (BIT) and the Information Technology Agreement (ITA)—we hope further progress can be made in opening China’s market and in creating a more level playing field for American companies.

At the same time, it should escape no one’s attention that the US-China bilateral relationship has been difficult in recent months. USCBC urges both the US and Chinese governments to find ways to highlight the importance of our commercial ties to make clear that while our countries may not see eye-to-eye on all political and strategic matters, our economic relationship is one that benefits both nations. To that end, we recommend that the US government reiterate its intention to honor the provisions of China’s Accession Protocol to the World Trade Organization (WTO) and treat China as a market economy starting in December 2016, 15 years after its accession to the WTO. Doing so would be an important reinforcement of the United States’ commitment to both the rule of law established under the WTO and to our commercial relationship with China.

**Market Access Barriers and the BIT**

The overwhelming majority of US companies are doing business in China to access the Chinese market. However, China’s continued prohibitions on investment in over 100 sectors limits the types of operations many companies can maintain and the services they can provide there. For instance, foreign law firms are severely restricted in their China practices. These restrictions—and others—make the opportunities that would be provided by a US-China BIT very important. These negotiations are a vital opportunity to address many of the challenges USCBC members face in China and to expand critical market access for American enterprises.

USCBC strongly supports the Obama administration’s continued work on the US-China BIT negotiations. To win strong support from the US business community, the BIT must significantly

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reduce foreign ownership barriers and cover all aspects of China’s economy except a narrow list of excluded sectors. We encourage US negotiators to ensure that China’s negative list is not simply a duplicate of their current list of ownership restrictions, but an ambitious offer that opens up China’s market broadly.

USCBC continues to encourage China to reduce current foreign-investment restrictions immediately — not simply at the end of the BIT negotiations. Doing so will help build crucial support in the United States for these negotiations—support that will be necessary for ultimate approval and implementation of the agreement by the US Senate.

**Intellectual Property Rights**

Though China has made progress in protecting investors’ intellectual property rights (IPR), the issue continues to trouble USCBC members. Companies are concerned with all types of IP, including patents, trademarks, copyrights, and trade secrets. While China has taken some steps year-to-year to improve its IPR environment, gains have been modest. Across industries, concerns remain, particularly in regards to insufficient IPR enforcement. Together, these issues impact US companies’ bottom lines, diminishing the chance that they will create new or expand existing China investments, especially in innovative industries that China’s policymakers have said they want to promote.

There is no single fix to address all IPR challenges in China, as these concerns can vary considerably based on the sector and operations of individual companies. However, companies see common themes in their recommendations to the Chinese government—namely, that China can and should take steps to prevent IPR infringement before it occurs. Adopting and implementing tougher deterrents will not only strengthen protections on US companies’ IP in China, but it will also help China become the more competitive global market it desires to be. Two ways China can create effective deterrents are by increasing the level of fines and damages for IPR infringement, and by replacing current value-based thresholds for criminal prosecution with a system that applies criminal penalties for commercial-scale infringement. The latter is in line with World Trade Organization (WTO) practices. Taking such steps will help American and Chinese companies retain the profits they have earned, allowing them to invest in new products and hire more workers in both markets.

Additionally, China should take steps to address issues related to specific areas of IPR. Some of these areas include:

- Increasing resources at the central and local levels to combat IPR infringement;
- Improving protection of trade secrets through legislative and enforcement reforms;
- Establishing and implementing clear and enforceable regulations and policies in IPR-related areas such as standards, taxation, and R&D;
- Creating innovation and government procurement policies that do not discriminate against a company’s IPR based on location of ownership;
- Restricting the use of compulsory licenses;
- Removing market access barriers to legitimate products, such as imported films; and
• Promoting better protection of trademarks and copyrights through traditional means and over Internet platforms.

**National Treatment**

National treatment is an essential principle for all companies doing business globally. However, in China, American companies continue to experience problems with unfair treatment, affecting both their operations and returns.

**Licensing** Companies continue to describe national treatment-related concerns in China’s licensing regime. At the central, provincial, and local levels, these issues affect almost every aspect of doing business in China. Further complicating the matter, most USCBC members report that their domestic competitors are not facing the same licensing problems. While we are encouraged that China’s central government has made progress on its initiative to reduce the number of approvals necessary to do business, companies report that decentralization has had only marginal impact on their business. Though reducing complexity in the licensing process is a positive step, China must ensure that American companies are treated equally in all licensing and approval processes, in line with WTO commitments.

**Competition Policy** USCBC’s concern about pricing investigations under China’s Antimonopoly Law has deepened this year. While both foreign and domestic companies have been targets of these investigations, in recent months foreign companies appear to have come under increasing scrutiny by enforcement agencies. Targeted or not, foreign companies have well-founded concerns about how investigations are conducted and decided. Company concerns include:

- Fair treatment and nondiscrimination;
- Lack of due process and regulatory transparency;
- Lengthy time periods for merger reviews;
- Role of non-competitive factors in competition enforcement;
- Determination of remedies and fines; and
- Broad definition of monopoly agreements.

Improvements on these issues would not only benefit foreign companies doing business in China—they would also benefit domestic Chinese companies. To read more information on this issue, USCBC’s extensive analysis on China’s competition-enforcement regime is attached.

**Innovation Policies** China’s innovation policies have been the focus of international attention since at least 2009, when the central government’s indigenous innovation policies were first released. While China has made modifications to address concerns about provisions that favored domestic firms, American companies have mixed views of the impact innovation promotion policies have had on market access in China. USCBC’s annual membership survey found that while most companies view China’s interest in
innovation as an opportunity, almost half view it as a “strategic concern.” The risk inherent in these policies is unchanged from 2009: They could create an unfair playing field that gives domestic companies an advantage over foreign competitors. For example, China has recently announced a new program that will promote the development of its domestic semiconductor industry, despite the fact that the world’s largest and most innovative international semiconductor companies are already present in China’s market—which poses the risk of discriminating against foreign companies or restricting access to the Chinese market. Overall, favoring certain companies has a negative impact on innovation in China, as it does not create a system of incentives that drives companies to pursue product and process innovation.

USCBC is also concerned about reports that China is implementing policies that will exclude US technology companies from key areas of China’s market. American companies have significant operations in China and have been partners and suppliers in China for many years. They are responsible corporate citizens with world-class product offerings. Decisions about technology purchases—both in China and in the United States—should be made on commercial factors and should not be politicized.

Conclusion

In closing, USCBC would like to reiterate a previous recommendation, which we believe could streamline the assessment of China’s WTO compliance. Much of the information gathered for this compliance report is duplicative of the Office of the US Trade Representative’s annual National Trade Estimate. We urge relevant policymakers to consider consolidating these statutory reporting requirements, particularly given USTR’s limited budget and human resources. The purpose of conducting a regular review of China’s compliance record would still be achieved by combining the reports, and such a move would more efficiently use limited US government resources.

Please let us know if you have questions on the issues raised in this submission.

Sincerely,

Erin Ennis
Vice President

Attachments
USCBC 2014 China Business Environment Survey Results:

Growth Continues Amidst Rising Competition, Policy Uncertainty
USCBC 2014 China Business Environment Survey Results
Growth Continues Amidst Rising Competition, Policy Uncertainty

Executive Summary

» The China market continues to deliver important revenue opportunities to American companies, even as GDP growth moderates. Nearly 50 percent of survey respondents report double-digit revenue expansion - fewer than in prior years, but still impressive compared to other markets around the globe.

» US companies remain overwhelmingly profitable in the China market, but increasing local competition and rising costs are combining to pressure profit margins.

» Policy uncertainty continues to temper executive optimism. Companies have seen little tangible impact from China’s economic reforms and report little improvement in any of the top 10 issues over the past year.

» There has been a steady 30 percentage point shift over the past four years in how companies view prospects in China’s market, from “optimistic” to “somewhat optimistic.” However, few executives are pessimistic about their prospects in China, a view consistent with other surveys.

» Uncertainty over policy direction is moderating expansion plans. Fifty percent of companies plan to boost resources in China over the next 12 months, down from almost 75 percent just three years ago. On the other hand, only 2 percent of companies say they will reduce resources in China, with the remainder neither increasing nor decreasing resources.

» Differential treatment of domestic and foreign companies in China runs throughout the top 10 issues and beyond. Real progress in implementing the market-based reforms announced by China’s new leadership and in concluding a US-China Bilateral Investment Treaty are necessary to put the commercial environment on a more positive trajectory.

» While American companies report that their primary competition is with other US and foreign companies in China, competition from domestic industry is growing. Some observers focus concern on preferential treatment received by Chinese state-owned enterprises, but survey data shows again that nationality may trump ownership - Chinese companies, whether state-owned or private, receive benefits that foreign companies do not.

» The lingering challenges of protecting intellectual property rights in China are well-known. While the enforcement environment continues to slowly improve, such improvements have been modest. American companies continue to limit their operations and IP exposure in China because of the lack of adequate protections.

» China’s environmental pollution is starting to impact staffing. Forty percent of companies report that air pollution has made it difficult to retain or assign expatriate staff to China. Pollution has also increased the use of sick leave by expatriate and local staff in China.

» China’s ramped-up enforcement of its relatively new antitrust and competition regime has garnered significant attention in recent months. While both foreign and domestic companies are being investigated, foreign companies appear to be facing increasing scrutiny. Eighty-six percent of respondents are concerned about the lack of transparency, due process, and other issues surrounding competition-related investigations.

» USCBC’s annual survey continues to stand out for the quality and unique profile of its respondents. Half of its respondents are China-based and half are based in the United States, resulting in responses that blend the on-the-ground experience with the global perspective and context. Eighty-five percent of participating companies have been in the China market for more than 10 years, with the majority bringing more than 20 years of experience to the survey’s results.

Top 10 Issues

1. Competition with Chinese companies in China
2. IPR Enforcement
3. Foreign investment restrictions
4. [Tie] Human resources: Talent recruitment and retention
4. [Tie] Cost increases
6. Uneven enforcement/implementation of Chinese laws
7. Licensing
8. Transparency
9. Nondiscrimination/national treatment
10. Overcapacity in the China market
USCBC 2014 China Business Environment Survey Results

**Growth Continues Amidst Rising Competition, Policy Uncertainty**

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Doing business in China can be a study in contrast for American companies. On the one hand, it remains a strong and growing market for American goods and services. On the other, it is a challenging and sometimes frustrating place to do business for multinational companies, with numerous regulatory barriers preventing the market from being as accessible — and large — as it should be.

This contrast is reflected in the results of the US-China Business Council’s (USCBC) 2014 member survey results. While most American companies continue to view China among the top five markets globally, their optimism about business prospects in China continues to moderate. Why? In addition to operating challenges such as increasing competition and rising costs, uncertainty about China’s policy direction colors perceptions about the business environment.

Foreign companies’ moderating optimism toward China is a significant trend. There has been a steady 30-point shift in outlook over the past four years from “optimistic” to “somewhat optimistic.” At the same time, it is important to note that this shift is within the optimistic side of the spectrum — hardly anyone is pessimistic. In fact, only 1 percent of USCBC members identified themselves as pessimistic or somewhat pessimistic in 2014, largely consistent with prior years (Fig. 1).

USCBC survey data is also consistent with surveys conducted by other business advocacy groups. A significant majority of respondents to surveys by the American Chambers of Commerce in Beijing and Shanghai indicate similar trends (Fig. 2).

Chinese policymakers should take note of the sagging confidence of foreign investors and its causes, particularly as they consider additional economic reforms. China’s leaders have frequently stated their intent to allow the market to be a driver of China’s economy. Doing so — and in a manner that treats domestic and foreign companies equally — will be a powerful signal that the period of policy uncertainty has come to a close.

Business Outlook
American companies continue to view China as a top five priority market (Fig. 3), but the number of companies increasing their resource commitment in China continues a slow taper. Fifty percent of companies report plans to boost resources in China over the next 12 months, down from almost 75 percent just three years ago (Fig. 4). Virtually no companies are cutting back on their operations in China, however. Those that are not expanding their operations in China are maintaining current levels and few are redirecting investments from China to other countries (Fig. 5).
Almost three-quarters of companies saw an increase in revenue last year, with nearly half seeing double-digit increases. Fifteen percent of companies reported a decrease in revenue in 2013. Most companies anticipate that their revenue will increase again in 2014 (Fig. 6, 7).

Overall, 83 percent of respondent companies are profitable—consistent with prior years—but at lower margins. Even so, 70 percent report that their China operations are performing better or the same as their global operations. (Fig. 8-10).

What’s squeezing profit margins? Competition from domestic companies and rising costs, as well as Chinese government policies and regulations that put foreign companies at a disadvantage against their domestic competitors. These issues rank among top company concerns in 2014 and are explored in detail later in this report (Fig. 11).
Market challenges remain largely unchanged

This year’s top 10 challenges include many issues that have made the list in previous years, though the order has changed from year to year. As with previous survey results, however, it is clear that issues that move down in rank are not necessarily doing so because the situation has improved. Rather, those issues are most likely eclipsed by more pressing concerns or by increased public scrutiny of other issues. Overall, companies report that little progress has been made in addressing many of these persistent challenges.

For instance, cost increases dropped from the top slot to the fifth, despite separate survey data that indicate costs have not moderated in China. In fact, most respondents note that the challenges associated with cost increases have gotten worse over the past year. This same trend holds true for other policy-related challenges.

To genuinely confront the recurring issues that foreign companies face in China, regulators must focus on major policy changes, such as the conclusion and implementation of a US-China bilateral investment treaty (BIT). Addressing this issue and others will help make real progress on persistent challenges, like investment restrictions, uneven enforcement of laws and regulations, licensing barriers, and lack of national treatment.

Challenges in the services sector

The US economy is largely based on services rather than manufacturing, and Chinese officials have set the development of services as an important imitative goal. Despite such an opportunity for cooperation, China has yet to make the transition from manufacturing to services due in large part to significant restrictions placed on foreign investment in the services sector. Such restrictions insulate Chinese companies from true global competition and prevent foreign companies from bringing knowledge, experience, and product innovation to China. Analyzing the 2014 survey inputs from services companies shows those realities.

Unsurprisingly, services firms rank restrictions on foreign investment as their top concern, followed by competition with Chinese companies and licensing challenges — all of which illustrate the limits China maintains on foreign services companies. Those issues are also reflected in the top constraints on growth in the services sector.
China’s government has regularly stated in broad policy documents and official speeches that it intends to build its services sector. That goal will be best and most effectively achieved by lifting the numerous ownership restrictions that limit American companies from fully participating in the market (Fig. 12). China made such a choice for its manufacturing sector when it joined the World Trade Organization in 2001. Competition is necessary for China to achieve its goals for developing its services sector.
What's not in the top 10

Other important issues in the US-China commercial relationship do not rank among the top 10, but still remain a challenge for companies. Key issues that fall outside of the top 10 explored in detail later in this report include technology transfer (ranked 11th), antitrust enforcement (ranked 22nd), and innovation policies (ranked 24th).

Cybersecurity concerns have moved up slightly since 2013, from number 14 to number 13. While the US and Chinese governments recently have been at an impasse on cybersecurity, the theft of commercial information and trade secrets remains a serious issue for companies. At this point, companies are well aware of the risks of cyberintrusions and are taking actions to put in place the best defenses possible. That said, individual companies can only do so much to combat these types of intrusions on their own. Effective government-to-government dialogue is needed to get at the sources of these activities and find common ground. USCBC urges both sides to put in place an effective dialogue on these issues and find ways to ensure that commercial espionage does not undermine the important economic relationship between the United States and China.

The impact of China’s exchange rate value on company competitiveness ranks near the bottom of company concerns once again. While the currency topic is one that periodically gets a great deal of attention on Capitol Hill, it is yesterday’s problem, not today’s. China’s currency has appreciated over 30 percent since the country removed its peg against the US dollar. Most economists, including some previous critics on the issue, now agree that the renminbi is at most only modestly undervalued. China needs to continue to move toward a fully-convertible, market-driven exchange rate — but this is an issue tied to China’s financial reforms and is not a trade or commercial issue.

How do we move forward?

The remainder of this report provides a detailed account of the challenges that American companies face in their China operations. It is important to keep in mind the contrast that China presents for companies: an extremely difficult business environment along with a vital, growing market for foreign businesses.

By USCBC’s calculations, China is at least a $300 billion market for American companies — but it should be bigger. Depending on which official statistical source is used, US firms have invested around $70 billion dollars in China since the early 1980s. Chinese companies are only now beginning to ramp up their investments in the United States, which will create additional jobs and opportunities for the American economy as well as tax revenue for local, state, and federal governments.

It is vitally important that the United States and China have a forward-looking framework to guide the commercial relationship, rather than allowing the issues detailed in the following pages to define the relationship between the world’s two largest economies.
Removing barriers that hold back the potential of the bilateral commercial relationship is essential. That is why a successful conclusion of BIT negotiations should be the top priority in the US-China economic relationship (http://uschina.org/reports/bilateral-investment-treaties-what-they-are-and-why-they-matter). USCBC will continue to push both governments to achieve passage of this treaty. A US-China BIT will level the playing field for American and Chinese companies and provide meaningful market access for American companies into China.

**Top 10 Challenges**

When assessing the challenges that American companies face in China, it is important to recognize that many issues overlap. In this year’s top 10, at least six issues are related to preferential treatment for China’s domestic companies:

- Competition with Chinese companies
- Foreign investment restrictions
- Uneven enforcement/implementation of Chinese laws
- Licensing
- Transparency
- Nondiscrimination/national treatment

These preferences are structural in some cases, such as foreign investment restrictions, but are simply a part of how rules and regulations are implemented in most areas. In all cases, they are mechanisms for protecting domestic enterprises. American companies report a variety of areas in which they are seeing signs of protectionism in China that are similar to the areas identified in the top 10 challenges (Fig. 13).

Regardless of type, differential treatment of domestic and foreign companies in China distorts how the economy functions and limits China’s ability to reach its ambitious economic reform goals. As Chinese regulators have noted, fair and vibrant competition is the only way to build a sustainable Chinese economy. As a consequence, it is in the interest of China’s policymakers to treat each of these challenges as priority areas to implement policies that treat domestic and foreign companies equally.

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**Fig. 13  Signs of Protectionism in China**

*Multiple responses allowed*
As China’s economy has grown in size and strength, so have its domestic companies — both private and state-owned. While American companies report that their primary competition is with other US and foreign companies in China, the competition they face from domestic industry has grown stronger, and it now ranks as the top challenge in the 2014 survey (Fig. 14).

Robust competition in itself is not a concern for foreign companies doing business in China. American companies are accustomed to strong competitors, which they face in markets all over the world. However, competition based on favoritism for one group of companies over others is a significant concern. While many have focused on preferential treatment for Chinese state-owned enterprises, survey data show that in reality the issue is not ownership structure, but simply nationality. Chinese companies, regardless of ownership, receive benefits that foreign companies cannot (Fig. 15).
Importantly, preferential treatment of domestic enterprise is not in the long-term interest of China or its companies. Access to preferential benefits, such as those shown above, does little to create the type of efficient and innovative companies that China hopes will lead its economy to the next stage of development (Fig. 16, 17). As senior leaders such as China’s Premier Li Keqiang have noted in public statements, Chinese companies will become internationally competitive only through increasing fair and robust competition in China’s market.
The lingering challenges of protecting intellectual property rights in China are well known, and this year’s survey findings reinforce that more must be done to address the issue. IP protection is not just an issue for American companies doing business in China — it also affects Chinese companies. USCBC’s annual membership surveys have consistently found that while some improvements have been made year to year, they are modest. As one survey respondent put it, “IPR enforcement is ever improving, but by far not enough (Fig. 18).”

The improvements that American companies have seen are varied, and they include more administrative actions, greater attention to the IPR legal framework, and the creation of IP-focused courts in Beijing, Shanghai, and other locations (Fig. 19).

However, challenges remain. Improved IP enforcement is not simply a matter of ensuring that IP owners are compensated for the fruits of their work — it is also an economic issue for China. The lost opportunities for job creation and innovation can be seen in the areas where American companies are limiting their operations in China because of the lack of
full protection for IP rights. Notably, almost 50 percent of companies hold back on investment and research and development (R&D) in China because of IP concerns; less than 25 percent say the IP environment has no impact on investment decisions (Fig. 20). Increased foreign investment in R&D would help to create the kind of innovative, value-added jobs that China’s government is actively seeking to develop. As a consequence, improving IP enforcement will be an important component of China’s innovation drive.

China has several specific IP enforcement channels, all of which receive mixed reviews from American companies that have considered or used them. In general, China’s civil courts and administrative agencies, such as the State Administration for Industry & Commerce (SAIC) and the Public Security Bureau, are viewed as being the most viable options for IP enforcement, though not in all cases (Fig. 21).

China’s criminal courts are viewed most skeptically by companies, with nearly 50 percent of companies indicating that pursuing criminal cases is not a viable option. A similar percentage of companies said that they have not had cases that would be eligible for criminal enforcement. These results are a strong reminder of USCBC’s longstanding recommendation that China impose criminal penalties for commercial-scale theft of IP and eliminate minimum value thresholds. If such a change were made, more criminal cases could be brought and enforced, and views on the viability of criminal courts would likely improve (Fig. 22).
Foreign ownership restrictions in China continue to serve as widespread market access barriers for American companies. While there were few, if any, new regulations issued in the last year to increase restrictions on foreign investment in China, the issue has been a top priority for many companies. That is due, in part, to China’s announcement in 2013 that it would use the US approach to negotiation of a US-China bilateral investment treaty (BIT).

Specifically, China agreed to use a “negative list” approach in which the terms of the investment treaty apply to all sectors except those expressly excluded in the final treaty. That approach is based on the concept of “pre-establishment,” or equal treatment of foreign and domestic companies even before an investment is made. That format contrasts with China’s current investment approval framework, set up in the Catalogue Guiding Foreign Investment, which restricts foreign companies from participating in over 100 industries and sectors throughout China based on a “positive list.”

China’s domestic economic reforms, announced after the Chinese Communist Party’s Third Plenum in late 2013, focused appropriately on goals such as letting the market play a more decisive role in the economy and widening investment access. For those reforms to be successful, China’s policymakers will need to ensure that foreign and domestic companies are treated equally. A BIT is an important tool to help achieve this objective.

Successful conclusion of US-China BIT negotiations is a high priority for American companies. Success will be assessed in significant part based on the number and range of sectors that China is willing to open to foreign companies. A Chinese negative list that simply codifies existing restrictions, reduces the list only modestly, or removes only low-priority sectors will not be well received by American companies and will significantly reduce the chances of the treaty securing passage by the United States Senate.

That said, Chinese regulators could build support in the American private sector by reducing the number of restricted and prohibited sectors within China’s Catalogue Guiding Foreign Investment prior to the conclusion of BIT negotiations. Steady reductions in investment restrictions in China would be the best sign to international stakeholders that China is serious about undergoing inclusive reforms to its economy, thus building support for passage of a US-China BIT.
Challenge #4 [tie]

Human Resources

Progress on Issue in Past Year: Unchanged

- Rank in 2013: 3 (tie)
- Rank in 2012: 1
- Rank in 2011: 1
- Rank in 2010: 3 (tie)
- Rank in 2009: 3
- Rank in 2008: 2 (tie)
- Rank in 2007: 1
- Rank in 2006: 1

While the majority of issues in the top 10 list are challenges that are unique to foreign companies in China, issues such as human resources difficulties impact all companies doing business there. The issue has been among the top five challenges identified in USCBC’s survey for all eight years that the survey has been conducted.

In the most general terms, American companies are paying wages to their Chinese employees at rates that are higher than their domestic competitors (Fig. 23). Even with that difference, most American companies report that they have been increasing wages between 5 and 10 percent annually for at least the last three years (Fig. 24). USCBC member companies anticipate further wage increases in the coming year, as China’s labor market becomes tighter (Fig. 25). Wages

**Fig. 23**

Wages at International Companies Versus at Domestic Chinese Enterprises

- Higher than the average wage: 72%
- Same as the average wage: 27%
- Lower than the average wage: 1%

**Fig. 24**

Wage Increases in the Past Year

- Did not raise wages: 1%
- Less than 5%: 7%
- Between 5-10%: 61%
- Between 10-15%: 28%
- Over 15%: 1%

2012  2013  2014
have risen fastest among skilled technical staff and middle management positions, yet turnover remains highest in middle management positions — an indication that these employees are among the most sought after and command higher wages (Fig. 26, 27).

Despite these significant annual wage increases, 55 percent of companies still plan to expand headcount in China in the next year. Although this represents a 15 percent decline from 2013, it still represents a majority of companies, indicating that companies are still actively looking to expand in China despite headwinds (Fig. 28).
At What Level Was Turnover Most Acute?

- Senior management: 2012: 1%, 2013: 1%, 2014: 2%
- Middle management: 2012: 36%, 2013: 39%, 2014: 42%
- White collar entry-level staff: 2012: 31%, 2013: 32%, 2014: 25%
- Experienced factory operator/technician: 2012: 16%, 2013: 19%, 2014: 17%
- Entry-level factory operator/technician: 2012: 16%, 2013: 9%, 2014: 14%

Company Head Count in Next Year Expected to...

- Expand: 2012: 72%, 2013: 71%, 2014: 55%
- Stay the same: 2012: 25%, 2013: 21%, 2014: 33%
- Contract: 2012: 3%, 2013: 8%, 2014: 12%
IN FOCUS:
Impact of China’s environmental pollution
China’s environmental pollution has created a related challenge for USCBC member companies. While environmental pollution can have a broad operational impact for companies, human resources are an important dimension: 40 percent of companies report that air pollution and environmental issues have made it difficult to retain staff and transition international talent to China. Pollution has also increased the use of sick leave by staff in China, and it has forced some companies to change operations in order to comply with new pollution policies (Fig. 29).

Fig. 29  Impact of China’s Air and Environmental Pollution

- Difficulty retaining staff and attracting international talent to China: 40%
- Increased cost pressure due to high environmental standards: 27%
- Increased sick leave: 19%
- Required changes to company operations to comply with pollution policies: 17%
- Improved competitiveness as domestic companies have to comply with high environmental standards: 15%
- Other: 20%
- No impact: 13%
Cost increases remain a nearly universal concern for American companies operating in China. Unsurprisingly, given its tied rank in the top 10, human resources costs top the list of specific cost concerns. Costs are increasing across the board, however, for energy and utilities, materials, product and operational compliance, and land and rental fees (Fig. 30, 31).

Progress on Issue in Past Year: Deteriorated
Rank in 2013: .................................. 1
Rank in 2012: .................................... 4
Rank in 2011: .................................... 3
Rank in 2010: .................................... 5
Rank in 2009: .................................... 13
Rank in 2008: .................................... 3
Rank in 2007: Not asked
Rank in 2006: Not asked

Are Rising Costs in China a Concern?

Did Your Company Reduce or Stop Planned Investment in China in the Past Year?

*Multiple responses allowed
Despite these concerns, few companies report that they reduced or stopped a planned investment in China in the last year — and no companies indicate they did so due to rising costs (Fig. 32, 33). If companies are reaching the threshold for tolerable cost increases in China, it is not yet impacting their investment plans in that market. As one respondent put it, “Costs are increasing at a pace that is difficult to offset.”
American companies have consistently reported that they are treated differently than their domestic counterparts in the implementation and enforcement of Chinese laws and regulations. One such concern relates to the uneven enforcement of labor and environmental laws in China, which allows companies with lower standards to violate established laws and puts those who bring their international standards to China at a competitive disadvantage. Another concern is the harsher enforcement of product safety regulations on foreign companies, despite their strong track records in these areas and rapid resolution of problems when they are identified. One survey respondent said that there has, “definitely [been] increased scrutiny since early 2013. Although [the laws also cover] local companies… MNCs [multinational companies] do seem to be getting special attention.”
Antitrust enforcement

This year, the area that has garnered the most attention from foreign companies is enforcement of China’s antitrust law, known as the Antimonopoly Law (AML). In recent months, the press and the public have paid considerable attention to this issue. While both foreign and domestic companies have been targets of investigations, foreign companies appear to have faced increasing scrutiny in recent months. Eighty-six percent of companies are at least somewhat concerned about these issues, with over half specifically citing enforcement as the issue, rather than the legal framework for the law (Fig. 34, 35).

Even though most American companies report that they have not been targeted with antitrust investigations, almost 30 percent of USCBC member companies are concerned they will be subjected to one. Among the most significant concerns for foreign companies are challenges with due process, lack of transparency, and fair treatment in investigations (Fig. 36, 37).

![Direct Experience with Enforcement Investigations in the Past Three Years*](chart)

### Fig. 36

<table>
<thead>
<tr>
<th>M&amp;A review</th>
<th>Pricing investigation</th>
<th>Other business investigation</th>
<th>Concerned will be targeted</th>
<th>No concerns</th>
</tr>
</thead>
<tbody>
<tr>
<td>21%</td>
<td>9%</td>
<td>9%</td>
<td>27%</td>
<td>30%</td>
</tr>
</tbody>
</table>

![Biggest Challenges in AML Enforcement*](chart)

### Fig. 37

<table>
<thead>
<tr>
<th>Lack of transparency in AML reviews</th>
<th>Lack of clarity on AML review key criteria and definitions</th>
<th>Excessive focus on foreign companies</th>
<th>Lack of due process for AML enforcement proceedings</th>
<th>Insufficient capacity among enforcement agencies</th>
<th>AML provisions that limit common business practices</th>
<th>Inability to have representation by legal counsel</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>64%</td>
<td>59%</td>
<td>54%</td>
<td>34%</td>
<td>33%</td>
<td>27%</td>
<td>20%</td>
<td>3%</td>
</tr>
</tbody>
</table>

*Multiple responses allowed
Licensing remains a top issue for American companies, though the issue slipped in the top 10 rankings — likely due to the higher profile of other issues in 2014. Almost 60 percent of companies report that they have experienced licensing problems in China, including securing product approvals, investment approvals, business expansion, renewing business licenses, and even routine business activities (Fig. 38-40). Just over half of companies, 52 percent, report that their domestic competitors do not face the same licensing challenges (Fig. 41).

**Fig. 38 Has Your Company Experienced Challenges with Administrative Licensing in China?**

- **No**: 43%
- **Yes**: 57%

**Fig. 39 Types of Licensing Problems Experienced**

- **Product approval or certification**: 49%
- **Foreign investment approval**: 43%
- **Business expansion**: 34%
- **Renewing or amending business licenses**: 21%
- **Routine business activities**: 21%
- **Other**: 4%

**Fig. 40 Where Licensing Problem Occurred**

- **Central government**: 74%
- **Provincial government**: 51%
- **City or district government**: 45%
- **Investment zone officials**: 6%

*Multiple responses allowed*
From one survey respondent, “The playing field is increasingly leaning in the favor of [Chinese] national champions, who continue to increase capacity and receive preferential treatment. We’re also seeing lengthy or stalled licensing and investment approvals, and a general lack of government action to move files forward in the approval process.”

Another respondent put it more simply, “[There are] significant delays in license application reviews and approvals for foreign firms.”

Many, though not all, of the licensing delays appear to be happening at the central government level, but they decline steadily as the level of the decision maker moves closer to the local and investment zone level. This may be a reflection of progress made in decentralizing licensing approvals. Still, most companies report that they have not seen a material impact from those changes, and questions remain about how evenly licensing and approval processes are conducted (Fig. 42). Regardless of reason, more needs to be done to ensure equal treatment of domestic and foreign companies in licensing (http://uschina.org/reports/improving-china%E2%80%99s-licensing-system-recommendations-key-sectors-2014).
Transparency and national treatment are two central components of a well-functioning and competitive market. Providing an opportunity for public comment on laws and regulations prior to implementation enables companies to provide constructive input on how policy goals can effectively be reached without hindering business and impacting consumers. Treating domestic and foreign companies equally ensures that the market allows the best products and most competitive companies to reach consumers.

American companies have seen some progress in these issues over the years. As one survey respondent noted, “Transparency has improved of information disclosure online, but overall [it is] still far from enough.” However, issues still remain with transparency throughout the regulatory process. USCBC’s 2014 transparency report highlights some of these challenges and how well key government agencies are doing in improving on these issues (http://uschina.org/reports/china-2014-regulatory-transparency-scorecard).

These issues are fundamental and relate to many of the challenges discussed elsewhere in this report, including licensing, IPR protection, competition, and preferences for domestic companies. Transparency and national treatment will also be included in US-China bilateral investment treaty (BIT) negotiations. They should both be priorities for China’s policymakers beyond the BIT negotiations, however, as they are the cornerstones of a well-functioning, market-based, competitive economy.

<table>
<thead>
<tr>
<th>Challenge #8</th>
<th>Transparency</th>
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</thead>
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<td>Progress on Issue in Past Year: Unchanged</td>
<td></td>
</tr>
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<td>Rank in 2012:</td>
<td>11</td>
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<td>Rank in 2008:</td>
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<tr>
<td>Rank in 2007:</td>
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<tr>
<td>Rank in 2006:</td>
<td>5</td>
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<table>
<thead>
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<th>Challenge #9</th>
<th>Nondiscrimination/ National Treatment</th>
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<tbody>
<tr>
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<td></td>
</tr>
<tr>
<td>Rank in 2013:</td>
<td>7</td>
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<tr>
<td>Rank in 2012:</td>
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<td>Rank in 2008:</td>
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<tr>
<td>Rank in 2007:</td>
<td>15</td>
</tr>
<tr>
<td>Rank in 2006:</td>
<td>9</td>
</tr>
</tbody>
</table>
Challenge #10
Overcapacity in the China Market

As with transparency and national treatment, overcapacity has an impact on markets. In China’s case, the impact can be felt both domestically and internationally. Overcapacity issues have arisen in a number of Chinese sectors, from cement and steel to glass and chemicals.

China has made some progress at stemming overcapacity issues. China’s movement toward market-determined prices for energy, for example, should help to slow overproduction by companies who are continuing to make products even as demand has slowed. While such changes will likely result in some businesses closing or consolidating, the appropriate balancing of supply and demand is in China’s best economic interests. At the same time, Chinese policymakers should consider methods to address overcapacity issues that are balanced and fair, and that do not unfairly burden foreign companies.
Other Issues of Interest

Innovation promotion policies and Strategic Emerging Industries

China’s innovation policies have been the focus of international attention since at least 2009, when the central government’s indigenous innovation policies were first released.

While China has made modifications to address some foreign company concerns about provisions that favored domestic companies, American companies have mixed views of the impact innovation promotion policies have on market access in China. Fifty-six percent of respondents view these policies as a strategic opportunity or have already seen a positive impact on their sales and operations. The remaining 44 percent view these policies as strategic concerns or have seen a negative impact on their operations (Fig. 43).

One survey respondent explained the opportunities created by China’s innovation policies this way: “The products we sell are high-end and allow our customers to create more differentiated and innovative products. As Chinese companies move away from simply competing on cost/price, and more towards innovation/differentiation, it creates more demand for high-end technology.”

By contrast, the risks of China’s innovation policies were explained this way by another respondent: “[China’s] national champion approach risks [creating an] unfair playing field.” Favoring certain companies has a negative impact on innovation in China, as it does not create the proper system of incentives to drive companies to pursue rigorous processes that promote product and process innovation.

The High and New Technology Enterprise (HNTE) designation, one of China’s primary innovation incentive programs that provides tax credits for innovative companies, has yet to be significantly accessed by American companies. Almost 30 percent of companies report that they have been approved for HNTE status and another 30 percent may apply in the future (Fig. 44). No companies report that they have applied for the status and been denied. That said, some companies have reported problems with local implementation of HNTE rules such as local IP ownership and information disclosure requirements that make the program less attractive to innovative foreign companies. In addition, some companies that have previously received HNTE status have faced challenges when trying to renew their approval, again due to new interpretations by local officials.

Similarly, China’s Strategic Emerging Industries (SEI) program has had limited impact for American companies. Seventy-two percent of companies assess their ability to participate in SEI programs as good or moderate, but only 35 percent report that they are very interested in doing so. Another 64 percent report that they are somewhat interested in receiving SEI benefits, but that participating in the program is not a top company priority (Fig. 45-48).

One potential issue for foreign companies may be the lack of clarity about the benefits of being characterized as an SEI.
As one survey respondent put it, “Our products fall into the SEI category, but we don’t know/understand the real implications and potential impact on our business.”

Questions remain about future policies in this area, and how policymakers may approach development in these industries. (http://uschina.org/government-change-course-china%E2%80%99s-strategic-emerging-industries) Ultimately, American companies’ concerns about these policies were summed up by a respondent, “We just want to make sure innovation is competition-neutral.”
Technology transfer

Related to China’s drive to become more innovative is its interest in having foreign companies transfer technology to Chinese companies in its market, thus significantly shortening the timeline for developing innovative products. This issue has gotten considerable attention from US policymakers and companies: Sixty-two percent of companies report that they are concerned about transferring their technology to China, particularly as it relates to the protection of intellectual property rights and proprietary information and the enforcement of technology licensing agreements (Fig. 49, 50).

The reality, however, is more nuanced. Despite these concerns, 80 percent of companies report that they have not been asked to transfer technology to China in the last three years (Fig. 51). Of those that have been asked to transfer technology, only 15 percent report that the technology would be controlled by a Chinese entity (Fig. 52, 53).

An important aspect of the discussion of these issues is the options that companies have when such requests are made. Only 7 percent of companies report that they had to comply with a technology transfer request even when they deemed it unacceptable. The other companies indicate that the requests were either acceptable or that they were able to modify, avoid, or withdraw from the transaction (Fig. 54, 55).
There is an important link between these issues and the investment barriers that American companies face in China. Due to current restrictions on foreign investment, some companies are forced to partner with domestic companies to operate in China. In those circumstances, companies may need to negotiate technology transfer agreements with current or potential investment partners — a business transaction that has implications for the protection of the company’s intellectual property. Eliminating these types of joint venture requirements would allow companies to maintain control of their IP in China and implement company-wide procedures to protect it.

**Fig. 52**  
Who Asked that Technology Be Transferred?*  

- Company: 54%
- Central government: 38%
- Local government: 23%

*Multiple responses allowed

**Fig. 53**  
Who Would Control the Technology in China?  

- Our company: 70%
- Our company and a Chinese entity: 15%
- Chinese entity: 15%

**Fig. 54**  
How Did Your Company Respond to This Requirement?  

- Acceptable and transferred: 43%
- Unacceptable and avoided request entirely: 7%
- Unacceptable and only transferred some: 14%
- Unacceptable but had to comply: 7%
- Unacceptable and withdrew from transaction: 29%

**Fig. 55**  
Negotiation of Licensing Fees for Transferred Technology  

- Able to negotiate commercially acceptable payments for technology transferred: 43%
- Able to negotiate some fees, but below commercially acceptable amount: 43%
- Unable to negotiate licensing fees and transferred technology at no charge: 14%
Respondent Profile

US- and China-based executives
The US-China Business Council (USCBC) annual membership survey incorporates a unique mix of US- and China-based executives. Respondents were almost equally divided between those based in China and those based in the United States. The remainder were located elsewhere in Asia (Fig. 56).

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-three percent of respondents represented manufacturing companies, and 42 percent represented service providers. Many respondents’ companies are active in both sectors. Nine percent worked for companies in primary industries, such as agriculture and oil and gas. Of USCBC’s 220 member companies, 110 participated in the survey (Fig. 57).

*Multiple responses allowed
Long experience in the China market

USCBC member companies have a long history of doing business in China: Fifty-six 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. 58).

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 13 percent use their China operations to produce products that are shipped back to the United States (Fig. 59).
Executive Summary

- China’s increased level of competition enforcement activity and the high-profile reporting of its competition investigations have prompted growing attention and concern from US companies. Eighty-six percent of companies responding to the US-China Business Council’s (USCBC’s) 2014 member company survey indicated they are at least somewhat concerned about China’s evolving competition regime—although more so about the potential impact than actual experience so far.
- China’s competition regime framework is relatively new. The Antimonopoly Law (AML) came into force in 2008 after Chinese authorities spent more than a decade drafting the law and consulting with foreign competition authorities from the United States, the European Union, and other jurisdictions. The AML draws from elements of both the US and EU competition laws, though it is more closely tied to the EU model and contains some elements unique to China.
- The rise in competition-related investigations has corresponded to the buildup in personnel at regulatory agencies following the AML’s implementation.
- USCBC monitoring of publicly announced cases indicates that both foreign and domestic companies have been targets of AML-related investigations, but that foreign companies appear to have faced increasing scrutiny in recent months.
- The perception that foreign companies are being disproportionately targeted is also fueled by China’s domestic media reporting, which has played up foreign-related investigations versus those of domestic companies.
- Targeted or not, foreign companies have well-founded concerns about how investigations are conducted and decided. Company concerns include:
  o Fair treatment and nondiscrimination
  o Lack of due process and regulatory transparency
  o Lengthy time periods for merger reviews
  o Role of non-competitive factors in competition enforcement
  o Determination of remedies and fines
  o Broad definition of monopoly agreements
- Bigger questions remain unanswered about the objectives of China’s competition regime, such as: Will China use the AML to protect domestic industry rather than promote fair competition? Is the government using the AML to force lower prices, rather than let the “market play the decisive role” as enshrined in the new economic reform program? The answers are not fully determined yet, but in at least some cases so far there are reasons for concern.
- Government and industry groups in the United States must take effective steps to engage with various stakeholders in China on these issues through high-level advocacy and working-level policy dialogue and technical exchanges. It should be expected that China, with its large economy, will develop into the third leg of the global antitrust regime, along with the United States and the European Union. The recommendations in this report are directed at supporting the development of a competition regime in China that protects the legitimate interests of all stakeholders and integrates rather than conflicts with international best practices.
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Introduction

China launched its first comprehensive competition law in 2008, and began taking steps to establish the infrastructure and capacity necessary to enforce it. While Chinese agencies conducted competition activity prior to 2008—such as National Development and Reform Commission (NDRC) enforcement of the Price Law—much of the enforcement capacity required to implement the new Antimonopoly Law (AML) did not exist. The AML created new institutions charged with monitoring competition and market order and a unique regulatory structure that divided competition enforcement among multiple Chinese government agencies. With the framework in place, these agencies began creating the processes of how China’s new competition regime would operate in practice.

Now after six years of implementation, a clearer picture is beginning to emerge about the direction of China’s competition regime. Each of the three main Chinese regulatory authorities—NDRC, the Ministry of Commerce (MOFCOM), and the State Administration of Industry and Commerce (SAIC)—have built enforcement capacity, particularly staffing. This increase in competition personnel corresponds to increasing activity by these agencies in enforcing competition law, including merger reviews and investigations of anticompetitive behavior related to pricing and monopolistic conduct.

China’s increasing AML enforcement activity has garnered considerable attention from a wide range of stakeholders around the world, including government agencies, companies with operations in China, and media outlets. While US-China Business Council (USCBC) monitoring of publicly announced cases in China indicates that both foreign and domestic companies have been targets of AML-related investigations, in recent months foreign companies appear to have faced increasing scrutiny. The level of concern has been raised in part by high-profile reporting on investigations of foreign companies—not only in western media, but also in China’s domestic media, which has covered foreign-related investigations much more extensively than those of domestic companies and fueled questions about fair and equal treatment.

This report provides a detailed summary of China’s competition enforcement activity, analyzes the questions and concerns of foreign companies, and provides specific recommendations for how to further improve the substance and perception of China’s competition regime.

Background and Regulatory Framework for China’s Competition Regime

The AML, passed in August 2007 and first implemented on August 1, 2008, serves as the foundation of China’s competition regime. Whereas previous laws contained some competition-related content—such as prohibiting the abuse of monopoly powers under the 1993 Anti-Unfair Competition Law (AUCL) and defining illegal pricing activities under the 1998 Price Law—the AML was the first Chinese law focused on competition as a whole. The law was in the drafting process for more than 13 years, during which Chinese authorities consulted repeatedly with foreign competition authorities from the United States, the European Union, and other jurisdictions. The process also included multiple rounds of public comment from outside stakeholders, including foreign companies and industry associations.

The AML draws from elements of both US and EU competition laws, though it is more closely tied to the EU model. Article 1, for example, states that the AML is designed to “prevent and restrain monopolistic conduct, protect fair market competition, enhance economic efficiency, safeguard the interests of consumers and of society as a whole, and promote the healthy development of socialist market economy.” Many of these goals—curbing monopolistic behavior, limiting intervention in the market place, and protecting consumer interest—match aspects of US competition practice. However, China’s goal of developing a healthy economy reflects an
EU-style approach, as does prioritizing economic integration, fairness for business operators of varying sizes, and technology development alongside consumer interests.¹

The AML also has provisions that are unique to China or that are applied differently in China than in other countries. Examples include articles that emphasize the need to harmonize competition policy with the specific needs of China’s socialist market economy (Articles 1 and 4), encourage mergers and acquisitions (M&As) as a means to achieve economic scale (Article 5), institute national security reviews of Chinese M&A transactions with foreign companies (Article 31), and prohibit the abuse of intellectual property to eliminate or restrict market competition (Article 55). Chapter V prohibits administrative monopolies—administrative agencies and government bodies that abuse administrative authority to eliminate or restrict market competition, particularly in support of government-owned or affiliated enterprises. The AML also exempts some areas from coverage, including state-owned industries with national security interests or in economic sectors deemed “critical” (Article 7). Other exemptions include agreements between enterprises that are designed to improve technology, develop new products through R&D, conserve energy, or enhance the efficiency of small and medium-sized businesses (Article 15).

In the six years since the implementation of the AML, Chinese agencies have released follow-up regulations to clarify key provisions. Important regulations include 2010 NDRC rules defining price monopolies, 2010 SAIC rules defining “abuse of a dominant market position” and “monopoly agreements,” 2011 MOFCOM national security review rules for foreign M&A transactions, and 2014 MOFCOM rules that created a simplified review procedure for certain types of M&A transactions. Other regulations, such as SAIC rules related to the abuse of intellectual property rights and MOFCOM rules for imposing remedies on mergers, remain in draft form at the time this report was published (for a fuller list of AML-related implementing rules and regulations, see Appendix 1).

AML Enforcement Structure

The AML established a new competition enforcement structure in China, involving both new and existing government agencies (see Chart 1). Article 9 of the AML established the Antimonopoly Commission (AMC) to organize and guide competition and antimonopoly work, including the drafting of competition policies and guidelines and the coordination of administrative enforcement and investigations. The AMC was initially headed by Vice Premier Wang Qishan in 2008 and included representatives of the State Council, NDRC, MOFCOM, SAIC, and 11 other government agencies. Its working office was set up within MOFCOM and led by the head of the agency’s Antimonopoly Bureau, Shang Ming. The AMC is likely now headed by Vice Premier Wang Yang since he inherited many of Wang Qishan’s former portfolios, though no official announcement has been made.

Chart 1: China’s Main Antimonopoly Authorities

Primary AML enforcement capacity is divided among three government agencies:

- **MOFCOM** Via its Antimonopoly Bureau, MOFCOM is responsible for reviewing M&A transactions and other types of proposed business concentrations. It may approve or reject these transactions, either with or without remedy conditions.

- **NDRC** Via its Price Supervision and Antimonopoly Bureau, NDRC manages enforcement of price-related conduct, including investigations of pricing practices by companies, price-related aspects of monopoly agreements, and company abuse of dominant market position to set or control prices.

- **SAIC** Through its Antimonopoly and Anti-Unfair Competition Bureau, SAIC is in charge of investigating non-price-related monopolistic behavior, including monopoly agreements, abuse of market dominance, and monopoly control.

The courts provide another channel for competition enforcement. Article 50 of the AML allows for civil liability, stating that a business operator engaging in monopolistic conduct that inflicts losses on other parties is subject to civil liability.

**AML Enforcement Since 2008: Growing Capacity, Increased Actions**

Since the AML went into force, China’s three main administrative enforcement agencies—MOFCOM, NDRC, and SAIC—have taken steps to implement competition enforcement by establishing internal structures to implement the law, increasing the number of personnel charged with competition enforcement, enhancing the professionalism and the economic rigor of competition analysis, and improving some aspects of transparency. Chinese regulators also actively and regularly engage with counterparts from the United States, the European Union, and other jurisdictions.

China’s competition regime is still in its early stages. Important concerns remain not just with the AML legal framework, but more importantly with China’s enforcement track record. Some concerns raised by international observers during the AML drafting process—such as the role of industrial policy considerations in competition reviews, lack of due process, and insufficient transparency—remain relevant based on China’s initial enforcement efforts. The persistence of these questions is impacting the international view of China’s role as a global competition regulator.

**M&A Reviews—MOFCOM**

Since the AML’s 2008 implementation, MOFCOM has increased enforcement capacity and laid down clear markers that global transactions—even those between foreign companies that have little business in China—must be reviewed in China. MOFCOM’s Antimonopoly Bureau has grown to approximately 30 staff in the past five years, and may increase further as MOFCOM continues to expand its number of M&A reviews.²

From August 2008 through the first half of 2014, MOFCOM conducted full reviews of 869 proposed merger transactions, with the number increasing steadily year-on-year (see Table 1). The vast majority (844) of cases reviewed, including transactions involving foreign companies were cleared in full by MOFCOM. Of the remaining 25 cases, all but two were approved with conditions, including high-profile deals such as InBev-Anheuser Busch (2009), Western Digital-Hitachi (2012), Marubeni-Gavilon (2013), and Thermo Fisher-Life Technologies (2014). The other two proposed transactions were rejected by MOFCOM: Coca-Cola’s proposed acquisition of Huiyuan (2009) and the proposed P3 Network shipping alliance between European shipping

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companies Maersk, MSC, and CMA CGM (2014). Nearly all of these cases involved foreign-foreign global acquisitions in which the reviewed companies had subsidiaries in China.

In these conditional cases, MOFCOM has applied a variety of remedies to address competition concerns, including structural remedies such as divestiture of assets and behavioral remedies such as information firewalls, non-discrimination, and mandatory licensing (for a fuller list and description of MOFCOM’s M&A reviews, including remedies, see Appendix 2).

MOFCOM also implemented “simplified” reviews of a handful of cases. Under MOFCOM’s April 2014 simplified case provisions, if there are no public objections, cases can be reviewed under new simplified standards. The first of these reviews was subsequently conducted on Rolls-Royce Holding PLC’s proposed buyout of Daimler AG’s 50 percent share of their joint venture, Rolls-Royce Power Systems AG. The transaction was posted on May 22, 2014 for public comment through May 31, 2014. The case was included among the list of transactions approved by MOFCOM during the second quarter of 2014, with final approval listed on June 9, 2014. As of this report’s publication, MOFCOM has posted 21 proposed simplified cases to its website since May 2014.

Primary questions and concerns raised by foreign companies about MOFCOM merger reviews relate to due process and transparency, MOFCOM’s consultation process with other enforcement agencies, lengthy time periods for merger reviews, consideration of non-competition factors (such as industrial policy concerns), and the application of remedies and fines.

Recent Activity

Some recent merger and acquisition reviews whose decisions have been released by MOFCOM include:

- **Merck kGaA-AZ Electronic Materials (April 2014)** MOFCOM approved the purchase of AZ Electronic Materials by Merck kGaA, after reviewing the merger for its impact on competition in flat panel display (FPD) manufacturing. MOFCOM argued that the two companies’ combined market share in two products used in FPD manufacturing—liquid crystals and photoresists—would have restricted competition in China and globally. In its decision, MOFCOM required the two companies to eliminate tie-in sales or subsidies for the two products, and required Merck to license liquid crystal patents on non-exclusive, commercially reasonable, and non-discriminatory terms. Both conditions were imposed for a period of three years.

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3 These statistics run through June 30, 2014, and thus do not include merger reviews announced after that date, including the July 2014 conditional approval of the battery joint venture formed by subsidiaries of Panasonic Corp., Toyota Corp., Hunan Corun New Energy, and Changshu Sinogy Venture Capital Co.
Maersk, MSC (Mediterranean Shipping Company) and CMA CGM’s “P3 Network” (June 2014)  
MOFCOM rejected plans by three leading European shipping companies—Denmark’s Maersk, Switzerland’s MSC, and France’s CMA CGM—to form a shipping alliance that would have allowed the companies to share ships and port facilities. In its decision, the agency noted that the three companies involved in the alliance already held a 46.7 percent market share in the Asia-Europe container shipping line market. Moreover, MOFCOM argued that the alliance would have allowed the companies to increase their market dominance in ways that would restrict competition and unfairly increase the alliance’s bargaining power against consignors and ports.

Primearth EV Energy, Toyota Motor China Investment, Toyota Tsusho, Hunan Corun New Energy, Changshu Sinogy Venture Capital (July 2014) MOFCOM gave conditional approval for plans by five domestic and foreign companies to form a new joint venture (JV) in the automotive battery industry. In its analysis, MOFCOM focused on nickel metal-hydride car batteries, used in the vast majority of hybrid vehicles, arguing that the industry was very concentrated. As such, the new JV could restrict or even eliminate competition in the hybrid vehicle market and increase Toyota’s market dominance. In its decision, MOFCOM required the JV to sell products to third parties on a non-discriminatory basis. Within three years, the JV must also bring product(s) to market to meet market demand.

Pricing Investigations—NDRC

NDRC has also taken significant steps to increase its level of enforcement activity, particularly since early 2013. Between 2008 and 2012, NDRC conducted nearly 20 price-related investigations. By comparison, the agency investigated more than 80 companies in 2013 alone across a range of sectors, including pharmaceuticals, infant formula, Chinese liquor, and the telecom industry. NDRC’s investigations of pricing issues have been supplemented by provincial and local level investigations.

NDRC’s investigative activity has grown as the agency has increased staff in its Price Supervision and Antimonopoly Bureau, with similar increases at the provincial level. In September 2013, NDRC Price Supervision and Antimonopoly Bureau Director Xu Kunlin reported that NDRC had added 150 new price investigation-related staff across the country since 2008. In December 2013, Xu announced plans to add at least 170 new employees to his department in Beijing and to NDRC local offices. Of that total, 20 joined the NDRC’s 46-person team in Beijing.

Western and Chinese media have highlighted price investigations targeting foreign companies. Ongoing USCBC monitoring of publicly announced cases indicates that the investigations are not focused only on foreign companies: More than half of the companies investigated in these cases are domestic (Appendix 3). Chinese companies have been investigated in sectors from pharmaceuticals to financial services. Notable foreign company investigations have occurred in the pharmaceutical, infant milk powder, and auto parts aftermarket sectors. In recent months, however, foreign companies seem to be gaining more scrutiny.

To date, NDRC investigations have largely been concentrated in specific industries. Some sectors appear to be targeted not because of the presence of foreign companies, but because they have had recent safety or corruption problems. Many of the sectors are also consumer-facing, suggesting that NDRC takes into account consumer complaints or perceived public concern when considering cases to investigate. In November 2013,

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4 It is challenging to compile a complete list of companies that have been investigated by NDRC for a number of reasons. First, it is not clear that all of NDRC’s investigations are made public. Additionally, foreign and domestic media coverage of investigations, which generally name foreign firms but sometimes exclude domestic firms, are uneven, making it difficult to fully evaluate whether the investigation of domestic companies is administered in proportion to their activity in sensitive industries.

5 Further evidence of this approach comes from an August 2014 interview with the NDRC’s pricing bureau head. Xu Kunlin indicated that the majority of NDRC cases “came to our attention mainly from informant reports.” See Fei Deng and Yizhe Zhang, “Interview with Xu Kunlin, Director General of the Bureau of Price Supervision and Anti-monopoly Under the National Development and Reform Commission of the People’s Republic of China,” The Antitrust Source 13:6 (August 2014): 1, accessed
NDRC Price Supervision and Antimonopoly Bureau Deputy Inspector Lu Yanchun announced his agency’s intent to focus on price fixing in six major industries: automobiles, aviation, cosmetics, household appliances, pharmaceuticals, and telecom—all consumer-facing products and services. While subsequent statements and actions from NDRC indicate that its focus will not be limited to these sectors, recent investigative activity still appears to be in line with a sector-driven focus.

As companies have learned more about NDRC investigations, concerns have arisen about the methods and procedures for examining anti-competitive behavior. These concerns include due process, treatment of foreign and domestic firms, the influence of industrial policy in launching and conducting investigations, and how key terms such as “fair price” are interpreted by Chinese regulators.

Recent Activity

Some recent pricing investigations conducted by NDRC include:

- **Banking** In October 2013, NDRC launched a round of investigations aimed at curbing arbitrary fees in the banking sector. The initial campaign targeted domestic banks of varying sizes and ownership types, including both state-owned and private national, municipal, and joint-stock commercial banks. In the first eight months of this ongoing campaign, NDRC levied total fines of RMB 825 million ($134.1 million) against 64 banks.

- **Telecom** NDRC has been active in the telecom sector since at least April 2011, when it announced an investigation of China Telecom and China Unicom for abuse of market dominance via price discrimination against Internet service providers (ISPs). Though that case was likely suspended, in late 2013 NDRC launched two high-profile investigations involving foreign companies: one against Qualcomm, Inc. (which is ongoing) and the other involving InterDigital, Inc. In May 2014, InterDigital announced that NDRC had suspended its antitrust investigation based on specific commitments InterDigital had made related to licensing practices, royalties, and the handling of future disputes with Chinese manufacturers.

- **Contact lenses and eyeglasses** In May 2014, NDRC announced that it had investigated seven foreign companies in the Chinese contact lens and eyeglass market for pricing violations under the AML, including Bausch & Lomb, Inc.; Essilor International SA; and Nikon Corp. Two companies were exempted from fines due to “cooperation.” NDRC statements allege that the companies had violated the AML by requiring suppliers to sign contracts mandating strict adherence to manufacturer’s suggested retail price, requiring resellers to hold similar promotions at the same time, and setting resale prices. Fines totaled RMB 19.6 million ($3.2 million) for the five non-exempt companies.

- **Automobiles** In August 2014, NDRC announced that local officials in several provinces had launched two separate competition enforcement proceedings in the auto industry for abusing prices: one against foreign luxury car manufacturers and one against foreign auto parts manufacturers. In the case against luxury automobiles, NDRC announced investigations against Chrysler, Audi, and Mercedes-Benz, conducted by the Shanghai Development and Reform Commission (SDRC), the Hubei Price Bureau, and the Jiangsu Price Bureau. The NDRC announcement stated that Chrysler and Audi had been found to have exhibited monopolistic behavior, and Jiangsu provincial officials subsequently came to a similar determination about Mercedes-Benz. At the time of publication, final penalties have not yet been announced, though the Chinese media has reported that Audi may be fined RMB 250 million ($40.6 million). Toyota subsequently said that it had also been approached by NDRC for information about its Lexus unit, and that it was cooperating with investigators. NDRC’s initial statements...
followed announcements from several foreign automakers that they would cut prices in response to NDRC pressure.

In the case against automobile parts, NDRC in August 2014 announced that it had fined 10 of 12 Japanese auto parts manufacturers a total of RMB 1.24 billion ($201.6 million) for colluding to set the pricing of vehicles, auto parts, and bearings. Fines ranged between 4 and 8 percent of the companies’ sales in the previous year. Two of the companies—Hitachi and Nachi-Fujikoshi Corporation—were exempted from fines for cooperation.

Investigations of Monopolistic Behavior—SAIC

Of the three agencies charged with carrying out AML enforcement, SAIC has received the least media attention internationally. Yet SAIC, like its counterpart agencies, continues to slowly build its enforcement capacity by increasing staffing and caseload. Unlike NDRC, SAIC has conducted most of its investigations to date at the sub-national level, via provincial and local associations of industry and commerce.

Based on statements in February 2014 by SAIC Deputy Commissioner Sun Hongzhi and additional notices posted on SAIC’s website, SAIC authorized its provincial branches to investigate more than 30 competition cases over the last six years, announcing formal decisions in 16 cases. In July 2013, SAIC announced a new information platform designed to publicize full texts of these decisions, which includes information on 16 concluded cases (for a selected list of SAIC investigations, including these 16 cases, see Appendix 4).

SAIC’s published decisions clearly indicate the agency’s priorities and also hint at future enforcement activities. The majority of closed cases involved monopoly agreements between domestic—not foreign—companies, particularly through local industry associations. However, SAIC’s most recent enforcement activity indicates that the agency is seeking to expand its enforcement efforts to include other areas of monopoly behavior such as vertical agreements, bundling, and the abuse of dominant market position. In addition, SAIC’s two most high-profile cases, both ongoing, involve foreign companies: TetraPak and Microsoft.

Fines in these cases have been imposed either on either companies or industry associations, depending on the nature of the anticompetitive activity. Penalties have ranged from RMB 200,000 to 500,000 ($32,512 to $81,281) for industry associations and from RMB 60,000 to 3 million ($9,754 to $487,686) for companies.

As with the NDRC, Chinese and foreign companies have a number of concerns about SAIC’s approach and procedures, including questions about due process, transparency, and fair treatment of foreign and domestic firms in non-price competition investigations.

Recent Activity

Some recent SAIC enforcement actions include:

- **Shankai Sports International** After a March 2013 report on China Central Television’s Jiaodian Fangtan (“Focus Interview”) program about World Cup ticket sales, the Beijing Administration of Industry and Commerce (AIC) launched an investigation into Shankai Sports International, the authorized vendor for 2014 World Cup package tours from China, Hong Kong and Macao. Shankai had been authorized to sell game tickets, accommodation, food and beverages, the services of multilingual hosts, and parking. The company bundled the options into packages, as opposed to offering each service individually. SAIC determined that the bundling violated a March 2011 agreement with Beijing China Travel Service Company (Beijing CTS), under which Beijing CTS would

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6 In February 2014, Sun indicated that SAIC had authorized provincial authorities to launch 30 investigations as of that point, with 13 decisions posted. SAIC’s official website has posted an additional three cases since then.
help to arrange hotel, transportation, and tourism services. In early June 2014, SAIC announced that it halted its probe based Shankai’s admission that its actions violated the AML.

- **Tetra Pak** In July 2013, SAIC announced its investigation against Swedish company Tetra Pak, the world’s largest manufacturer of food packaging, SAIC authorized more than 20 provincial and municipal AICs to investigate whether the company abused its dominant position in liquid food packaging, in terms of bundling and preferential treatment. At the time of publication, the investigation is still ongoing.

### Private Litigation—Chinese Courts

As administrative enforcement of competition cases has increased, private litigation has also increased. With the exception of 2011, the number of monopoly cases in local courts has increased year-on-year (see Table 2). According to official court statistics through the end of 2013, Chinese courts have ruled on 171 monopoly-related cases since 2008, with nearly 70 taking place in 2013 alone. Competition cases are generally first heard in intermediate courts at the provincial level, usually within those courts’ intellectual property tribunals, as monopoly and unfair competition cases are classified under the IP umbrella.\(^7\)

Most of the cases that have been brought in civil courts allege abuse of “dominant market position.” For the first several years of the AML, the majority of cases brought before local courts found that the plaintiffs had not provided sufficient evidence of the defendant’s dominant market position. In May 2012, the Supreme People’s Court issued the Provisions on Several Issues Concerning the Application of Law in the Trial of Civil Dispute Cases Arising from Monopolistic Conduct, addressing some of these issues by lowering the burden of proof for plaintiffs under certain circumstances.\(^8\)

Companies’ concerns about court cases largely overlap with their broader concerns about enforcement. The most significant issues are lack of transparency and due process. Companies have also noted concerns that parallel issues in non-competition-related civil cases, including a high burden of proof and admissibility of non-documentary evidence.

### Recent Activity

Some high-profile civil suits involving monopoly issues include:

- **Qihoo v. Tencent** In September 2010, Tencent, the owner of China’s popular QQ online communication platform, bundled its QQ Doctor anti-virus application into its QQ instant messaging

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app. In November 2011, Qihoo—a major Chinese anti-virus software company—filed a monopoly suit in the Guangdong Higher People’s Court charging Tencent with abusing its dominant market position. Its basis for this claim was Tencent’s bundling of its antivirus software with its QQ software. Qihoo claimed lost sales and damages of RMB 150 million ($24.4 million). In March 2013, the court ruled against Qihoo, finding it had not defined the appropriate relevant market or proven Tencent’s dominant position. The court ordered Qihoo to pay RMB 790,000 ($128,424) in legal costs. Qihoo appealed to the Supreme People’s Court, but the original decision was upheld in February 2014.

- **Huawei v. Interdigital** In December 2011, Chinese telecommunications giant Huawei alleged that US wireless firm InterDigital abused its market dominant position and failed to negotiate on fair, reasonable, and non-discriminatory licensing terms for standard-essential patents related to 2G, 3G, and 4G technology. In its February 2013 ruling, the court upheld several of Huawei’s claims. The court ruled that InterDigital did indeed hold a dominant market position and engaged in various monopolistic behaviors. The court required damages of RMB 20 million ($3.3 million) and set a royalty rate for InterDigital’s relevant patents not to exceed 0.019 percent of the sales price of Huawei products. This ruling was upheld in October 2013 by the Guangdong Higher People’s Court. In December 2013, the two companies announced a settlement, with both sides agreeing to submit to binding arbitration and to withdraw other pending legal actions in the United States and Europe.

### US Company Views on Competition Enforcement

China’s increased level of competition enforcement activity and the high-profile reporting of competition investigations have prompted increasing attention, questions, and concerns among US companies. The results of USCBC’s 2014 member company survey (see Charts 2 and 3) provide a good illustration of this, as 86 percent of companies surveyed indicate they are at least somewhat concerned about these issues, with over half citing enforcement as a primary concern.

#### Chart 2: China’s Competition Legal/Enforcement Environment

<table>
<thead>
<tr>
<th>Level of Concern</th>
<th>Primary Concern</th>
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<tbody>
<tr>
<td>Not concerned 14%</td>
<td>Enforcement 56%</td>
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<tr>
<td>Very concerned 25%</td>
<td>Other 8%</td>
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<tr>
<td>Somewhat concerned 61%</td>
<td>Legal and regulatory framework 36%</td>
</tr>
</tbody>
</table>

Source: USCBC 2014 Member Company Survey

Although most companies reported that they have not been targeted by an antitrust investigation, almost 30 percent of companies are concerned they will be subjected to one. Twenty-one percent of surveyed companies reported having undergone MOFCOM merger reviews, and an additional 18 percent also indicated experience with either pricing or other types of competition-related investigations.
Chart 3: Direct Company Experience with Competition Enforcement Actions

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<tr>
<th></th>
<th>21%</th>
<th>9%</th>
<th>9%</th>
<th>4%</th>
<th>27%</th>
<th>30%</th>
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<tbody>
<tr>
<td>M&amp;A review</td>
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<td>Pricing investigation</td>
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<td>Other business</td>
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<td>investigation</td>
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<td>Other processes</td>
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<tr>
<td>No, but concerned will</td>
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<td>be targeted</td>
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<tr>
<td>No concerns</td>
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</table>

Source: USCBC 2014 Member Survey; multiple responses allowed

The biggest AML challenges that companies cited in the survey include:

- Fair treatment and nondiscrimination
- Lack of due process and regulatory transparency
- Lengthy time periods for merger reviews
- Role of non-competitive factors in competition enforcement
- Determination of remedies and fines
- Broad definition of monopoly agreements

Top Challenges and Policy Recommendations

Many questions remain unanswered about the objectives of China’s competition regime. Among them: Will China use the AML to protect domestic industry rather than promote fair competition? Is the government using the AML to force lower prices rather than letting the “market play the decisive role” as enshrined in the new economic reform program? What approach will China ultimately adopt for its economy and its antitrust regime—a government-dictated, state-run model, or a market- and consumer-oriented model? The answers are not fully determined yet, but in at least some cases so far there are reasons for concern.

Government and industry groups in the United States must take effective steps to engage with various stakeholders in China through high-level advocacy and working-level policy dialogue and technical exchanges. It should be expected that China, with its large economy, will develop into the third leg of the global antitrust regime, along with the United States and the European Union. The following recommendations are directed at supporting the development of a competition regime in China that protects the legitimate interests of all stakeholders and integrates rather than conflicts with international best practices.

Fair Treatment/Nondiscrimination

Chinese authorities regularly state that AML enforcement activities do not target foreign companies. While USCBC research indicates that competition enforcement activities have involved both domestic and foreign companies, the data is incomplete. Improved transparency about investigations from Chinese regulators would allow a better assessment of whether China’s competition enforcement is considering foreign and domestic firms equally.
Targeted or not, foreign companies have well-founded concerns about how investigations are conducted and decided. China’s legal framework for antitrust enforcement provides opportunities for protectionism and industrial policy to sway decisions. For example, MOFCOM merger reviews can consider non-competition factors including those related to industrial policy. The framework also lays out a specific time period during which MOFCOM must consult with industry regulators such as NDRC, the Ministry of Industry and Information Technology, or the Ministry of Agriculture, providing domestic-focused regulators and interests the ability to influence decisions based on protectionist or industrial policy goals rather than competitive factors. NDRC and SAIC also have considerable leeway to select investigation targets and carry out the investigations. Some high-profile cases appear to reflect broader Chinese industrial policy concerns on intellectual property, standards, and the protection of domestic industries, as opposed to the interests of fair competition.

Companies also have concerns about security reviews for the foreign acquisition of domestic companies (detailed in Article 31 of the AML), which MOFCOM began to implement more than four years ago. While China has the right under international trade law to consider national security, concerns remain that these procedures could be used to promote domestic economic protectionism.

Finally, Chinese competition enforcement practices can create de facto discrimination against foreign companies by not giving proper weight to market considerations. For example, pricing investigators have shown an interest in assessing price discrimination by comparing the prices companies charge in China versus what they and their competitors charge in other markets. In other cases, investigators appear to have taken an approach that calculates the sum of a product’s component parts as an indication of the fair price of a finished product. Such comparisons do not take into account that product prices are based on local market conditions, including a fair calculation of supply and demand, resulting in appropriately different prices in different markets. The lack of easily accessible public summaries of how pricing decisions are made, combined with various cost factors in certain industries that have been investigated, lead some analysts to believe that the decisions do not fully account for pricing factors that are specific to particular markets, such as transportation costs, distribution costs, import duties, taxes and other fees. Further, they conclude that China does not properly account for important factors in product pricing such as design costs, intellectual property costs, and the cost of skilled labor.

At the 2014 Strategic and Economic Dialogue (S&ED), the US and China affirmed that “the objective of competition policy is to promote consumer welfare and economic efficiency rather than promote individual competitors or industries, and that enforcement of their respective competition laws should be fair, objective, transparent, and non-discriminatory.” Implementing this language fully and consistently during competition reviews would alleviate many of the concerns that US stakeholders have about China’s competition regime.

**Recommendations**

To address concerns about fair treatment and national interest, USCBC recommends that relevant Chinese government agencies:

- Fully implement China’s 2014 S&ED commitment to ensure that competition enforcement is “fair, objective, transparent, and non-discriminatory.” This commitment would include not only ensuring that sectors and companies under investigation are chosen based on these principles, but also in ensuring fair treatment for all parties during those reviews.

- Clarify the process by which companies can appeal administrative decisions on antitrust matters, including merger reviews and anti-monopoly investigations, to provide greater confidence in these processes.
• Limit the use of MOFCOM merger security reviews only to those transactions that have genuine national security concerns, and ensure that such reviews are not used by either industry regulators or competitors to delay or distort M&A review decisions based on foreign ownership.

• Revise MOFCOM’s 2011 Provisions on the Implementation of a Security Review System for the Acquisitions of Domestic Enterprises by Foreign Investors to give consideration to the scope, criteria, and procedures for conducting such reviews to ensure that they are not protectionist in nature. Such recommendations have previously been submitted by USCBC and other stakeholders.

• Improve the economic analysis used in pricing investigations to better account for underlying factors that result in different prices in different markets.

Due Process and Transparency

Each of China’s main enforcement bodies (MOFCOM, NDRC, SAIC, and Chinese courts) have taken initial steps to introduce transparency to their procedures over the last several years, but more needs to be done. Progress in this area has been most notable in the increased publishing of information and decisions about completed cases. Most of the key agencies have established specific platforms to publish more detailed information as a resource for interested parties, such as SAIC’s dedicated webpage for case decisions. These agencies also regularly brief the public on progress in expanding competition enforcement and the handling of specific cases, as NDRC did in February 2014. MOFCOM has also established a formal pre-consultation process that allows potential applicants to have frank discussions about merger transactions.

However, as Chinese regulators increase the level of enforcement activity, there is a growing concern that such efforts have not ensured that these procedures are fair and robust for all parties in all investigations. Such concerns primarily relate to weaknesses in due process: Proceedings should be fair for all parties involved and carried out in accordance with established rules and principles.

Specific issues include:

• Pressure to “admit guilt” without the ability to see and respond to evidence Some companies involved in AML investigations or discussions with enforcement officials have raised concerns that there is undue pressure to confess they have violated the AML. In these cases, company representatives are often not told why they are under investigation or on what grounds an investigation has been launched, but they are still told they will face a reduced penalty if they “cooperate.” Such steps not only make it difficult for a company to prepare for a conversation with AML regulators, but also undermine confidence in the enforcement system.

• Inability to have appropriate legal representation at “dawn raids” Companies involved in competition-related “dawn raids” — unannounced on-site investigations of anticompetitive conduct — indicate that enforcement officials are often unwilling to wait even a short amount of time to allow for legal representation (either internal or external legal counsel) to be present, as is often done in the United States and the European Union. While it is reasonable to expect that officials would desire to conduct such investigations quickly and efficiently, best practices in other jurisdictions often allow, upon request, a short window of time—even as little as 30 minutes-- to have a company’s counsel present before investigators proceed. Chinese investigators have in some cases also prohibited legal counsel from being present during employee interviews, even in an observer capacity. Many companies note that they are not even permitted to know what evidence investigators have seized. Such procedures do not align with international best practices, and they create significant challenges in understanding the scope and nature of investigations. This makes it much more difficult for companies to prepare for future discussions with enforcement agencies and respond to questions and allegations.
• **Inability to have appropriate legal representation at ongoing proceedings**  Even after initial “dawn raids,” companies report that requests to have legal counsel present at competition enforcement proceedings — such as merger and pricing reviews — are often denied. While NDRC and MOFCOM officials have told USCBC they are willing to admit outside legal counsel to AML-related proceedings if they receive specific requests and evidence of standing contractual relationships, companies continue to report that these requests are frequently denied. Excluding legal counsel hinders companies from being able to fully respond to and address regulator concerns. Additionally, AML-related procedures frequently have an international dimension (including global mergers, international pricing practices, contract provisions with multinational business partners, and investment decisions of small and large investors), and companies must work with competition enforcement officials in multiple jurisdictions. Thus, the inability to have legal counsel present makes it difficult for companies to ensure full compliance.

• **Suspicion toward companies that ask for legal counsel to be present**  In some cases, Chinese officials have indicated that company requests to have legal counsel present during competition proceedings is a “red flag” that could signal guilt. In other cases, companies have been pressured to omit legal counsel from the process to help the process “run more smoothly.” Such practices contradict both the letter and the spirit of China’s efforts to promote rule of law and due process, and they are out of line with international best practices.

• **Insufficient transparency during competition reviews**  Companies continue to note questions and concerns about transparency and information-sharing during competition reviews. For example, during merger reviews, MOFCOM officials may indicate they have received complaints from third-parties, but say that they cannot share further information about the complainant or the specific complaints. This makes it difficult for companies to be able to place complaints in context or to address specific concerns. When companies do not understand the nature of the complaints, the review process is lengthened, causing unnecessary delays. It also allows non-competitive factors to be introduced into proceedings. Some international jurisdictions allow parties to view third-party complaints either in full or in a redacted version, helping the process run more efficiently.

• **Insufficient transparency in publishing case decisions**  While all of China’s key enforcement agencies have made progress in publishing case information, such publications are often incomplete. MOFCOM, for example, publishes detailed information about decisions and remedies for merger cases that it rejects or conditionally clears. It also releases public notices about cleared simplified cases. However, these cases represent only a small percentage of the total number of cases, and MOFCOM does not release decisions for cases it clears unconditionally. Similarly, NDRC releases some — but not all — the results of past investigations, often just announcing the final charge and the fine. In many cases, these results provide limited rationale for why different companies receive different penalties, and how a company’s level of “cooperation” is judged. Such incomplete information makes it challenging for potential applicants to fully understand how Chinese regulators review transactions, and ultimately makes it harder for them to fully and properly comply with Chinese competition laws and practices.

**Recommendations**

To address the issues that companies face with due process concerns, USCBC recommends that appropriate Chinese government agencies strengthen due process and build confidence in AML enforcement processes among all key stakeholders. These steps include:

• Adjust the investigation process to allow a brief window of time for the company’s legal counsel or an appropriate legal representative to be present for “dawn raids” and all further investigative proceedings. Other international competition regulators, such as the US Federal Trade Commission (FTC), US Department of Justice (DOJ), and the European Commission competition authorities can...
share best practices on how they handle requests from companies under investigation to have company legal counsel present.

- Provide companies facing competition investigations with the legal grounds and evidence prompting an investigation, and ensure that they have a fair opportunity to present evidence in their defense. China made a specific commitment on this point at the 2014 S&ED. Fully implementing this commitment would ensure a cooperative dialogue with regulators and result in a more efficient discussion on remedies and better compliance in the future.

- Provide more information about MOFCOM concerns and third-party complaints to companies undergoing merger reviews, and provide it as early as possible to avoid delays and better allow companies to provide evidence to address the issues.

- Strengthen education and training of enforcement officials about due process issues and international legal practices to ensure that legitimate company requests to have legal counsel present is not viewed as a sign of guilt, but as a part of normal legal practice.

- Allow qualified foreign and domestic lawyers to consistently accompany clients to AML-related proceedings, including merger reviews and AML enforcement proceedings.

- Release more information about case decisions to help all parties better prepare for competition review, which will make them more efficient. USCBC recommends that each agency—MOFCOM, NDRC, SAIC, and courts at varying levels—release complete information for cases that they handle, including summaries of the cases and how decisions and final remedies are determined. If this is not possible in the near term due to capacity constraints, USCBC recommends that agencies consider other means to increase transparency, such as inviting industry representatives to attend roundtables with government officials and experts to discuss sample cases and releasing batches of model cases that could provide more information. For any of these means taken, USCBC recommends that enforcement agencies coordinate with the parties to the case to appropriately redact sensitive information and to release the remainder to the general public to protect trade secrets and other confidential business information.

**Time Periods for M&A Reviews**

While long and uncertain timeframes across the range of competition investigations create challenges for companies, these challenges have been most acute for merger reviews. Articles 25 and 26 of the AML describe a specific timeline for M&A review processes—a preliminary review that lasts up to 30 days, a more detailed review that lasts up to 90 days, and an extension period if the review is not completed that can last up to 60 days. Clear timelines for reviews were established to provide important guidance to potential filers, helping them make preparations preceding transactions.

In practice, however, the 180-day period is increasingly stretched as the number of transactions that MOFCOM reviews grows. Moreover, the length of time for reviews of normal processes is longer than in other jurisdictions. There are a number of factors contributing to these long processes:

- **Limited regulator capacity** MOFCOM capacity to tackle its growing caseload remains limited. Although MOFCOM’s Antimonopoly Bureau has increased its staff in recent years, half of its 30 staff members are administrative and do not review cases. At the same time, the number of cases MOFCOM reviews has ballooned—nearly tripling from 77 in 2009 to 215 in 2013.

- **Challenges of the pre-consultation process** The 180-day review timeline does not officially begin until MOFCOM accepts the company’s application and supporting materials. Companies may have to engage in several rounds of communication with MOFCOM up front to gather and provide necessary materials. This pre-consultation process can help to foster better communication between MOFCOM
and potential applicants, but in practice can also cause unnecessary delays. Companies have heard informally that increasing workloads are causing MOFCOM officials to “slow-walk” the pre-consultation process. This pre-filing period has lengthened from several weeks in 2009 to up to two to three months today.

- **Increasing requests to withdraw and refile merger applications** Some companies undergoing merger reviews that have been unable to agree with MOFCOM on remedies have been asked to withdraw their application and refile anew, thus extending the review period even further. This now appears to be the rule as opposed to the exception. Of the 15 cases that have been conditionally cleared or rejected since the beginning of 2012, only one of these cases—Merck KGaA’s acquisition of AZ Electronic Materials—was finalized within the required 180 day period (at 106 days). Many of these other cases had to formally withdraw their application and re-file. Such practices negate the value of setting a specific time period for reviews.

- **Last-minute concerns raised without sufficient time to address them** Companies report that challenges arise when MOFCOM presents new concerns to filers late in the review period. Some of this is structural: MOFCOM is required to consult with other government agencies during the process, which takes place late in the review process, typically late in the second phase. This process often dredges up new concerns that MOFCOM did not previously raise with merger filers, thus significantly changing the ongoing conversation and potential remedies.

As noted previously, MOFCOM released a set of simplified merger guidelines earlier this year that could alleviate time pressures by providing the means to more quickly and efficiently handle merger cases that do not require a more detailed review. These measures are a welcome step forward, especially if they are applied in practice to a significant portion of MOFCOM reviews.

Prolonged timelines and delays in merger reviews create challenges for both foreign and domestic companies seeking to build and grow their business in China through M&A. Such anticipated and unanticipated delays hamper companies managing global M&A transactions as they can impact merger approvals in other jurisdictions. These inefficiencies also limit China’s ability to be viewed as a pro-competitive market for M&A.

**Recommendations**

To alleviate concerns about lengthening timeframes for merger reviews, USCBC recommends that MOFCOM and other relevant agencies take several key steps:

- **Significantly increase the number of professional personnel conducting merger review activities, commensurate with MOFCOM’s increased caseload.**

- **Expand education and training programs for new and existing competition enforcement personnel from MOFCOM, NDRC, and SAIC.** Such training programs should focus not only on best practices and procedures under Chinese domestic law for merger reviews, but should also include international regulatory best practices, global industry analysis, and international business practices. This training will help to ensure that personnel have a solid understanding of the industries and businesses they regulate, enabling them to better target behavior that is truly anticompetitive, and ensuring more efficient use of resources.

- **Commit that regulators will use the pre-consultation process solely as a means to work with applicants to ensure they are submitting complete applications, and not as a de facto means of extending review periods.**

- **Encourage companies to pursue merger filings under MOFCOM’s new Interim Provision on Standards Used for Simple Cases of Concentrations of Business Operators.** Ensure that the new simplified procedures are applied broadly and that both foreign and domestic companies have equal
eligibility to apply under the guidelines. This would free up limited bandwidth for MOFCOM reviewers to focus on more difficult cases.

- Limit the use of withdrawal/re-filing procedures to extreme circumstances, and work to improve China’s track record of prolonged reviews. As part of this, MOFCOM should consider adjustments to the interagency consultation process to limit the possibility that new issues are raised with merger transactions without sufficient time to address them within statutory timelines. The agency should also work with merger filers to provide more information earlier about potential concerns raised by other agencies. This will allow applicants to prepare relevant materials and consider potential remedies.

Role of Non-Competitive Factors in Competition Enforcement

Article 4 of the AML grants competition agencies the ability to weigh competitive factors along with non-competitive factors when it comes to enforcement. Article 27 provides some additional clarity on the scope of non-competitive factors. The article lays out five specific areas that competition regulators may consider, representing both kinds of factors:

- Market share and the degree of control in the relevant market;
- Degree of market concentration in the relevant market;
- Influence on market access and technological progress;
- Influence on consumers and other business operators; and
- Influence on national economic development.

Additionally, the article contains a general clause allowing regulators to consider undefined “other areas” that may impact market competition. Such language is broad enough to give considerable discretion to regulators. Such broad discretion in this area has already raised concern.

Recent competition enforcement proceedings have raised strategic and operational concerns about how regulators consider non-competitive factors. For example, in recent proceedings involving large innovative companies and their royalty rates and licensing practices, regulators have given strong consideration to the impact of their business activity on Chinese policy goals such as innovation, patent creation, and technology licensing. This limits companies’ ability to exercise their intellectual property rights. Such actions contradict regulations such as the December 2013 Interim Administrative Provisions for Patents Involved in National Standards. Language in this regulation seeks to balance China’s goal of encouraging the adoption of innovative standards with the need to preserve the free exercise of intellectual property by patent owners. Such balance is essential to incentivize companies and individuals to invest in innovation. This concern is also mirrored in ongoing discussions about SAIC’s Draft Regulations on the Prohibition of Conduct that Eliminates or Restricts Competition through Abuse of Intellectual Property Rights, including language related to “essential facilities” (for more information, see USCBC’s July 2014 comments on these draft regulations).

Competition reviews have built in time for government stakeholders to express non-competitive concerns, including those related to industrial policy. MOFCOM is required to consult with other agencies during the merger review process. Some analysts are concerned that this allows for domestic-focused regulators and interests to influence decisions based on protectionist or industrial policy goals and not competitive factors. This process remains opaque.

Recommendations

To address concerns that companies have with non-competitive factors in competition enforcement, USCBC recommends that appropriate Chinese government agencies:

- Commit to basing competition enforcement practices—including merger reviews and investigations of monopoly conduct—on competition considerations only, and not on protectionist or industrial policy
concerns. Agencies should fully implement China’s 2014 S&ED commitment that “the objective of competition policy is to promote consumer welfare and economic efficiency rather than promote individual competitors or industries.” To this end, they should ensure that existing competition laws and regulations, including the AML, keep with the letter and spirit of this commitment. The government should also eliminate AML Article 27(5) (“the influence of the concentration of business operators on the national economic development”) to alleviate concerns that protectionism and industrial policy factor into competition reviews. Alternatively, clarify through public statements and follow-up regulations that this clause is to be invoked only under narrow, defined circumstances, and provide greater clarity as to those circumstances.

- Provide clearer timetables and information about the interagency review process for M&A transactions, including how MOFCOM consults with agencies, what information is provided, and what scope of feedback is sought and considered.

- Revise regulations such as SAIC's Draft Regulations on the Prohibition of Conduct that Eliminates or Restricts Competition through Abuse of Intellectual Property Rights to ensure that efforts to tackle anticompetitive behavior balance competing goals, such as promoting innovation and the free exercise of intellectual property rights in China (additional recommendations are provided in USCBC’s July 2014 comments on these draft regulations).

### Application of Remedies and Fines

As China’s antitrust enforcement agencies have gained experience and set best practices for competition enforcement, they have also signaled acceptable remedies to address monopoly concerns.

- **MOFCOM** Like its international counterparts, MOFCOM utilizes both structural and behavioral remedies, including divestiture of assets, information firewalls, and mandatory licensing. However, MOFCOM has been increasingly willing to impose a mix of remedies that differs from international best practice. In the United States and the European Union, regulators generally apply structural remedies to cases of horizontal mergers (mergers involving firms who operate in the same relevant market, often as competitors), and limit use of behavioral remedies to vertical mergers (mergers involving firms that operate in different segments of an industry supply chain, often in supplier-customer relationship). MOFCOM, however, favors a heavier use of behavioral remedies, including regular application of behavioral remedies even in cases where the monopoly concerns raised have been horizontal. Some of these behavioral remedies restrict or eliminate the legitimate business value of conducting the transaction in the first place.9

  For example, in the Marubeni/Gavilon transaction (2013), MOFCOM required the post-merger entity to maintain separate Marubeni and Gavilon subsidiaries for the purposes of exporting and selling soybeans to China, and required those subsidiaries to compete on market terms. MOFCOM also prohibited Marubeni from purchasing Gavilon soybeans except as an arms-length transaction and set up an information firewall to prevent information flow between the subsidiaries. Such conditions seriously impacted the business value of the transaction for the two parties by limiting corporate integration. In contrast, the United States and European Union passed the transaction without any conditions, structural or behavioral.

Divergent application of remedies partially stems from the fact that Chinese enforcement agencies are legally bound to consider non-competitive factors. However, the remedies imposed—particularly by MOFCOM—create significant challenges for foreign and domestic companies alike. For MOFCOM remedies, the broader use of behavioral remedies tests firms seeking to expand their operations in

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9 For a more in-depth analysis of MOFCOM’s remedies and how they differ from their international counterparts, see Fei and Huang.
China through M&A. In many cases, these behavioral remedies require ongoing monitoring and government intervention in corporate operations. Such activities may contradict broader Chinese economic development goals, such as the third plenum goals of giving the market a decisive role in the economy, creating a more efficient high value-added economy, and promoting industry consolidation in fragmented sectors. By being out of line with international best practice, they hinder China’s development as a viable and attractive global destination for M&A. This ultimately harms Chinese companies’ ability to gain important experience in using M&A as a tool for business expansion on a global scale.

- **NDRC and SAIC** As noted, these agencies have a shorter track record of investigations and resulting fines, and greater variability in terms of fines. NDRC fines have ranged widely from RMB 530,000 ($86,158) in the August 2014 decision against five manufacturers of aerated bricks in Hainan to 1.24 billion ($201.6 million) in the August 2014 decision against 12 Japanese auto parts manufacturers. To date, SAIC fines have generally been smaller due in part to their investigative activity against smaller players. Penalties for the industry associations ranged from 200,000 RMB to 500,000 RMB ($32,512 to $81,281), and the companies were fined from 60,000 RMB to 3 million RMB ($9,754 to $487,686).  

The AML’s Article 47 lays out specific fines—between 1 and 10 percent of the previous year’s sales revenue—for cases in which a company abuses its dominant market position. This is the basis for both NDRC and SAIC competition investigations. However, these standards create specific obstacles, for regulators and companies alike. First, it is unclear how pricing decisions are made, which raises questions about whether they fully account for pricing factors that are specific to particular markets, such as transportation costs, distribution costs, import duties, taxes and other fees. In addition, basing fines on a percentage of sales serves to discriminate against both domestic and foreign large companies while limiting flexibility in setting fines based on the level of the infraction.

**Recommendations**

To ensure that fines and remedies applied in competition enforcement proceedings achieve the goals that Chinese regulators seek while also being commensurate with the violations in question, USCBC recommends that relevant Chinese government agencies:

- Set greater harmonization with international practice as an explicit goal for the development of China’s competition regime. To further that goal, regulators should increase engagement with international competition regulators and experts to share information on best regulatory practices, remedy and penalty options, and individual cases. They should also expand existing mechanisms—including the 2011 memorandum of understanding (MOU) among FTC, DOJ, MOFCOM, NDRC, and SAIC and the 2011 Guidance for Case Cooperation between MOFCOM and the DOJ and FTC on Concentration of Business Operators (Merger) Cases—as well as similar mechanisms with other competition regulators to promote more regular exchange, training, and collaboration on individual cases. Regulators should also deepen exchanges with new cooperative mechanisms, including agreement and information exchanges involving NDRC, MOFCOM, and SAIC.

- Avoid the excessive application of behavioral remedies and limit their use to circumstances in which such remedies are necessary to address monopoly concerns. Ensure that the application of such remedies does not unduly negate the pro-competitive impact of the proposed transaction.

- Revise the AML’s Article 47 to first, add specific language communicating that fines are based on a company’s net sales in the relevant market in China, or at a minimum on the company’s China sales; second, eliminate the minimum fine as a percentage of turnover, as it may discriminate against large companies.

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companies and limit local officials’ ability to assess a fine based on the level of the infraction; and third, replace the current 10 percent maximum fine with a fixed maximum fine that would be appropriate for companies of all sizes while still serving as an appropriate deterrent.

**Broad Definition of Monopoly and Pricing Agreements**

US companies have a number of lingering questions about provisions within the AML that define monopolistic behavior. Many of their concerns related to the ways in which China’s competition regime deviates from international best practices. Companies also highlight provisions designed to protect against anticompetitive practice but instead yield unintended negative consequences for foreign and domestic companies operating in China.

One key difference between Chinese and international best practices relates to the types of agreements that companies are permitted to sign with their trading partners under the AML’s Article 14. This article specifically prohibits manufacturers and their trading partners from signing certain agreements with distributors. These include agreements to fix resale prices or set minimum resale prices, known as resale price maintenance (RPM) agreements, and “other monopoly agreements” as determined by NDRC or SAIC (further details on the latter are provided in the NDRC’s February 2010 Anti-Price Monopoly Provisions and SAIC’s December 2010 Provisions on the Prohibition of Monopolistic Agreements).

Such clauses—which appear to eliminate RPM agreements in blanket fashion—are out of sync with evolving practices in other legal jurisdictions. While some RPM agreements are justifiably construed as price-fixing arrangements, some may have pro-competitive benefits. For example, RPM agreements can help to avoid so-called “free-rider effects,” in which customers try products at retailers that offer full service and then purchase final products from discount retailers. Such practices disincentivize retailers from offering better customer service and promotional activities. RPM agreements can thus promote consumer welfare by incentivizing distributors to offer better customer service that benefit both customers and distributors. International thinking by antitrust scholars in the United States, the European Union, and other jurisdictions has evolved considerably over time from blanket bans of RPMs to greater consideration of the so-called “rule of reason,” under which an RPM agreement is judged on its merits. The judgment weighs the pro- and anti-competitive effects of the agreement.

To date, there have been a handful of cases involving RPM, including administrative price investigations involving vision care products, milk powder, baijiu and the Rainbow-J&J civil case. While it appears in these cases that Chinese regulators consider the impact of the RPM agreements rather than determining they are by their very nature illegal, all of these decisions have ultimately found the RPM agreements to be anti-competitive. It thus remains unclear whether or not the “rule of reason” approach was the basis or the justification for these decisions. Notably, none of these decisions set a formal precedent for other decisions. As such, regulators and companies cannot fully evaluate how existing and potential RPM agreements might be considered in the future.

Companies also fear that other agreements they sign with distributors could be construed as monopolistic. For example, many companies selling complex products such as automobiles frequently sign agreements with their manufacturing partners to ensure that the product-specific parts those partners manufacture are only sold through company-authorized dealers. These agreements are designed to promote strong customer service and customer safety by ensuring that only trained, certified personnel conduct repairs of such products using spare parts.

**Recommendations**

To permit greater room for business arrangements that promote competition while still appropriately prohibiting anticompetitive monopoly agreements, USCBC recommends that relevant Chinese government agencies:
Draft and release regulatory and judicial guidance stating that relevant competition enforcement authorities—including NDRC, SAIC, and the courts—will apply a “rule of reason” analysis to monopoly agreements considered under Article 14. Such guidance could be provided by:

- Drafting a joint NDRC-SAIC notice to clarify implementation of Article 14, requiring regulators as part of their competition analysis to adopt a “rule of reason” analysis that would weigh both the pro- and anti-competitive impacts of potential monopoly agreements;
- Adding a new clause to the AML’s Article 15 exempting any agreements “whose pro-competitive impact can be shown to outweigh any monopoly concerns” from the prohibitions in Article 13 and 14; and
- Releasing a judicial interpretation clarifying how the courts should consider RPMs and other monopoly agreements. This would require judges to adopt a “rule of reason” analysis that would weight both the pro- and anti-competitive impact of potential monopoly agreements.

Provide guidance to regulators and court officials as they consider agreements between companies and manufacturers to sell contracted components only through company-authorized dealers. Such direction would be in line with competition policy goals such as promoting consumer interests and broader economic goals, like guaranteeing product safety.
Appendix 1: China's Core Competition Laws, Regulations, and Policies

National Laws

- **Anti-Unfair Competition Law (AUCL) (National People’s Congress, passed September 1993)**
  This law, which took effect December 1, 1993, aims to encourage and protect fair market competition, prohibit unfair competition, and safeguard the rights and interests of both businesses and consumers.

- **Price Law (National People’s Congress, passed December 1997)**
  This law, which took effect May 1, 1998, seeks to standardize pricing, give a greater role to pricing in allocating resources, stabilize market prices, and protect the rights and interests of both businesses and consumers.

- **Anti-Monopoly Law (AML) (National People’s Congress, passed August 2007)**
  This law, which took effect August 8, 2007, represents China’s first comprehensive law to cover competition and monopoly behaviors, including merger reviews, price cartels, and monopoly behaviors.

Regulations, State Council

- **Notice on the State Council Antimonopoly Commission Main Functions and Members (July 2008)**
  This notice, which took effect July 28, 2008, describes the main functions of the State Council Antimonopoly Commission, establishes its working group within MOFCOM, and lists the group’s members.

- **Provisions on the Notification Thresholds for Concentrations of Business Operators (August 2008)**
  These provisions, which took effect August 3, 2008, define concentrations of business operators and provide specific notification thresholds for M&A to notify MOFCOM.

- **Guidelines on the Definition of the Relevant Market by the Anti-Monopoly Commission of the State Council (May 2009)**
  These guidelines, which took effect May 24, 2009, provide competition enforcement agencies with the tools to define a relevant market and also describe the analytical approach of defining a hypothetical monopolist.

- **Provisions on Administrative Penalties for Price Violation Behavior (December 2010)**
  These regulations, which took effect December 4, 2010, describe detailed administrative penalties for those violating the Price Law. They replaced a 2008 version of these regulations that predated the implementation of the AML.

- **Notice on Establishing a Security Review System Regarding M&A of Domestic Enterprises by Foreign Investors (February 2011)**
  This notice, which took effect March 5, 2011, establishes a national security review process in certain cases where foreign investors are purchasing domestic companies, including creation of panels to review and block or impose conditions on relevant transactions.
Regulations, MOFCOM

- **Interim Measures on Evidence Collection Related to Concentrations of Business Operators that Fall Below Notification Thresholds but Are Suspected of Anticompetitive Effects (Draft)** *(January 2009)*
  These draft measures, which were released twice for public comment in January and February 2009, have not yet been finalized, set evidence collection and procedural rules for MOFCOM (and other agencies) to review certain types of concentrations of business operators that are below notification thresholds where there is suspicion of a negative competitive impact.

  These measures, which took effect August 14, 2009, provide more specific detail on notification thresholds specifically for financial institutions, explain the calculation of business turnover of financial institutions, and provide specific guidance on how to determine if a financial deal should be reported.

- **Measures on Reporting Proposed Concentrations of Business Operators** *(November 2009)*
  These measures, which took effect January 1, 2010, define and specify several key concepts on how to calculate business turnover in concentrations of business operators, such as what constitutes an acquisition of control over other business operators.

- **Interim Measures Concerning the Divestiture of Assets or Businesses when Implementing Concentrations of Business Operators** *(July 2010)*
  This measure, which took effect July 5, 2010, clarifies the requirements and procedures for companies that must divest assets or businesses as part of the conditions placed by MOFCOM after it reviews a proposed concentration.

  These provisions, which took effect September 1, 2011 and replaced March 2011 interim regulations, describe the detailed structure and process for how China should conduct national security reviews of foreign company acquisitions of domestic companies. MOFCOM and NDRC are placed at the head of a joint committee to handle reviews.

- **Interim Provisions on Evaluating the Competitive Effects of Concentrations of Business Operators** *(August 2011)*
  These provisions, which took effect September 5, 2011, describe the factors that MOFCOM should consider in evaluating the competitive impact of a proposed transaction, such as market concentration and impact on market entry, with detailed descriptions of how regulators should consider each.

- **Interim Measures on the Investigation of Concentrations of Business Operators not Notified in Accordance with the Law** *(December 2011)*
  These measures, which took effect February 1, 2012, provide greater clarity on the investigation of concentrations of business operators that are above notification thresholds but failed to notify MOFCOM.

- **Provisions on Standardizing Competitive Behavior in the Overseas Investment Cooperation** *(March 2013)*
  These provisions, which took effect April 17, 2013, set rules for proper competition related to overseas investment cooperation and define unfair competition.
• **Provision on the Imposition of Restrictive Conditions on Business Operators during Concentrations of Business Operators (Draft) (March 2013)**
  This draft provisions, which were released for public comment in March 2013 but have not yet been finalized, aim to clarify restrictive conditions that can be placed on concentrations of business operators and reduce the negative impact these concentrations have on competition. The measures, when finalized, would replace the July 2010 Interim Measures Concerning the Divestiture of Assets or Businesses when Implementing Concentrations of Business Operators.

• **Interim Provisions on Standards Used for Simple Cases of Concentrations of Business Operators (February 2014)**
  These provisions, which took effect February 12, 2014, establish a simplified process to allow more rapid approvals of certain types of concentrations between business operators.

• **Trial Guiding Opinions on Filing of Simple Cases of Concentration of Business Operators (April 2014)**
  These provisions, which took effect April 18, 2014, lay out more specific procedures governing the application, evaluation, and approval of certain types of concentrations between business operators under a simplified review.

**Regulations, NDRC**

• **Interim Provisions Prohibiting on the Seeking of Excessive Profits (January 1995)**
  These provisions, which took effect January 25, 1995, permit provincial branches of NDRC to evaluate and determine appropriate rules and bounds for appropriate pricing behavior, with behavior outside of those ranges determined to be “excessive profits.” The provisions were amended slightly by the State Council’s 2011 Decision on Eliminating and Revising Certain Administrative Laws and Regulations.

• **Provisions Prohibiting Low-Cost Dumping (August 1999)**
  These provisions, which took effect August 3, 1999, provide further details on provisions in the Price Law related to dumping, or selling products below cost as anticompetitive behavior.

• **Anti-Price Monopoly Provisions (December 2010)**
  These provisions, which took effect February 1, 2011, clarify and define price-related monopoly acts, including price monopoly agreements, abuse of dominant market position, and abuse of administrative powers to eliminate or restrict competition. They replace the 2003 Interim Provisions Prohibiting Price Monopoly Behavior.

• **Provisions on Procedures for Administrative Law Enforcement on Anti-Price Monopoly (December 2010)**
  These provisions, which took effect February 1, 2011, outline NDRC’s enforcement structures, powers and obligations as they relate to pricing monopolies, specifically how investigations are conducted and how to handle leniency on self-reporting.

**Regulations, SAIC**

• **Procedural Provisions Prohibiting Behavior Abusing Administrative Power to Eliminate or Restrict Competition (June 2009)**
  The provisions, which took effect July 1, 2009, prohibit entities from abusing administrative power for the purpose of eliminating or restricting competition, and describe procedures under which SAIC can address such abuse.
• **Procedural Provision on Investigating Cases Involving Prohibition on Monopoly Agreements and the Abuse of Dominant Market Position** (*June 2009*)

The provisions, which took effect July 1, 2009, set specific rules and procedures for SAIC and its local branches to investigate cases involving monopoly agreements and abuse of dominant market position.

• **Provision on the Prohibition of Monopolistic Agreements** (*December 2010*)

These provisions, which took effect February 1, 2011, provide detailed definitions and criteria for judging monopoly agreements, and prohibit business operators from reaching monopolistic agreements.

• **Provision on the Prohibition on the Abuse of a Dominant Market Position** (*December 2010*)

These provisions, which took effect February 1, 2011, provide detailed definitions and criteria for judging “dominant market position,” defining it to mean a business operator has the ability to control price, quantity, or other conditions of goods, or has the ability to obstruct or affect other business operators.

• **Provision on the Prohibition of the Anti-Competitive Abuse of Administrative Power** (*December 2010*)

These provisions, which took effect February 1, 2011, provide detailed definitions and criteria for determining inappropriate use of administrative power and for judging its anti-competitive effects.

• **Provisions to Prohibit Intellectual Property Abuse to Eliminate or Restrict Competition (Draft)** (*June 2014*)

The regulations, which were most recently released for public comment in June 2014 but have not been finalized, discuss the relationship between intellectual property and competition. They aim to provide clear guidance to antitrust regulators about when the protection and exercise of intellectual property rights constitutes anti-competitive behavior.

**Regulations, Supreme People’s Court**

• **Notice on Studying and Implementing the Antimonopoly Law** (*July 2008*)

This notice, which took effective July 28, 2008, states that the People’s Court should accept and try cases that are brought by any party concerned about monopolistic conduct of another party.

• **Provisions on Certain Issues relating to Application of Laws for Hearing Civil Monopoly Disputes** (*May 2012*)

These provisions, which took effect June 1, 2012, cover a range of topics including burden of proof, the relationship between administrative and civil enforcement, and the statute of limitations.
Appendix 2: Merger Reviews Rejected or Modified by MOFCOM (2008 – present)

According to statistics through the first half of 2014, MOFCOM has conducted full reviews of approximately 870 proposed merger transactions, with the number increasing steadily year-on-year (see Table 1). The vast majority of these cases (844) that have been reviewed were approved by MOFCOM unconditionally. Of the remaining 25 cases, all involve foreign companies. Twenty-three of these were approved with conditions, and two rejected.

The table below includes information and descriptions for each case that MOFCOM has either approved conditionally or rejected since the launch of the Antimonopoly Law in August 2008, including the 25 cases mentioned above and one additional conditional clearance issued in July 2014.

<table>
<thead>
<tr>
<th>Date Announced</th>
<th>Industry</th>
<th>Parties</th>
<th>Remedy</th>
<th>Case Duration</th>
</tr>
</thead>
<tbody>
<tr>
<td>November 2008</td>
<td>Beverage Manufacturing</td>
<td>InBev, Anheuser-Busch</td>
<td>Conditionally approved: Pre-merger, Anheuser-Busch had a 27 percent stake in Tsingtao Brewery (the second-largest beer producer in China) and InBev had a 29 percent stake in Zhuijiang Brewery (fourth-largest). MOFCOM imposed three conditions on the post-merger entity: InBev and AB should not increase their stakes in Zhuijiang Brewery and Tsingtao Brewery from pre-merger levels; InBev may not acquire any stakes in China Resources Snow Breweries or Beijing Yanjing Brewery (largest and third-largest, respectively); and InBev will be obliged to notify MOFCOM of any changes in its controlling shareholders.</td>
<td>70 days</td>
</tr>
<tr>
<td>March 2009</td>
<td>Beverage Manufacturing</td>
<td>Coca-Cola, Huiyuan</td>
<td>Rejected: MOFCOM asserted that the proposed acquisition would enable Coca-Cola to leverage its dominant position in the carbonated soft drinks to dominate the neighboring juice market. Such dominance would raise entry barriers and limit the ability of medium and small-sized juice companies to compete and innovate. MOFCOM stated that since the two parties were not able to agree on an acceptable remedy with MOFCOM, they had to reject the transaction.</td>
<td>182 days</td>
</tr>
<tr>
<td>Date</td>
<td>Industry</td>
<td>Companies</td>
<td>Conditionally approved:</td>
<td>MOFCOM’s Considerations</td>
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<td>------------</td>
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<tr>
<td>April 2009</td>
<td>Chemical Manufacturing</td>
<td>Mitsubishi Rayon, Lucite</td>
<td>This case raised competition concerns in the methylmethacrylate (&quot;MMA&quot;) market, where the parties would have a post-merger market share of 64 percent. According to MOFCOM, Mitsubishi had businesses in both the MMA market and downstream markets, and thus would have been able to foreclose downstream competitors by leveraging its dominant position in the MMA market. MOFCOM required the parties to divest assets, with Lucite to divest 50 percent of its annual MMA production capacity for five years to one or more unaffiliated third party purchasers. Lucite China must also grant third-party purchasers the right to purchase 50 percent of Lucite China's annual MMA production for five years at cost (equal to the production and management cost per unit), with no added profit margin, with compliance verified annually by an independent auditor.</td>
<td>124</td>
</tr>
<tr>
<td>September 2009</td>
<td>Auto Manufacturing / Equipment Manufacturing</td>
<td>General Motors, Delphi</td>
<td>MOFCOM argued that GM would have the ability to bar its competitors in the auto manufacturing market as Delphi was the exclusive supplier for various Chinese auto manufacturers. MOFCOM cleared the transaction subject to conditions: GM/Delphi must continue to supply Chinese auto manufacturers on a non-discriminatory basis; GM and Delphi would not exchange confidential information relating to any third party; GM/Delphi must cooperate with customers to achieve a smooth transition when they switch to other auto parts suppliers; and GM must continue its diversified and non-discriminatory policy of purchasing auto parts from multiple suppliers.</td>
<td>42</td>
</tr>
<tr>
<td>September 2009</td>
<td>Pharmaceuticals</td>
<td>Pfizer, Wyeth</td>
<td>MOFCOM believed the acquisition would have anti-competitive effects on the swine mycoplasma pneumonia vaccine (SMPV) market in China. The agency argued that the combined entity would possess a 49 percent market share in an increasingly concentrated SMPV market in China. According to MOFCOM, this would have enabled Pfizer/Wyeth to enlarge their market share and consequently increase the price of SMPV and raise entry barriers to the SMPV market. MOFCOM ordered a divestiture of Pfizer’s SMPV business in China. Pfizer had to find a third party buyer approved by MOFCOM within six months and ensure that the divested business included all tangible and intangible assets necessary for the survival and competitiveness of the divested business.</td>
<td>113</td>
</tr>
<tr>
<td>Month</td>
<td>Industry</td>
<td>Companies</td>
<td>Approval Type</td>
<td>MOFCOM's Argument</td>
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<tr>
<td>------------</td>
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<tr>
<td>October 2009</td>
<td>Battery Manufacturing</td>
<td>Panasonic, Sanyo</td>
<td>Conditionally approved</td>
<td>MOFCOM argued that the acquisition would have adverse competitive effects in three highly concentrated battery markets: rechargeable button-shaped lithium batteries, nickel-hydride batteries for daily use, and nickel-hydride batteries for automobile use. Post-transaction, Panasonic/Sanyo would have market shares of 62, 46 and 77 percent, respectively. MOFCOM considered that the high market shares in already concentrated markets would easily enable the parties to raise prices. Both parties were ordered to divest substantial businesses in all three merger-relevant markets. Sanyo and Panasonic were to spin off their relevant businesses within six months to an independent third party approved by MOFCOM.</td>
</tr>
<tr>
<td>August 2010</td>
<td>Healthcare</td>
<td>Novartis, Alcon</td>
<td>Conditionally approved</td>
<td>MOFCOM believed that post-transaction Novartis/Alcon would be able to coordinate with Hydron (a key supplier of contact lens care products) on price, quantity, and sales territories. Therefore, the transaction was cleared on conditions that Novartis cease sales of its ophthalmic anti-inflammatory/anti-infective combinations under its current brands in China, and not sell any of these products under the same or different brands in China for the next five years. Furthermore, Novartis would terminate its distribution agreement with Hydron within 12 months.</td>
</tr>
<tr>
<td>June 2011</td>
<td>Chemicals / Fertilizer</td>
<td>Uralkali, Silvinit</td>
<td>Conditionally approved</td>
<td>The potassium chloride market was highly concentrated with the top three producing countries accounting for more than 80 percent of the world’s total reserves. MOFCOM believed that, since China relies heavily on imports of these products, 50 percent of which are from Uralkali, Silvinit, or their affiliated companies, the transaction would increase the level of concentration in the market. In addition, the merged entity would benefit from an increased market power through the ownership of more potassium resources and stronger production capabilities. Thus, MOFCOM imposed acquisition conditions to maintain a stable level of imports of potassium chloride into China. The merged entity would have to continue to provide the whole range of potassium chloride products to the Chinese market in sufficient quantity and maintain the current methods, processes, and existing customary negotiations procedures.</td>
</tr>
<tr>
<td>Month</td>
<td>Industry</td>
<td>Companies</td>
<td>Acquisition Details</td>
<td>Approval Days</td>
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<td>------------</td>
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<tr>
<td>October 2011</td>
<td>Textile Machine Manufacturing / Private Equity</td>
<td>Alpha V, Savio</td>
<td><strong>Conditionally approved</strong>: Uster (28 percent owned by private equity investor Alpha V) and Leopfe (a wholly-owned subsidiary of Savio) were the only two global suppliers of yarn clearers – devices to remove faults from yarn and improve its quality – remove faults (thick places, thin places, foreign matter) from the yarn. MOFCOM believed that after the transaction it is likely that Uster and Leopfe could coordinate with each other through Alpha V to restrict and/or eliminate the competition in the yarn clearer market. MOFCOM imposed several conditions on the acquisition, including requiring Alpha V to divest its shares in Uster to an independent party within 6 months upon MOFCOM’s approval of the transaction and prohibiting Alpha V from participating in or influencing Uster’s operations and management before completion of the divestiture process.</td>
<td>110 days</td>
</tr>
<tr>
<td>November 2011</td>
<td>Energy</td>
<td>General Electric, Shenhua (formation of a JV)</td>
<td><strong>Conditionally approved</strong>: GE China and China Shenhua Coal to Liquid and Chemical Co., Ltd. (CSCLC, a subsidiary of state-owned Shenhua Group) had announced plans to establish a 50/50 joint venture (JV) to license coal-water slurry (CWS) gasification technology to industrial and power projects in China. GE Infrastructure Technology, another subsidiary of GE, would license GE’s CWS gasification technology to the proposed JV. MOFCOM found that this transaction might exclude or restrict competition in the CWS gasification technology licensing market. The JV was approved, subject to the condition that it may not force potential licensees for CWS gasification technologies to use its technology. Further, it may not raise these licensees’ cost of using other technologies by restricting feedstock supply.</td>
<td>212 days</td>
</tr>
<tr>
<td>December 2011</td>
<td>Computing Components</td>
<td>Seagate, Samsung</td>
<td><strong>Conditionally approved</strong>: MOFCOM raised concerns regarding market share in the hard disk drive (HDD) manufacturing industry, with Seagate and Samsung representing two of the top five companies that collectively hold a virtual monopoly in the market. MOFCOM believed that reducing the number of competitors would encourage collusion. The acquisition was approved, but required that Samsung HDD remain an independent competitor to Seagate and others. Seagate was also required to ensure that an unaffiliated Chinese supplier would not be restricted from supplying other HDD manufacturers.</td>
<td>208 days</td>
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<tr>
<td>Month</td>
<td>Industry</td>
<td>Company A</td>
<td>Company B</td>
<td>Approval Status</td>
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<tr>
<td>February</td>
<td>Chemical Manufacturing</td>
<td>Henkel Hong Kong, Tiande</td>
<td>(formation of a JV)</td>
<td>Conditionally approved</td>
</tr>
<tr>
<td>March 2012</td>
<td>Electronics Components</td>
<td>Western Digital, Hitachi</td>
<td></td>
<td>Conditionally approved</td>
</tr>
<tr>
<td>May 2012</td>
<td>Mobile Phone Manufacturing</td>
<td>Google, Motorola Mobility</td>
<td></td>
<td>Conditionally approved</td>
</tr>
<tr>
<td>June 2012</td>
<td>Aviation Electronic Systems</td>
<td>UTC, Goodrich</td>
<td></td>
<td>Conditionally approved</td>
</tr>
<tr>
<td>Date</td>
<td>Industry</td>
<td>Companies</td>
<td>Result</td>
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<tr>
<td>August 2012</td>
<td>E-Commerce</td>
<td>Walmart, Yihaodian</td>
<td><strong>Conditionally approved</strong>: MOFCOM argued that Walmart’s rich experience in operating physical markets for goods and grocery shopping could allow it to expand and eliminate competition in the online e-commerce goods and groceries shopping space. MOFCOM limited Walmart’s acquisition to Yihaodian’s online direct sales business, and prohibited the company from providing online trading services to other trading parties without first obtaining a value-added telecom services permit. Walmart was also prohibited from operating Yihaodian’s current online trading platform service.</td>
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</tr>
<tr>
<td>December 2012</td>
<td>Application Processors / Intellectual Property</td>
<td>ARM, G&amp;D, Gemalto (formation of a JV)</td>
<td><strong>Conditionally approved</strong>: Key concerns raised by MOFCOM about this joint venture focused on licensing of intellectual property related to application processors to offer a trusted execution environment (TEE) – a secure area in application processors used in electronics. MOFCOM argued that ARM’s globally dominant position in IP licensing and role in establishing TEE created risk that the JV would restrict other companies from providing TEEs by limiting IP licensing. MOFCOM ruled that ARM disclose the security monitoring code and other information that is necessary to develop alternative TEE solutions based on its application processor technology.</td>
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<tr>
<td>April 2013</td>
<td>Natural Resources/ Mining</td>
<td>Glencore, Xstrata</td>
<td><strong>Conditionally approved</strong>: MOFCOM was concerned with competition in the minerals market, largely due to China’s heavy reliance on imports of copper, lead, and zinc. Specifically, the agency was concerned that the post-merger market shares of Glencore and Xstrata for these three minerals would harm competition, with downstream Chinese users of Glencore’s inputs likely affected negatively. MOFCOM required the combined entity to divest and sell a copper mine in Peru within 18 months of the decision. Additionally, Glencore was required to provide lead and zinc concentrate to Chinese customers for eight years after the decision.</td>
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<tr>
<td>April 2013</td>
<td>Agricultural Products</td>
<td>Marubeni, Gavilon</td>
<td><strong>Conditionally approved</strong>: MOFCOM argued that Marubeni’s sales infrastructure in China and share of the soybean import market in China, combined with Gavilon’s US soybean sourcing operations, would limit competition in the soybean import market. MOFCOM approved the acquisition with conditions on the deal: establishing two independent subsidiaries as relating to soya bean exports and sales to China; maintaining two separate operating teams with independent operations; prohibiting the exchange of competitive information between the two subsidiaries, backed up by a mandatory firewall; and prohibiting the Marubeni subsidiary’s purchase of soya beans from the Gavilon subsidiary, except on an arm’s length basis.</td>
<td></td>
</tr>
<tr>
<td>Date</td>
<td>Industry</td>
<td>Acquirers</td>
<td>Approval Status</td>
<td>Notes</td>
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<td>August 2013</td>
<td>Medical Devices</td>
<td>Baxter, Gambro</td>
<td>Conditionally approved</td>
<td>Baxter and Gambro were both major competitors in the highly concentrated CRPT device market (equipment used for treatment of kidney issues). MOFCOM concluded that Baxter would have a dominant market position for CRPT products after the merger, since the transaction would eliminate one of Baxter's main competitors and thus negatively impact competition. The transaction was approved, but with conditions that Baxter divest its worldwide CRPT business and discontinue its OEM agreement with competitor Niplo in the Chinese market.</td>
</tr>
<tr>
<td>August 2013</td>
<td>Electronic Components</td>
<td>Mediatek, MStar</td>
<td>Conditionally approved</td>
<td>MOFCOM found that Mediatek and MStar were primary competitors in the LCD TV control chip market, which they stated was a market with high technical barriers to entry. MOFCOM argued that the post-acquisition environment would eliminate the benefits the competitive relationship brought to the market, as the combined company would have a market share as high as 61 percent in the global market and 80 percent in China. MOFCOM also alleged that other LCD TV control chip manufacturers would not be able to compete effectively with the combined entity, meaning that downstream TV makers in China would have restricted choices in the procurement of LCD TV control chips. MOFCOM’s approval required MStar’s Taiwanese subsidiary to take ownership of MStar’s LCD TV control chip business, and continue operating as a competitor in the Chinese market.</td>
</tr>
<tr>
<td>January 2014</td>
<td>Biotechnology</td>
<td>Thermo Fisher, Life Technologies</td>
<td>Conditionally approved</td>
<td>MOFCOM found considerable overlap in the two companies’ businesses in three biotechnology areas, with 59 relevant products between them. MOFCOM’s analysis led it to focus on a portion of those products that would have high market concentration and estimated price increases in a post-acquisition environment. The final approval of the acquisition set conditions that Thermo Fisher divest its global cell culture business, sell its 51 percent stake in a Chinese bioengineering subsidiary, and reduce prices of certain products that had potential for significant price increases due to market concentration after the acquisition. (Those prices should be reduced by 1 percent per year for 10 years.)</td>
</tr>
<tr>
<td>April 2014</td>
<td>IT / Software / Mobile Equipment Manufacturing</td>
<td>Microsoft, Nokia</td>
<td><strong>Conditionally approved:</strong> While Microsoft’s acquisition of Nokia’s handset business seemed to have little direct impact on competition in China’s mobile market because of the parties’ relatively small market shares in operating systems and devices, MOFCOM raised concerns that the transaction could result in restrictions in licensing of patents deemed essential to competition for smartphones. The agency argued that Microsoft held essential patents for Android operating system licenses, which has an 80 percent market share of mobile devices in China, and would have an incentive to increase licensing costs to other smartphone makers utilizing the Android operating system. MOFCOM imposed conditions that Microsoft and Nokia were required to honor fair, reasonable, and non-discriminatory (FRAND) commitments for standard-essential patents (SEPs); and to refrain from seeking injunctions for infringement of such SEPs against smartphones produced by Chinese producers.</td>
<td>208 days</td>
</tr>
<tr>
<td>May 2014</td>
<td>Mobile Device Manufacturing</td>
<td>Merck kGaA, AZ Electronic Materials</td>
<td><strong>Conditionally approved:</strong> Merck kGaA is the world’s leading manufacturer of liquid crystal for use in tablets and smartphones, while AZ Electronic Materials has significant global and China market share in photoresist, a complementary product used in tablets and smartphones. MOFCOM found that after the acquisition, Merck would be the world’s largest supplier of both, while competitors would only be able to supply one of the two aforementioned raw materials. This, they argued, would thus allow Merck to restrict competition. MOFCOM’s conditions for acquisition include: Merck must report any licensing deals it signs in China to the ministry; Merck cannot force Chinese customers to buy products from both companies; and Merck must license liquid crystal patents on non-exclusive terms.</td>
<td>106 days</td>
</tr>
<tr>
<td>June 2014</td>
<td>Transportation Shipping</td>
<td>Maersk, MSC, CMA CGM</td>
<td><strong>Rejected:</strong> MOFCOM rejected plans by three leading European shipping companies – Denmark’s Maersk, Switzerland’s MSC, and France’s CMA CGM – to form a shipping alliance that would allow the companies to share ships and port facilities. In its decision, MOFCOM noted that the three companies involved in the alliance already held a 46.7 percent market share in the Asia-Europe container shipping line market, and that the alliance would allow them to enhance their market dominance in ways that would restrict competition and unfairly increase their bargaining power against consignors and ports.</td>
<td>273 days</td>
</tr>
<tr>
<td>July 2014</td>
<td>Battery Manufacturing</td>
<td>Primearth EV Energy, Toyota Motor China Investment, Toyota Tsusho, Hunan Corun New Energy, Changshu Sinogy Venture Capital (formation of a JV)</td>
<td><strong>Conditionally approved</strong>: MOFCOM’s review of the proposed JV focused on nickel metal-hydride car batteries, used in the vast majority of hybrid vehicles. Globally, the top four suppliers of nickel metal-hydride car batteries have 97 percent global market share, with Primearth EV Energy (PEVE) among them. MOFCOM considered that, due to high concentration of major players and high market entry barriers, this joint venture could restrict or even eliminate competition in the hybrid vehicle market. Further, MOFCOM believed that the JV would further increase Toyota’s dominance in the hybrid vehicle market and thwart development of China’s domestic hybrid vehicle companies. The JV was approved with the conditions that it must continue to sell products to third parties on a non-discriminatory basis. Also, within three years, the JV must bring their product(s) market to meet market demand.</td>
<td>184 days</td>
</tr>
</tbody>
</table>
Appendix 3: Selected Pricing Investigations by NDRC and Its Provincial Branches (2008-present)

NDRC has taken significant steps to increase its level of enforcement activity, particularly since the beginning of 2013. From the time the Antimonopoly Law (AML) was passed in 2008 to 2012, the NDRC conducted less than 20 price related investigations. By comparison, the agency investigated more than 80 companies in 2013 alone across a range of sectors, including pharmaceuticals, infant formula, Chinese liquor, and the telecom industry. 2014 has been, if anything, even more active.

The two tables below include information about selected price-related investigations concluded by NDRC and its provincial branches since the launch of the AML in August 2008. It also includes information about pricing investigations that were announced, but—according to public sources—have yet to be concluded. Both lists are compiled based on publicly available information, and therefore may not include every investigation conducted by NDRC officials at the central and provincial level.

### Completed Cases

<table>
<thead>
<tr>
<th>Date Announced</th>
<th>Industry</th>
<th>Location</th>
<th>Companies Involved</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 2010</td>
<td>Rice noodle manufacturing</td>
<td>Guangxi</td>
<td>Juezhihe, Xianyige, Liuzhou Brothers, Yongcai and other involved rice noodle manufacturers</td>
<td>Starting in 2010, eighteen rice noodle manufacturers held a series of meetings to discuss profit sharing and business integration and to set market prices. The Guangxi Price Bureau ruled that these behaviors violated the Price Law and the Antimonopoly Law. The bureau fined three of the leading companies RMB 100,000 (US $16,256) apiece, and ordered fines of RMB 30,000-80,000 (US $4,877-13,005) for other manufacturers according to their behavior.</td>
</tr>
<tr>
<td>August 2010</td>
<td>Paper making</td>
<td>Zhejiang</td>
<td>Fuyang Paper Manufacturing Industry Association</td>
<td>In 2010, the Fuyang Paper Manufacturing Industry Association held five meetings with more than 20 attending member companies to discuss the sales price for white paperboard. The Zhejiang Price Bureau ruled that the behavior violated both the Price Law and Antimonopoly Law, and ordered the Association to pay fines of RMB 500,000 (US $81,281).</td>
</tr>
<tr>
<td>Date</td>
<td>Sector</td>
<td>Location</td>
<td>Company/Agreement Name</td>
<td>Summary</td>
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<tr>
<td>November 2010</td>
<td>Household products</td>
<td>Hubei</td>
<td>Wuchang Salt Company</td>
<td>In July and August 2010, the Wuchang Salt Company required distributors to purchase both salt and Huolierba detergent powder. After an investigation, the Hubei Price Bureau announced that Wuchang had violated Articles 7 and 17(5) of the AML, but that the company had voluntarily returned illegal revenue to distributors. The Hubei Price Bureau also required Wuchang to take further unspecified corrective measures within the month.</td>
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<tr>
<td>May 2011</td>
<td>Household products</td>
<td>Shanghai</td>
<td>Unilever</td>
<td>In March 2011 Unilever released information to the media that it might raise detergent and soap prices because of raw materials costs, activity that caused customers to engage in &quot;panic buying.&quot; NDRC ruled that such behavior violated Article 14(3) of the Price Law, ordered Unilever to cancel its price hike, and fined the group RMB 2 million (US $325,124).</td>
</tr>
<tr>
<td>November 2011</td>
<td>Pharmaceuticals</td>
<td>Shandong</td>
<td>Weifang Shuntong, Huaxin</td>
<td>NDRC found that Shutong and Huaxin had ignored exclusive distribution agreements with the only two domestic producers, allowing them to control the supply of promethazine hydrochloride, a key raw material for the compound reserpine commonly used in high blood pressure treatments. Those agreements required the producers to obtain approval from both companies before selling product to any other party, thus eliminating competition. NDRC found that these actions violated the AML and the Price Law, and, under the AML, fined Weifang Shuntong RMB 6.877 million (US $1.1 million) and Huaxin RMB 150,000 (US $24,384).</td>
</tr>
<tr>
<td>February 2012</td>
<td>Chemicals</td>
<td>Hubei</td>
<td>Hubei Yihua Group</td>
<td>NDRC and its branch in Hubei found that Yihua, one of the world's largest manufacturers of sodium hydrosulphite, had worked with other companies to fix prices and subsequently imposed those prices on its customers. Methods included requiring customers to enter purchase agreements with Yihua and its subsidiaries and imposing conditions on material and equipment suppliers. These actions caused the price of sodium hydrosulphite to increase by 300 percent in 2011. NDRC and its branch in Hubei found that these actions violated the AML and imposed fines of RMB 10.12 million (US $1.6 million).</td>
</tr>
<tr>
<td>March 2012</td>
<td>Sea sand</td>
<td>Guangdong</td>
<td>Guangdong Sea Sand Association and its members</td>
<td>Investigation reports stated that several companies took steps to set and manipulate resource fees for mining sea sand under the umbrella of the Guangdong Sea Sand Association. The Guangdong Price Bureau determined these actions violated Article 16(2) of the AML and issued fines and warnings to members of the association. Three members of the association - Guangdong Baohai Sand and Stone, Dongguan Jianghai, and Shenzhen Donghai Century Information Consulting – were collectively</td>
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<td>Date</td>
<td>Industry</td>
<td>Region</td>
<td>Companies / Details</td>
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<tr>
<td>January 2013</td>
<td>LCD panels</td>
<td>Nationwide</td>
<td>Samsung, LG, Chimei, AUO, Chunghwa Picture Tubes (CPT), HannStar Display Corporation. NDRC’s investigation found that these six foreign LCD manufacturers met repeatedly between 2001 and 2006 to exchange information on the LCD panel market and set or manipulate LCD panel prices in China. NDRC ruled that these behaviors violated Article 14.1 and Article 40 of the Price Law. NDRC ordered the parties to return the overcharged funds to Chinese television enterprises (RMB 172 million (US $28.0 million)). NDRC confiscated other illegal gains (RMB 36.75 million (US $6.0 million)) and ordered the companies to pay fines of RMB 144 million (US $23.4 million). NDRC also ordered the parties to take other corrective measures, including providing fair treatment of all customers in the procurement of high-end or new technology products, and extending the free repair warranty period from 18 to 36 months for LCD panels used on televisions that Chinese television enterprises sell in mainland China.</td>
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<tr>
<td>February 2013</td>
<td>White liquor (baijiu)</td>
<td>Guizhou</td>
<td>Kweichow Moutai Group. The Guizhou Price Bureau ruled that Kweichow Moutai hassought to fix the minimum resale price to third-party distributors since 2012, taking punitive measures against those who did not implement the price. The bureau ruled that such activities violated Article 14 of the AML as a resale price maintenance agreement and fined Kweichow Moutai RMB 247 million (US $40.2 million), or 1 percent of the “related” sales revenue in the previous year.</td>
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<tr>
<td>February 2013</td>
<td>White liquor (baijiu)</td>
<td>Sichuan</td>
<td>Wuliangye Group. The Sichuan Development and Reform Commission found that between 2009 and 2013, Wuliangye signed agreements with over 3,200 independent dealers to limit the lowest resale price for its products. It then enacted punitive measures against those who did not implement the price. The commission ruled that such activities violated Article 14 of the AML as a resale price maintenance agreement and fined Wuliangye RMB 202 million (US $32.8 million), or 1 percent of the “related” sales revenue in the previous year.</td>
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<td>Date</td>
<td>Industry</td>
<td>Region</td>
<td>Companies</td>
<td>Summary</td>
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<tr>
<td>August 2013</td>
<td>Gold jewelry</td>
<td>Shanghai</td>
<td>Shanghai Laofengxiang, Yuyan Plaza</td>
<td>The Shanghai Price Bureau ruled that Shanghai Laofengxiang and several other gold jewelry stores sought to set retail prices within strict bounds for gold jewelry products under the umbrella of the Shanghai Gold &amp; Jewelry Trade Association. The bureau ruled that this behavior violated Articles 13 and 16 of the AML and fined the association RMB 500,000 (US $81,281) and the five stores a total of RMB 10.09 million (US $1.6 million), or 1 percent of their previous year's sales.</td>
</tr>
<tr>
<td>August 2013</td>
<td>Milk powder</td>
<td>nationwide</td>
<td>Biostime, Mead Johnson Nutrition, Dumex, Abbott, FrieslandCampina, Wyeth, Fonterra, Beingmate, Meiji</td>
<td>The nine milk powder companies were accused of fixing resale prices for distributors and retailers, including fixing or restricting prices for resale to a third party and adopting punitive measures for parties that do not meet those requirements. NDRC judged these behaviors to violate Article 14 of the AML and fined six of these producers a total of RMB 668.7 million (US $108.7 million). Fines ranged from 3 percent to 6 percent of prior year revenue.</td>
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<tr>
<td>September 2013</td>
<td>Tourism</td>
<td>Hainan</td>
<td>Sanya Platinum Crystal Crafts, Crystal Source, Good Royal Crystal</td>
<td>The Hainan Price Bureau ruled that these three companies formed a cartel, holding coordination meetings and signing a formal agreement in June 2012 to fix prices, commission rates, and market share for crystal products. They also formed a joint bank account to guarantee the agreement. The bureau found these activities violated Article 13 of the AML. Sanya Platinum Crystal Crafts and Crystal Source were fined RMB 3.6 million (US $585,223) (4 percent of the previous year's revenue) and RMB 1.35 million (US $219,459) (2 percent of the previous year's revenue), respectively, for the monopoly agreement. They were also fined RMB 99,000 (US $16,094) and RMB 90,000 (US $14,631), respectively, for concealing, transferring, or destroying financial data and evidence. Good Royal Crystal was exempt from punishment due to “cooperation.”</td>
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<tr>
<td>September 2013</td>
<td>Tourism</td>
<td>Hainan, Yunnan</td>
<td>Tourist shops selling crystal and spirulina products</td>
<td>Tourist-oriented shops selling crystal products and spirulina (a popular Chinese herbal product) in the tourist hubs of Sanya, Hainan, and Lijiang, Yunnan were accused of using price discounts to lure customers. According to the investigation, They first raised prices on these products far above cost and then offered discounts to bring prices back down. Sticker prices for these products were often tens or hundreds of times the cost of the products. Pricing agencies in Hainan and Yunnan found these practices to violate Article 14(4) of the Price Law, and fined each offending shop RMB 300,000 (US $48,769).</td>
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<td>Date</td>
<td>Sector</td>
<td>Location</td>
<td>Details</td>
<td>Outcome</td>
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<tr>
<td>September 2013</td>
<td>Tourism</td>
<td>Yunnan</td>
<td>Eight travel agencies in Yunnan, including the Lijiang branch of Ctrip, under the guidance of the Lijiang Tourism Association Travel Agency Division signed agreements in 2009 and 2010 to set prices for tour groups, sharing RMB 227 million (US $26.9 million) in profits over two years. The commission found this conduct violated Articles 13 and 16 of the AML as a price monopoly agreement. The agency was fined RMB 500,000 (US $81,281) and the travel agencies were collectively fined RMB 3.35 million (US $544,583), or 5 percent of the previous year's revenue.</td>
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<tr>
<td>September 2013</td>
<td>Tourism</td>
<td>Hainan</td>
<td>Travel agencies in Hainan, including Hainan Haikou Civil Tourism Agency and the Hainan Tongxing Tianxia Travel Agency used bait-and-switch tactics to lure customers. They priced tours at or below cost in order to attract tourists. They then made up for those losses with high commissions from shopping activities organized by the tour groups and pressuring tourists to purchase. The bureau ruled that such behavior violates Article 14 of the Price Law and fined each agency RMB 300,000 (US $48,769).</td>
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<tr>
<td>December 2013</td>
<td>Insurance</td>
<td>Hunan</td>
<td>Hunan Loudi City Insurance Industry Association and 12 domestic insurance-related companies organized companies to conduct anticompetitive behavior, including setting unified prices for new car insurance discount rates, dividing up the market, and signing agreements with the association-organized automobile service center. The Hunan Price Bureau found that this behavior violated the AML and fined the association and six of the insurance companies RMB 2.19 million (US $256,011). The other five companies were exempt from penalties for cooperating with authorities.</td>
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<tr>
<td>February 2014</td>
<td>Banking</td>
<td>nationwide</td>
<td>Domestic commercial banks (unnamed) Chinese banks were accused of imposing arbitrary charges and fees on customers. In February 2014, NDRC held a press conference announcing that to date it has ordered 64 branches of different banks to return RMB 409 million (US $66.5 million) in fees from those charges, and imposed fines of RMB 416 million (US $67.6 million). Further investigations and fines are possible.</td>
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<tr>
<td>May 2014</td>
<td>Telecommunications</td>
<td>nationwide</td>
<td>InterDigital InterDigital was accused of abuse of market dominance, charging discriminative high price patent license fees for China's communications equipment manufacturers, and issuing bundled license for non-standard essential patents and standard essential patents. In June 2014, NDRC announced that the investigation was suspended.</td>
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<tr>
<td>Date</td>
<td>Industry</td>
<td>Location</td>
<td>Companies</td>
<td>Summary</td>
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<tr>
<td>May 2014</td>
<td>Vision care</td>
<td>nationwide</td>
<td>Essilor, Zeiss, Nikon, Bausch &amp; Lomb, Johnson &amp; Johnson, Hoya, Weicon</td>
<td>Seven manufacturers of eyeglasses and contact lenses were accused of setting minimum resale prices and running promotions that effectively served as resale price maintenance (RPM) arrangements. NDRC determined that their activities violated Article 14 of the AML and fined five of the manufacturers a total of more than RMB 19 million (US $3.1 million), with rates of either 1 percent or 2 percent of the previous year's sales.</td>
</tr>
<tr>
<td>July 2014</td>
<td>Brick manufacturing</td>
<td>Hainan</td>
<td>Five domestic manufacturers of aerated bricks: Hainan Houde New Century Building Materials; Guangyiduo New Environmentally Friendly Wall Materials; Hainan Xinhongda Building Materials; Hainan Guangsheng New Building Materials; and Hainan Hailiyuan Industrial</td>
<td>According to the investigation reports, in October 2012, five manufacturers of aerated bricks – bricks with holes to allow airflow – established without authorization an aerated brick industry association to harmonize sales price, supervision and control and statistics for each company's production, sales, and shipments. The five companies subsequently agreed upon and coordinated price increases, signed monopoly agreements to divide sales. Two companies were exempted from fines due to their cooperation; the other three companies were fined RMB 530,000 (US $86,158), or 1 percent of the previous year's sales.</td>
</tr>
<tr>
<td>August 2014</td>
<td>Automotive</td>
<td>Nationwide</td>
<td>Hitachi, Denso, Aisan, Mitsubishi Electric, Mitsuba, Yazaki, Furukawa Electric, Sumitomo Electric, Nachi-Fujikoshi, NSK, JTEKT, and NTN</td>
<td>NDRC announced that 12 Japanese companies – eight auto parts manufacturers and four bearings manufacturers – had held frequent consultations to set and influence pricing of vehicles, auto parts, and bearings. NDRC exempted Hitachi and Nachi-Fujikoshi Corporation from fines due to their collaboration, but issued high fines for the other companies: RMB 832 million (US $135.3 million) for the other 7 auto parts companies and RMB 403.4 million (US $65.6 million) for the other three bearings companies. These figures range between 4 and 8 percent of the company’s previous year sales.</td>
</tr>
<tr>
<td>August 2014</td>
<td>Automotive</td>
<td>Hubei</td>
<td>Four Mercedes-Benz dealerships</td>
<td>The Hubei Price Bureau announced that four Mercedes-Benz dealerships had overcharged customers for the pre-delivery inspection (PDI) of purchased automobiles, and had colluded to set prices. The bureau fined the dealerships a collective total of RMB 1.63 million (US $264,976).</td>
</tr>
</tbody>
</table>
## Ongoing Cases

<table>
<thead>
<tr>
<th>Date Launched</th>
<th>Industry</th>
<th>Companies Involved</th>
<th>Potential Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>November 2011</td>
<td>Telecommunications</td>
<td>China Mobile, China Unicom</td>
<td>Alleged abuse of market dominance through price discrimination</td>
</tr>
<tr>
<td>August 2012</td>
<td>E-Commerce</td>
<td>360 Buy, Gome, Suning</td>
<td>Alleged illegal and fraudulent behavior while engaging in low-cost competition</td>
</tr>
<tr>
<td>March 2013</td>
<td>Cement</td>
<td>Cement companies nationwide</td>
<td>Alleged supply restrictions</td>
</tr>
<tr>
<td>July 2013</td>
<td>Pharmaceutical</td>
<td>GlaxoSmithKline, Merck, Astellas, Novartis, Boehringer Ingelheim, Baxter International, Fresenius, UCB, and many others</td>
<td>Alleged unfair import pricing (33 companies); internal cost structure (transfer pricing) (27 companies)</td>
</tr>
<tr>
<td>August 2013</td>
<td>Automobile</td>
<td>Imported cars and domestic auto joint ventures (no specific companies named)</td>
<td>Alleged “excessive” pricing</td>
</tr>
<tr>
<td>November 2013</td>
<td>Telecommunications</td>
<td>Qualcomm</td>
<td>Alleged abuse of market dominance through discriminatory royalty rates for patents</td>
</tr>
<tr>
<td>April 2014</td>
<td>Pharmaceutical</td>
<td>Nine unnamed pharmaceutical companies across six provinces, including Jiangsu, Anhui, Zhejiang, Hebei, Liaoning and Shanghai</td>
<td>Alleged monopolistic pricing practices</td>
</tr>
<tr>
<td>July 2014</td>
<td>Automotive</td>
<td>Luxury car makers, including Mercedes-Benz, Audi, Toyota, Land Rover, and others</td>
<td>Alleged abuse of dominant market position; imposition of horizontal and vertical restraints on competition (initial findings released, but fines not yet announced)</td>
</tr>
<tr>
<td>August 2014</td>
<td>Express delivery</td>
<td>Domestic express delivery companies in Chongqing and Xiangtan, Hunan, including HT Express, STO Express, TK Express, YTO Express, Yunda, and ZTO Express</td>
<td>Alleged illegal pricing behavior, including collusion</td>
</tr>
<tr>
<td>August 2014</td>
<td>Real estate</td>
<td>Real estate brokers in Tianjin (no specific companies named as targets)</td>
<td>Alleged monopolistic pricing practices</td>
</tr>
</tbody>
</table>
Appendix 4: Selected Monopoly Investigations by SAIC and Its Provincial Branches (2008-present)

Based on February 2014 statements by SAIC Deputy Commissioner Sun Hongzhi and follow-up notices posted on SAIC’s website, it appears that over the last six years SAIC has authorized its provincial branches to investigate at least 31 cases and announced formal decisions in 14 of them.

The two tables below include information about price-related investigations that were closed by SAIC and its provincial branches since the launch of the AML in August 2008. It also contains information about pricing investigations that were announced—but according to public sources—have not yet concluded.

### Completed Cases

<table>
<thead>
<tr>
<th>Date Announced</th>
<th>Industry</th>
<th>Location</th>
<th>Companies Involved</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 2010</td>
<td>Concrete</td>
<td>Jiangsu</td>
<td>Lianyungang Construction Material and Machinery Association and 16 member companies</td>
<td>Jiangsu investigators ruled that in 2009, the Lianyungang Construction Material and Machinery Association’s Concrete Committee and 16 member companies signed agreements to monopolize the market. The deal prohibited all involved from independently signing contracts with buyers. The Jiangsu AIC ruled that this behavior constituted an illegal monopoly agreement under the AML. It confiscated illegal profits of more than RMB 136,481.20 (US $22,187) and fined five participants in the cartel a combined total of RMB 530,723.19 (US $86,275).</td>
</tr>
<tr>
<td>Date</td>
<td>Industry</td>
<td>Location</td>
<td>Description</td>
<td>Outcome</td>
</tr>
<tr>
<td>------------</td>
<td>----------</td>
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<td>------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>April 2011</td>
<td>Liquefied Petroleum Gas</td>
<td>Jiangxi</td>
<td>Taihe County Huawei LPG Station and six other gas companies</td>
<td>According to the investigation report, Taihe County Huawei Liquefied Petroleum Gas (LPG) Station in October 2008 signed an agreement with six other LPG companies to monopolize and divide up the market, with each company getting a specific piece. The Jiangxi AIC found such behavior illegal under Article 14(1) of the AML, and as a result, confiscated illegal gains of RMB 205,537 (US $33,413) and fined Taihe County Huawei LPG Station RMB 130,230 (US $21,170).</td>
</tr>
<tr>
<td>January 2012</td>
<td>Second-hand automobiles</td>
<td>Henan</td>
<td>11 secondhand car dealerships in Anyang, Henan</td>
<td>SAIC ruled that a group of three secondhand auto dealerships in Anyang, Henan formed a cartel and signed an agreement to set a uniform price and market share in 2007. By 2009, this cartel expanded to include 11 dealerships. SAIC ruled that these activities violated Article 13 of the Antimonopoly Agreement. It then confiscated RMB 1.468 million (US $238.641) in illegal profits and imposed a fine of RMB 265,000 (US $43,071) on the participants.</td>
</tr>
<tr>
<td>August 2012</td>
<td>Cement</td>
<td>Liaoning</td>
<td>Liaoning Construction Material Industry Association and 12 member companies</td>
<td>According to investigation reports, the Liaoning Construction Material Industry Association's Cement Committee and 12 member companies from central Liaoning signed agreements in 2010 to monopolize the market, control production, and set market share. The Liaoning AIC ruled that their behavior constituted an illegal monopoly agreement under the AML and imposed fines of RMB 16.37 million (US $2.7 million) on the association and the 12 involved members.</td>
</tr>
<tr>
<td>November 2012</td>
<td>Insurance</td>
<td>Hunan</td>
<td>Yongzhou Insurance Association and 10 member companies</td>
<td>SAIC ruled that the Yongzhou (Hunan) Insurance Industry Association and 12 insurance companies in October 2011 signed an agreement establishing a new car insurance service center. This center served as a window for consumer purchases of new car insurance, of which 10 proceeded to set-up. SAIC judged the agreement to be an illegal monopoly agreement under the Antimonopoly Agreement, fining the insurance companies RMB 400,000 (US $65,025) and the twelve companies a combined total of RMB 972,000 (US $158,010).</td>
</tr>
<tr>
<td>Date</td>
<td>Industry</td>
<td>Location</td>
<td>Association/Companies</td>
<td>Summary</td>
</tr>
<tr>
<td>------------</td>
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</tr>
<tr>
<td>December 2012</td>
<td>Insurance</td>
<td>Hunan</td>
<td>Zhangjiajie Insurance Industry Association and 8 member companies</td>
<td>Investigation reports indicate that the Zhangjiajie (Hunan) Insurance Industry Association and 8 insurance companies in October 2010 signed agreements to establish a new car insurance service center as a window for consumer purchases of new car insurance. SAIC determined the agreement was an illegal monopoly agreement under the Antimonopoly Agreement and fined the association RMB 400,000 (US $65,025).</td>
</tr>
<tr>
<td>December 2012</td>
<td>Insurance</td>
<td>Hunan</td>
<td>Changde Insurance Association and 9 member companies</td>
<td>SAIC ruled that the Changde (Hunan) Insurance Industry Association and 9 insurance companies in May 2006 signed agreements to establish a new car insurance service center as a window for consumer purchases of new car insurance. SAIC believed the agreement was an illegal monopoly agreement under the Antimonopoly Agreement and fined the association RMB 450,000 (US $73,153).</td>
</tr>
<tr>
<td>December 2012</td>
<td>Insurance</td>
<td>Hunan</td>
<td>Chenzhou Insurance Association and 14 member companies</td>
<td>SAIC investigation reports indicate that the Chenzhou (Hunan) Insurance Industry Association and 10 insurance companies in June 2007 signed an agreement to establish a new car insurance service center as a window for consumer purchases of new car insurance. Ultimately, 14 companies participated. SAIC judged the agreement to be an illegal monopoly agreement under the Antimonopoly Agreement and fined the association RMB 450,000 (US $73,153).</td>
</tr>
<tr>
<td>December 2012</td>
<td>Concrete</td>
<td>Zhejiang</td>
<td>Jiangshan Tiger Product Concrete, Jiangshan Yongcheng Concrete, and Jiangshan Hengjiang Product Concrete</td>
<td>The Zhejiang AIC ruled that three concrete companies - Jiangshan Tiger Product Concrete, Jiangshan Yongcheng Concrete, and Jiangshan Hengjiang Product Concrete - in September 2009 made an oral agreement to divide the city's concrete market, set prices, and eliminate competition between them. The Zhejiang AIC judged the agreement to be an illegal monopoly agreement under the Antimonopoly Agreement and fined the three companies a total of RMB 1.18 million (US $191,823).</td>
</tr>
<tr>
<td>Month</td>
<td>Industry</td>
<td>Location</td>
<td>Organizations</td>
<td>Summary</td>
</tr>
<tr>
<td>--------</td>
<td>------------</td>
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<td>------------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>March</td>
<td>Construction Equipment</td>
<td>Zhejiang</td>
<td>Cixi Construction and Engineering Testing Association, Cixi Building and Engineering Quality Supervision Station Energy Office, and three companies</td>
<td>The Zhejiang AIC stated that the Cixi Construction and Engineering Testing Association, along with the Cixi Building and Engineering Quality Supervision Station's Energy Office and three companies, signed in March 2010 an agreement to divide market share among the three companies and set ground rules for competition. The Zhejiang AIC determined that this was illegal behavior, but decided in early 2012 to suspend the investigation for one year based on initial submissions provided by the parties. In March 2013, the Zhejiang AIC closed the investigation without punishing the enterprises.</td>
</tr>
<tr>
<td>March</td>
<td>Bricks/ceramics</td>
<td>Sichuan</td>
<td>Yibin Building Material Industry Association Brick Committee, three of its member companies, and one individual</td>
<td>The Sichuan AIC ruled that three major brickmaking companies working under the Yibin Building Material Industry Association Brick Committee signed a series of agreements in May 2009 designed to limit the output of bricks in the market and control market share. The Sichuan AIC judged the agreement to be an illegal monopoly agreement under the Antimonopoly Agreement and fined the three companies a total of RMB 1 million (US $162,562). The Sichuan AIC also fined an individual involved in the case RMB 60,000 (US $9,754).</td>
</tr>
<tr>
<td>April</td>
<td>Tourism</td>
<td>Yunnan</td>
<td>Xishuangbanna Tourism Association, Xishuangbanna Travel Agency Association</td>
<td>According to investigation reports, the Xishuangbanna Tourism Association launched a new information platform in 2003. Between 2009 and 2011, the association convinced more than 80 other groups -- hotels, attraction, passenger car services, and travel agencies -- to sign on. This agreement promoted specific tours to specific stops with punitive actions for those who deviated from those recommendations. Meanwhile, the Xishuangbanna Travel Agency Association and 24 travel agencies signed agreements to set prices and itineraries for travel. The Yunnan AIC found the behavior of both organizations to violate the AML and fined each organization RMB 400,000 (US $65,025).</td>
</tr>
<tr>
<td>Date</td>
<td>Industry</td>
<td>Region</td>
<td>Company/Brand</td>
<td>Summary</td>
</tr>
<tr>
<td>----------</td>
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<td>-------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>December 2013</td>
<td>Water supply engineering</td>
<td>Guangdong</td>
<td>Huizhou Daya Bay Yiyuan Purified Water</td>
<td>Investigation reports state that Huizhou Daya Bay Yiyuan Purified Water used its strong market position to require local real estate companies to sign agreements bundling water supply with other services. The Guangdong AIC determined that Yiyuan's behavior constituted a violation of Article 17(5) of the AML and required Huizhou halt business practices, turn over illegal gains of just over RMB 860,000 (US $139,803), and to pay a fine of 2 percent of Yiyuan’s 2012 revenue, or just under RMB 2.4 million (US $390,149).</td>
</tr>
<tr>
<td>June 2014</td>
<td>Sports and entertainment</td>
<td>Beijing</td>
<td>Shankai Sports International</td>
<td>Shankai Sports International – the authorized vendor of package tours to the 2014 FIFA World Cup in Brazil for China, Hong Kong, and Macao – was accused of bundling various products and services, such as game tickets, accommodation, food and beverages, multilingual hostesses, and parking and requiring customers to purchase set bundles. This violated a March 2011 agreement with Beijing China Travel Service Company in which that agency was assigned to arrange such hotel, transportation, and tourism services. The Beijing AIC launched an investigation, but suspended it in June 2014, stating that Shankai admitted that its actions violated the AML and it took undisclosed steps to address concerns.</td>
</tr>
<tr>
<td>July 2014</td>
<td>Fireworks</td>
<td>Inner Mongolia</td>
<td>6 fireworks companies in Chifeng, Inner Mongolia</td>
<td>Six fireworks companies in Chifeng, Inner Mongolia that were designated by local product production safety bureaus as the sole wholesalers for various fireworks products were accused of abusing their dominant market position. Specifically, these companies were accused of requiring distributors to apply for fireworks purchases, use standard markings, and pay for fireworks in advance throughout the year or see their purchasing quotas cut. Four of the companies also signed an illegal monopoly agreement. The Inner Mongolia AIC fined the six companies RMB 583,700 (US $94,887).</td>
</tr>
</tbody>
</table>
### Ongoing Cases

<table>
<thead>
<tr>
<th>Date Launched</th>
<th>Industry</th>
<th>Companies involved</th>
<th>Potential Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2013</td>
<td><strong>Food and beverage</strong></td>
<td>Tetra Pak</td>
<td>Alleged abuse of market dominance</td>
</tr>
<tr>
<td></td>
<td><strong>packaging</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>July 2014</td>
<td><strong>Information technology</strong></td>
<td>Microsoft</td>
<td>Alleged abuse of market dominance</td>
</tr>
<tr>
<td></td>
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</tr>
</tbody>
</table>
China remains in the midst of an active process of promoting and implementing economic reform. This process first began to advance in late 2011, more than a year before China’s 2012-2013 leadership transition. That transition ultimately resulted in the ascension of Xi Jinping as president and the head of the Chinese Communist Party (CCP) and Li Keqiang as premier and head of China’s powerful State Council. Xi came to power as a strong proponent of economic reform, fueling speculation about its scope, scale, and speed.

In 2013, government agencies began to release official regulations, statements, and editorials supporting reform goals and hinting at the evolving internal discussions about reform implementation. These releases covered an array of reform issues, including financial liberalization, the role of state-owned enterprises (SOEs) in the economy, administrative licensing, and tax reform. Two major developments reflecting this debate were:

- **September 2013**: The Shanghai government announced the launch of the China (Shanghai) Pilot Free Trade Zone (SFTZ), a pilot area for broader economic reforms in areas such as...
investment approvals, trade facilitation, financial innovation, risk management, and administrative licensing.

- **November 2013:** The Third Plenum of the CCP’s 18th Party Congress served as a platform for the broader reform agenda, through both high-level statements and a set of post-plenum documents that provided more detail on the direction of reform. These documents included key indicators of priorities, including setting a “decisive” role for the market in the economy, reforming China’s tax and finance regime, and improving foreign investment. However, they gave few concrete details on how such objectives would be implemented.

Since 2011, USCBC has closely monitored developments related to the current wave of economic reform to track its progress and answer two specific questions:

- What tangible progress have Chinese government agencies made towards implementing economic reform?
- What impact will reforms have on US companies and their operations in China?

To answer these questions, USCBC has compiled a list of policy developments related to economic reform since the start of the Xi administration. Such policies are divided into key reform themes, such as the role of the state and the market, foreign investment, institutional reform, and others. Given the stated role of the SFTZ as the “test lab” for potential reforms nationwide, this report pulls out the specific policy announcements and changes that relate directly to the SFTZ into a separate appendix. The current assessment includes data from March 2013 through mid-May 2014.

This report also aims to assess the impact on foreign company operations of China’s reform efforts by rating both individual policies as well as an overall score for Chinese government’s efforts to promote economic reform. In each case, an assessment is made specifically on how well the policy (or policies) addresses top foreign company concerns and the level of impact on foreign companies across sectors.

USCBC’s overall assessment uses a three-color dashboard, rating China’s reform policies as either limited, moderate, or significant based on their tangible impact on foreign companies.

USCBC also assesses the significance of each policy for foreign company operations in China, categorizing that impact into one of four categories: “significant impact” (marked as green in the list of policies) a “moderate impact” (orange), a “limited impact” (yellow), or “no impact” (red).

For more information about USCBC’s methodology, see Appendix 1.

**USCBC Assessment**

Chinese government authorities have laid the groundwork for broad economic reforms with high-level reform plans. Yet few concrete policies have been finalized and released since then, and even fewer have made significant progress on foreign company issues. Many address minor operational issues, are limited to particular sectors, or are unclear as to whether they apply to foreign companies. While China’s economic reform plans have the potential to promote reform in ways that address market access barriers and operational challenges of concern to foreign companies, these reforms have had only a limited impact to date.

Key areas to monitor for progress include revisions to China’s foreign investment laws, future reductions in the SFTZ negative list, and stronger efforts to ease administrative approval burdens that impact foreign companies.

Appendix 1: Methodology

Researching and Compiling Policies

For the purposes of this report, USCBC compiled a database of policy developments and announcements related to economic reform. These policies include:

- National-level policies that direct and implement reforms in broad areas;
- National-level policies that promote reform in a specific priority area; and
- Policies related to the Shanghai Free Trade Zone (SFTZ), given that zone’s importance as a mechanism to test and promote for economic reform.

This report does not attempt to include every policy change that has been made since China’s March 2013 leadership transition. Instead, this report focuses on concrete policies that may have an impact on business operations and are either explicitly tied to economic reform goals or whose drafting is clearly spurred by the broader push for economic reform. This report also includes landmark reform documents such as the Third Plenum Decision that set clear, high-level direction for broad economic reforms, though the impact of these is assessed based both on their strategic significance and the implementing policies they have spurred. This report excludes other speeches and pronouncements made by Chinese leaders about intended reforms unless they include specific policy announcements, as such plans cannot and do not promote change until they are implemented.

USCBC’s research is focused at the central government level for several reasons. First, reforms are being most directly driven by the central government leadership. Second, it is extremely challenging to track and assess policies released by governments at all levels, making it difficult to provide a comprehensive picture of implementation at that level. Thus, this report excludes reform policies by provincial and local governments are not included unless they have national implications, such as those related to the SFTZ.

To compile data for this report, USCBC staff conducted detailed reviews of relevant government webpages on a fixed schedule. USCBC also monitored other government websites, media sources, and a broad mix of information channels to identify concrete policies related to economic reform.

Assessing Individual Policies

Each policy was first categorized based on a preset list of key themes for reform, with some themes further tagged with specific subthemes. USCBC used the following themes and subthemes to categorize policies:

- Overall Reform
- Foreign Investment
- Administrative Licensing and Approvals
- Institutional Reforms (Subthemes: Reform-Related Agencies and Groups; Government Restructuring & Other Institutional Reforms)
- Role of the State and the Market (Subthemes: SOE Reform; Private Capital)
- Financial Reforms (Subthemes: Banking/Interest Rates; Exchange Rate/Foreign Exchange; Insurance; Securities)
- Pricing Reform and Competition Policy (Subthemes: Pricing Reforms; Competition Policy)
- Rule of Law/Legal and Judicial Reform
- Taxation and Budget (Subthemes: Taxation; Budget/Debt Issues)
- Corruption, Bribery and Party Discipline
- Urban/Rural Issues (Subthemes: Urbanization; Hukou/Household Registration Reform; Land Rights)
- Other
Each policy was then assessed based on its impact on foreign company operations in China, with consideration given to the breadth of impact across industries, the geographic scope impacted by the policy, and the level of foreign company concern addressed. The policy impact is rated into one of four categories:

- **Significant** (marked in green): The policy has an impact on a wide variety of industries with foreign investment in China, and has the potential to have significant impact on companies’ ability to operate in those sectors nationwide. For these policies, implementation is completed or seems likely. This category may also include State Council or National People’s Congress directives that indicate a significant shift in policy direction across multiple areas of reform.

- **Moderate** (yellow): The policy has: (1) the potential to have an important impact on companies in a wide variety of industries with foreign investment in China, but there are significant questions about the speed or ability to implement; (2) a moderate impact on a wide variety of industries with foreign investment in China; or (3) a significant positive impact for companies in only one sector or a narrow range of sectors with foreign investment in China.

- **Limited** (orange): The policy has either: (1) a limited impact on one sector or a narrow range of sectors with foreign investment in China; or (2) only an indirect impact/benefit for foreign companies investing in China.

- **None** (red): The policy will have no clear direct or indirect impact for foreign companies.

The database includes a handful of broad policy documents that set high-level strategic direction for economic reform but do not implement those reforms, such as the November 2013 Decision on Major Issues Concerning Comprehensive and Far-Reaching Reforms. In these cases, the assessment is made based on how well the scope of reform is relevant to top foreign company issues – but these policies are marked with specific text indicating that the impact of these policies is aspirational.

**Providing an Overall Assessment**

Based on an overall review of the importance and impact of individual policies, this report assesses the Chinese government’s overall efforts to promote meaningful reform based on how well they address top foreign company concerns.

USCBC’s overall assessment uses a three-color dashboard, rating China’s overall reforms as either limited, moderate, or significant based on the impact they have had on foreign companies. This rating is based on a consideration not only of the average rates of existing policies, but on an overall consideration of how broad and impactful these policies have been – not the average rates of policies in the database.
## Appendix 2: Policy Announcements Related to Nationwide Economic Reform

### I. Overall Reform

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>10/26/13</td>
<td>383 Plan</td>
<td>State Council Development Research Center</td>
<td>Promotes significant reforms to China’s economy focused on reducing the role of the state and increasing the role of the market, reforming SOEs, promoting private participation in the market, streamlining administrative procedures, and other key areas.</td>
<td>Significant: Addresses broad areas of economic reform relevant to foreign companies, with some specific policy suggestions. To date, the impact is largely aspirational.</td>
</tr>
<tr>
<td>11/15/13</td>
<td>Decision on Major Issues Concerning Comprehensive and Far-Reaching Reforms</td>
<td>CCP</td>
<td>Outlines more than 300 reform priorities discussed during the Third Plenum, including the market’s decisive role in the economy, streamlining administrative procedures, and promoting rule of law. Reforms are to be implemented by 2020.</td>
<td>Significant: Describes a litany of government reforms that will have a direct impact on foreign companies. Clearly sets an increased role for the market in the economy. To date, the impact is largely aspirational.</td>
</tr>
<tr>
<td>2/28/14</td>
<td>Second Meeting of Central Leading Group for Comprehensively Deepening Reform</td>
<td>State Council</td>
<td>Announces a series of policies pushing forward reforms introduced during the Third Plenum, including the Central Leading Group for Comprehensively Deepening Reform 2014 Work Priorities, the Opinions on the Legislative Work Requirements and Tasks Proposed by Third Plenum of 18th CCP Congress, and the Opinions and Implementation Program on Deepening the Reform of the Judicial System and the Social System.</td>
<td>Moderate: Sector coverage of these policies is broad, but implementation is in early stages. To date, the impact is largely aspirational.</td>
</tr>
<tr>
<td>5/24/13</td>
<td>Notice on Key Priorities in Deepening Economic Reforms</td>
<td>State Council</td>
<td>Sets key priorities for deepening economic reform in 2013, and assigns them to key agencies. Key areas include administrative licensing, taxation and budgeting, financial reform, investment, pricing, social security, and urbanization.</td>
<td>Limited: While the document laid out key areas of reform in 2013, implementation of those reforms was largely muted pending the release of broader reform related documents (such as the Decisions document following the Third Plenum).</td>
</tr>
</tbody>
</table>
# II. Foreign Investment

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>9/23/13</td>
<td>Notice on Relevant Matters Regarding RMB Settlement of Foreign Investors Investing in Domestic Financial Institutions</td>
<td>PBOC</td>
<td>Allows foreign investors approved to invest in domestic financial institutions to use RMB for capital increases, mergers and acquisitions, equity transfer, distribution of profits, liquidation, and other activities.</td>
<td>Significant: Broadens the ability for foreign companies to directly use RMB to expand investments in China.</td>
</tr>
<tr>
<td>5/11/13</td>
<td>Regulations on the Administration of Foreign Exchange in Onshore Direct Investment by Foreign Investors</td>
<td>SAFE</td>
<td>Simplifies procedures and policies on foreign exchange for foreign direct investment, including registration, opening an account, payment, selling and purchasing of foreign exchange. The regulation also abolishes 24 existing foreign exchange administrative regulations.</td>
<td>Moderate: Streamlines relevant foreign-exchange related procedures for foreign companies in China, but only applies to SAFE rules and does not address broader barriers and delays that most concern foreign companies.</td>
</tr>
<tr>
<td>3/1/14</td>
<td>Administrative Provisions on Company Registered Capital Registration</td>
<td>SAIC</td>
<td>Brings SAIC’s company registration rules in line with amendments to China’s Company Law by eliminating minimum registered capital requirements, transitioning from a paid-in capital system to a subscribed capital system, and replacing the annual inspection system with an annual reporting system.</td>
<td>Moderate: Streamlines administrative processes, but with limited impact because the registration procedure for foreign companies is subject to separate set of MOFCOM rules for foreign invested enterprises.</td>
</tr>
<tr>
<td>3/27/13</td>
<td>Implementing Opinions on Further Developing Local Medical Institutions</td>
<td>Shanghai Municipal Health Bureau</td>
<td>Encourages foreign investment and pledges future reductions in investment barriers in healthcare services, including new medical institutions, high-level medical service centers, and underdeveloped healthcare services including elderly care, rehabilitation, mental health, pediatrics and obstetrics.</td>
<td>Limited: Discusses concrete investment openings in key areas, but does not fully realize any openings, and impact localized to Shanghai.</td>
</tr>
<tr>
<td>6/8/13</td>
<td>Modification to Regulations on Foreign Insurance Companies</td>
<td>CIRC</td>
<td>Revises regulations to allow foreign insurance companies to make capital contributions via RMB or other currencies, and allows foreign insurance companies to allocate working capital to their branches in China via RMB-denominated income.</td>
<td>Limited: Improves registered capital processes for insurance companies, but does not impact market access and limited to one sector.</td>
</tr>
<tr>
<td>5/15/14</td>
<td>Opinions on Promoting Foreign Trade</td>
<td>State Council</td>
<td>Encourages Chinese government agencies to increase multilateral trade and outbound investment, promote a free-floating RMB exchange mechanism and RMB settlement, strengthen trading competitiveness, and improve online and traditional trading platforms.</td>
<td>Limited: Contains positive language about liberalizing trade, but does not include specific policy measures.</td>
</tr>
</tbody>
</table>
5/2/13 | **Notice on RMB-Qualified Foreign Institutional Investors (RQFII) Issuing Securities in China** | PBOC | Clarifies procedures and requirements for the RQFII registration process and responsibilities of regional PBOC offices to regulate pilots. | None: Makes minor process changes with limited impact on foreign companies.  

### III. Administrative Licensing and Approval Reform

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
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</thead>
<tbody>
<tr>
<td>2/7/14</td>
<td><strong>Notice on Registered Capital Registration System Reform</strong></td>
<td>State Council</td>
<td>Reduces requirements for registering new businesses and simplifies registered capital procedures.</td>
<td><strong>Significant</strong>: Reduces registered capital requirements and eases the incorporation process for domestic and foreign companies.</td>
</tr>
<tr>
<td>9/19/13</td>
<td><strong>Notice Strictly Limiting New Administrative Licensing Procedures</strong></td>
<td>State Council</td>
<td>Calls for agencies to limit the number of new administrative licensing procedures introduced.</td>
<td><strong>Moderate</strong>: Broad potential impact on overall reform push to simplify administrative licensing procedures, but with few details to date.</td>
</tr>
<tr>
<td>12/2/13</td>
<td><strong>Catalogue of Investment Projects Subject to Government Ratification (2013 revision)</strong></td>
<td>State Council</td>
<td>Transitions numerous investment projects from the approval system to the record-filing system, and adopts a &quot;negative list&quot; approach designating investment projects that will still be subject to administrative approvals.</td>
<td><strong>Moderate</strong>: Impacts companies across a range of sectors, and supports government efforts to shift towards a negative list approach in investment approvals. However, the impact is limited to NDRC approvals and does not affect other steps in the foreign investment approval process, such as MOFCOM or other agency reviews.</td>
</tr>
<tr>
<td>2/18/14</td>
<td><strong>Decision on Cancelling and Decentralizing Several Administrative Approval Items (No. 5)</strong></td>
<td>State Council</td>
<td>Cancels or decentralizes 64 administrative approval items and 18 sub-items related to business development such as enterprise establishment, production license, business scope and disposal of assets and capital.</td>
<td><strong>Moderate</strong>: Eliminates approvals in a range of areas, including approvals related to foreign-invested banks and financial institutions.</td>
</tr>
<tr>
<td>3/25/14</td>
<td><strong>Opinions on Further Optimizing the Market Environment for Enterprise Mergers and Reorganizations</strong></td>
<td>State Council</td>
<td>Streamlines M&amp;A approval procedures by addressing issues in examinations and approvals, financing, audits, and service and institutional mechanisms that serve as obstacles for reorganization.</td>
<td><strong>Moderate</strong>: Marks progress for foreign companies in simplifying M&amp;A approvals and increasing transparency, but questions remain as to how many foreign transactions can take advantage of streamlined procedures.</td>
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<tr>
<td>Date</td>
<td>Title</td>
<td>Agency</td>
<td>Summary</td>
<td>Analysis</td>
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<tr>
<td>4/22/14</td>
<td>Circular on the Elimination of Non-Administrative Approval Items</td>
<td>State Council</td>
<td>Requires administrative agencies to review and eliminate non-administrative approval items.</td>
<td><strong>Moderate:</strong> Requires agencies to review and eliminate these items, creating significant opportunities for administrative licensing reform. The notice does not, however, directly eliminate any administrative items.</td>
</tr>
<tr>
<td>5/15/13</td>
<td>Decision on Cancelling and Decentralizing Administrative Items by the State Council (No. 19)</td>
<td>State Council</td>
<td>Eliminates or decentralizes 104 administrative items, including administrative approvals, awards, and administrative fees in areas such as representative office registration, shipping, service outsourcing, and education appointments.</td>
<td><strong>Limited:</strong> Addresses few items that concern foreign companies.</td>
</tr>
<tr>
<td>7/13/13</td>
<td>Decision on Removing 50 Administrative Approvals</td>
<td>State Council</td>
<td>Eliminates or decentralizes 50 administrative approval items, including those related to industries such as imported cosmetics, medical services, and film.</td>
<td><strong>Limited:</strong> Eliminates a small number approval items that apply to foreign investments in a few specific areas.</td>
</tr>
<tr>
<td>7/24/13</td>
<td>Notice on the Release of Regulations on Foreign Exchange for Services Trade</td>
<td>SAFE</td>
<td>Shortens the approval process for cross-border services to ensure the healthy growth of the domestic service industry.</td>
<td><strong>Limited:</strong> Relaxes requirements restricting domestic companies from depositing foreign exchange overseas.</td>
</tr>
<tr>
<td>8/2/13</td>
<td>Notice on Partially Cutting Administrative Fees</td>
<td>NDRC, MOF</td>
<td>Lowers administrative fees for a variety of approvals required by 14 ministries.</td>
<td><strong>Limited:</strong> Marginally reduces administrative fees in certain areas, such as trademark application fees.</td>
</tr>
<tr>
<td>8/20/13</td>
<td>Notice Easing the Visa and Residency Process for Foreign Talent</td>
<td>MHRSS</td>
<td>Streamlines the visa and residency permit application process for qualified foreign talent working in China.</td>
<td><strong>Limited:</strong> Streamlines the application process for foreign and domestic companies high-skilled employees from overseas, but this is not a huge issue for foreign companies.</td>
</tr>
<tr>
<td>9/27/13</td>
<td>Notice on CSRC Branch Agencies Administrative Penalty Work Rules</td>
<td>CSRC</td>
<td>Decentralizes administrative penalties and enforcement, granting 36 branches the authority to conduct enforcement activities.</td>
<td><strong>Limited:</strong> Increased enforcement structures could impact foreign company operations in the sector, though the notice has no immediate impact on foreign companies.</td>
</tr>
<tr>
<td>10/24/13</td>
<td>Notices on Removing 314 Provincial-Level Administrative Fees</td>
<td>MOF, NDRC</td>
<td>Eliminates 314 administrative fees collected by local authorities.</td>
<td><strong>Limited:</strong> Advances central government efforts to reduce administrative fees, but few of the fees impacted are among US companies’ top concerns.</td>
</tr>
<tr>
<td>11/8/13</td>
<td>Decision on Cancelling and Decentralizing Several Administrative Approval Items (No. 44)</td>
<td>State Council</td>
<td>Cancels or decentralizes 82 administrative approval items in areas such as road transportation, accounting, and art imports.</td>
<td><strong>Limited:</strong> Advances government reforms to streamline administrative approvals, but few of these decentralizations touch on top foreign company concerns.</td>
</tr>
</tbody>
</table>
**IV. Institutional Reforms**

**Reform-Related Agencies and Groups**

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<tr>
<th>Date</th>
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<tbody>
<tr>
<td>11/15/13</td>
<td><strong>Catalogue Decentralizing MEP Approval Authority Over Environmental Impact Assessment Documents</strong></td>
<td>MEP</td>
<td>Decentralizes approval authority over a total of 25 projects, mainly infrastructure projects and projects with minor environmental impact, such as distributed gas-fired generation, urban rapid rail transportation, civil airport expansion, pump storage power station and other projects.</td>
<td>Limited: Streamlines approval for environmental and infrastructure projects, but impact is limited, and only for foreign companies interested in this sector.</td>
</tr>
<tr>
<td>1/13/14</td>
<td><strong>Circular Implementing the Decision of the State Council on Eliminating and Delegating a Batch of Administrative Approval Items</strong></td>
<td>SAT</td>
<td>Reduces administrative tax approval items and increases transparency requirements.</td>
<td>Limited: Small step forward in reducing administrative approval requirements, but does not address investment barriers that are of greatest concern to foreign companies.</td>
</tr>
<tr>
<td>11/14/13</td>
<td><strong>Administrative Approval Rules for Domestic Commercial Banks</strong></td>
<td>CBRC</td>
<td>Eliminates some approval items, and delegates authority for others to lower-level authorities.</td>
<td>None: Only applies to domestic banks, though it promotes administrative licensing reforms.</td>
</tr>
<tr>
<td>1/8/14</td>
<td><strong>State Council Executive Meeting on the Cancellation and Decentralization of 70 Administrative Inspection and Approval Items</strong></td>
<td>State Council</td>
<td>Cancels and decentralizes 70 administrative examination and approval items, though the list was not publicly released.</td>
<td>None: List is not yet publicly released, so no indication of any impact.</td>
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## Government Restructuring & Other Institutional Reforms

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<tbody>
<tr>
<td>12/31/13</td>
<td>Establishment of the Central Government Leading Group for Overall Reform</td>
<td>State Council</td>
<td>Sets up a central leading group to comprehensively deepen reforms.</td>
<td>Significant: Signals the central government's intention to move forward with reforms introduced during the Third Plenum. To date, the impact is largely aspirational.</td>
</tr>
<tr>
<td>1/22/14</td>
<td>Work Plan for Relevant Central Authorities to Implement the Important Initiatives of Third Plenum of the Eighteenth CCP Congress Decision</td>
<td>State Council</td>
<td>Establishes six special teams under the central leading group for comprehensively deepening reform. Those teams cover economic and ecological civilization system reform, democracy and the rule of law, cultural reform, social reform, party construction reform, and discipline and inspection system reform.</td>
<td>Significant: Sets key structures and personnel to push forward economic reforms introduced during the Third Plenum. To date, the impact is largely aspirational.</td>
</tr>
<tr>
<td>1/10/14</td>
<td>Announcement on 2012 Central Budget Implementation and the Rectification of Other Issues Concerning Financial Revenue and Expenditure Audits Problem</td>
<td>NAO</td>
<td>Lays out direction of reform in several areas, including the government fund budget management, regional tax incentives adjustment, the state capital operating budget management, transfer payments management, etc.</td>
<td>Moderate: Clarifies that MOF will explicitly decouple regional development from tax incentives, a step towards addressing discriminatory tax policies.</td>
</tr>
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## V. Role of the State and the Market

### SOE Reform

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<tbody>
<tr>
<td>12/18/13</td>
<td>Opinions on Further Deepening the Reform of Shanghai State-Owned Assets and Promoting Enterprise Development</td>
<td>Shanghai Municipal Government</td>
<td>Introduces 20 reform measures designed to accelerate SOE structural adjustments, standardize corporate governance structures, improve personnel selection and incentive mechanisms, enhance SOE international competitiveness, and optimize SOE supervision.</td>
<td>Moderate: Promotes reforms for SOEs to operate based on market factors. Scope is limited only to Shanghai-controlled SOEs, but applies to their operations nationwide.</td>
</tr>
<tr>
<td>12/6/13</td>
<td>Notice on Improving the Operating Budget for State-Owned Assets</td>
<td>CSRC</td>
<td>Requires SOEs to provide a portion of revenues collected to the state.</td>
<td>Limited: Promotes SOE reforms, particularly related to profits and revenues, but does not make much change to the role of SOEs in the economy.</td>
</tr>
</tbody>
</table>
1/20/14  Guiding Opinions on Strengthening Value Management of Central State-owned Enterprises with Focus on Evaluation of Economic Value-Added (EVA)  SASAC  Calls for SOEs to focus on improving efficiency and use EVA as a key performance indicator.  Limited: Holds SOEs more accountable for their performance, but does not fundamentally alter the competitive dynamics that impact foreign companies.

Private Capital

<table>
<thead>
<tr>
<th>Date</th>
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<tbody>
<tr>
<td>9/26/13</td>
<td>Guiding Opinions on Government Procurement of Services from Social Organizations</td>
<td>State Council</td>
<td>Allows further market access in the public service sectors to eligible social organizations and enterprises.</td>
<td>Limited: Promotes the establishment of a services procurement system that includes public participation, but does not clarify if this includes foreign companies.</td>
</tr>
<tr>
<td>12/31/13</td>
<td>Opinions on Accelerating the Operations of Medical Institutions with Social Capital</td>
<td>NHFPC</td>
<td>Requires government agencies to incorporate medical institutions with social capital into health planning efforts, and require local jurisdictions to develop reasonable policies to provide equal treatment to both private and public hospitals.</td>
<td>Limited: Promotes the establishment of private hospitals, but seems focused on those established with social capital and does not specify access for foreign companies.</td>
</tr>
<tr>
<td>8/19/13</td>
<td>Opinions on Reforming the Railway Investment and Financing System and Accelerating Railway Construction</td>
<td>State Council</td>
<td>Opens ownership and management rights of intercity rail, urban-suburban rail, resource development-related rail and rail branches to local governments and to social capital, and encourages social capital to invest in railway construction.</td>
<td>None: Encourages the use of private capital in railway construction -- but private capital does not likely include foreign investment.</td>
</tr>
<tr>
<td>2/13/14</td>
<td>Regulatory Measures on the Equal Opening of Oil and Gas Pipeline Facilities (Trial)</td>
<td>NEA</td>
<td>Requires government agencies to regulate oil and gas pipeline facilities fairly, openly, and transparently, and opens investment to the private sector.</td>
<td>None: Allows private capital investment in an area dominated by state capital -- but private capital does not likely include foreign investment.</td>
</tr>
<tr>
<td>4/22/14</td>
<td>Infrastructure and Public Utility Franchise Law (Franchise Law)</td>
<td>NDRC</td>
<td>Further opens infrastructure and public utility sector to the private sector.</td>
<td>None: Allows more private participation in areas largely dominated by public investment, but foreign investment in this sector is not clarified and is unlikely.</td>
</tr>
</tbody>
</table>
4/23/14 **Opinions on Establishing the Long-term Mechanism of Natural Gas Supply**  
State Council  
Increases natural gas supply to as much as 420 billion cubic meters per year by 2020, and opens energy market to private capital.  
**None:** Opens investment in the energy market to more private capital – but private capital in this context does not likely include foreign investment.

### VI. Financial Reforms

#### Banking/Interest Rates

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<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
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<tbody>
<tr>
<td>7/26/13</td>
<td>Guiding Opinions on Strengthening Financing Services to Support Small- and Medium-Sized Enterprises (SMEs)</td>
<td>NDRC</td>
<td>Requires government agencies at all levels to promote greater financing channels for SMEs.</td>
<td>Limited: Focuses efforts on domestic SMEs, with an indirect impact for foreign companies in the banking sector.</td>
</tr>
<tr>
<td>8/30/13</td>
<td>Guidelines on Protecting Consumer Rights and Interests</td>
<td>CBRC</td>
<td>Requires banks to improve governance, including formulating internal codes of conduct and halting practices such as failure to disclose investment risks, overstating returns, deliberately giving misleading information, and divulging or leaking personal information to any third party without consent.</td>
<td>Limited: Impacts foreign financial institutions operating in the China market from an operational standpoint, but mainly to bring these practices in line with global industry best practices; does not make progress on top financial reform concerns for foreign companies.</td>
</tr>
<tr>
<td>9/27/13</td>
<td>Measures on Consumer Finance Pilots</td>
<td>CBRC</td>
<td>Creates 10 pilot projects that allow non-financial companies mainly engaged in providing consumer credit services to launch consumer finance businesses, lift the geographical restrictions on business operations, and lower the minimum capital ratio for shareholders from 50 percent to 30 percent.</td>
<td>Limited: Lowers the minimum shareholder requirements for foreign companies to invest in consumer finance companies, but does not clearly permit them to set up their own consumer finance businesses.</td>
</tr>
<tr>
<td>11/8/13</td>
<td>Guidance on Commercial Banks Issuing Corporate Bonds to Replenish Capital</td>
<td>CSRC, CBRC</td>
<td>Allows commercial banks that are listed on domestic or overseas exchanges (or are queued to be listed) to issue corporate bonds.</td>
<td>Limited: Allows commercial banks an additional channel to raise capital, but bond market still dominated by domestic players -- and it remains unclear whether this policy would impact or be applied to foreign commercial banks.</td>
</tr>
<tr>
<td>Date</td>
<td>Description</td>
<td>Organization(s)</td>
<td>Summary</td>
<td>Notes</td>
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<td>2/14/14</td>
<td>General Plan for the Qingdao Wealth Management Comprehensive Reform Pilot</td>
<td>PBOC, NDRC, MOF</td>
<td>Establishes a special pilot zone aimed at encouraging the establishment of diversified wealth management organizations and participation of private capital in order to build a professional wealth management market in the city. Though the zone is local to Qingdao, it was approved by the State Council.</td>
<td>Limited: Increases access for private capital to invest in financial services, but does not clearly specify opportunities for foreign companies.</td>
</tr>
<tr>
<td>2/14/14</td>
<td>Measures for the Administration of Service Prices of Commercial Banks</td>
<td>CBRC, NDRC</td>
<td>Makes services fees by commercial banks subject to either government-determined prices, government-guided prices or market-adjusted prices based on the nature and characteristics of services and market competition situation.</td>
<td>Limited: Represents a small step forward in allowing the market to determine prices, but still requires significant government oversight.</td>
</tr>
<tr>
<td>2/19/14</td>
<td>Circular on Re-Approvals of Standards for Charging Supervision Fees for the Banking Sector</td>
<td>MOF, NDRC</td>
<td>Adjusts standards on collecting fees in the banking sector.</td>
<td>Limited: Though the notice makes a concrete policy change, the impact is focused just on one aspect of the banking business -- and thus is limited in both sector and operational impact.</td>
</tr>
<tr>
<td>2/20/14</td>
<td>Administrative Measures for the Liquidity Risk of Commercial Banks</td>
<td>CBRC</td>
<td>Institutes a new measurement system aimed to gauge the ability of commercial banks to resist short-term stress from credit squeezes.</td>
<td>Limited: Focuses on commercial banks, which could include foreign banks. However, this will have only a minor operational impact, and most foreign banks already have prudential measures in place to address these types of challenges.</td>
</tr>
<tr>
<td>2/27/14</td>
<td>Credit Industry Management Measures</td>
<td>PBOC</td>
<td>Encourages the credit industry to adopt more market-oriented approach and calls for the construction of social credit information system along with increased information transparency.</td>
<td>Limited: Provides greater opportunity for the private sector in the credit industry, but no clear indication that foreign companies are included.</td>
</tr>
<tr>
<td>7/1/13</td>
<td>Guidelines on Financial Support for Economic Restructuring, Transformation and Upgrading</td>
<td>State Council</td>
<td>Encourages private capital investment in established and restructure financial institutions; allows established village banks to change their capital contribution structure; and promotes a diversified regulatory mechanism for different financial sectors in order to better support the real economy.</td>
<td>None: Allows qualified private companies to invest in private banks, financial rental companies and consumer finance companies, but private capital does not likely include foreign investment.</td>
</tr>
<tr>
<td>3/17/14</td>
<td>Regulations on Financial Leasing Companies</td>
<td>CBRC</td>
<td>Clarifies entry standards, service scopes, operating rules, and regulation and supervision standards for the financial leasing industry.</td>
<td>None: Encourages the use of private capital in leasing -- but private capital does not likely include foreign investment.</td>
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<tr>
<td>3/27/14</td>
<td>Opinions on Accelerating the Construction of Microenterprise and Rural Credit Systems</td>
<td>PBOC</td>
<td>Creates a social risk system that functions like the credit reporting management industry, with a focus on micro-enterprises and rural economic actors.</td>
<td>None: Promotes innovation in the financial services sector, but does not provide new market opportunities for foreign companies.</td>
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<td>Exchange Rate/Foreign Exchange</td>
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<tr>
<td>7/5/13</td>
<td>Notice on Simplifying Cross-Border RMB Business Processes and Improving Relevant Policies</td>
<td>PBOC</td>
<td>Allows domestic and qualified foreign banks to offer a broader range of RMB clearance and other RMB-denominated services, and permits domestic banks to offer RMB-denominated loans to domestic and foreign holding companies to qualified offshore entities.</td>
<td>Limited: Expands the market space for foreign banks to offer RMB-denominated services, and provides additional financing room for qualified foreign companies in China, but both openings are minor.</td>
</tr>
<tr>
<td>4/30/14</td>
<td>Provisions on Cross-Border Foreign Currency Flows</td>
<td>SAFE, GAC</td>
<td>Promotes the development of the foreign currency cash management business. Simplifies the management process and delegates administrative approvals to local SAFE branches and allows approved institutions to conduct foreign currency business.</td>
<td>Limited: Simplifies internal procedures related to foreign currency cash management, decentralizes approval to local agencies, and creates some opportunities for domestic and foreign companies in this sector.</td>
</tr>
<tr>
<td>1/24/14</td>
<td>Circular on Further Improving and Adjusting the Foreign Exchange Control Policy for Capital Accounts</td>
<td>SAFE</td>
<td>Reforms foreign exchange management under company capital accounts, simplifies the process of administrative approvals, and facilitates trade and investment.</td>
<td>Moderate: Simplifies the registration procedures for accepting domestic non-performing assets by foreign investors, creating some new opportunities for foreign companies.</td>
</tr>
<tr>
<td>4/25/14</td>
<td>Measures on Management of the Foreign Exchange Funds of Multinational Companies</td>
<td>SAFE</td>
<td>Allows multinational companies to open overseas and domestic accounts simultaneously as well as conduct collection and settlement of accounts in foreign exchange.</td>
<td>Moderate: Allows MNCs more flexibility in using foreign exchange.</td>
</tr>
<tr>
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<tr>
<td>3/21/14</td>
<td>Administrative Measures on Insurance Company Mergers and Acquisitions</td>
<td>CIRC</td>
<td>Allows insurance companies and individual shareholders that meet conditions to own stakes in more than one other insurance company in the same market and allows insurers to use borrowed capital for up to 50 percent of the transaction price.</td>
<td>Moderate: Allows foreign and domestic insurance companies to hold controlling stakes in up to two competitors in the same product market (i.e. life insurance, property and casualty insurance, reinsurance), though impact limited to this sector.</td>
</tr>
<tr>
<td>3/28/13</td>
<td>Administrative Measures on the Issuance of Subordinated Debts by Insurance Companies</td>
<td>CIRC</td>
<td>Allows insurance groups to issue subordinated debts, where in the past only licensed subsidiaries could issue such bonds.</td>
<td>Limited: Permits insurance groups to issue debt to broaden financing options, but sector impact quite limited.</td>
</tr>
<tr>
<td>4/16/13</td>
<td>Notice Regarding Article 4 of the Administrative Measures for Equities of Insurance Companies</td>
<td>CIRC</td>
<td>Aims to improve management by allowing single shareholders of qualified Chinese-invested insurance companies to hold stakes over 20 percent, while also setting an ownership cap of 51 percent.</td>
<td>Limited: Will have some impact on foreign companies in the insurance industry, but no impact on others.</td>
</tr>
<tr>
<td>4/25/13</td>
<td>Administrative Measures of Telephone Sales of Life Insurance</td>
<td>CSRC</td>
<td>Provides rules for companies selling life insurance over the telephone to protect consumers.</td>
<td>Limited: Minimal impact for companies focused on one small aspect of a particular industry.</td>
</tr>
<tr>
<td>2/20/14</td>
<td>Circular on Improving Regulation on the Proportional Use of Insurance Funds</td>
<td>CIRC</td>
<td>Raises the maximum share of total assets that insurers can invest in shares and private equity to 30 percent, up from 25 percent under previous rules.</td>
<td>Limited: Changes will have a limited direct impact on the insurance industry.</td>
</tr>
<tr>
<td>4/24/13</td>
<td>Notice on Regulating the Limited Partnership Equity Investment Enterprises to Invest in Insurance Companies</td>
<td>CIRC</td>
<td>Permits qualified domestic and foreign limited partnership firms to invest in insurance companies.</td>
<td>None: Creates more openings for private capital in the insurance market, but private capital in this case does not likely include foreign companies.</td>
</tr>
<tr>
<td>8/27/13</td>
<td>Guidance on Insurance Industry Support of Economic Restructuring, Transformation and Upgrading</td>
<td>CIRC</td>
<td>Encourages innovation and restructuring of the insurance industry, as well as the use of private capital to establish insurance agencies, brokerages, and assessment institutions, along with participation in the rural insurance market.</td>
<td>None: Encourages the use of private capital in insurance -- but private capital does not likely include foreign investment.</td>
</tr>
<tr>
<td>2/26/14</td>
<td>Opinions on Establishing a Unified Basic Pension Insurance System for Urban and Rural Residents</td>
<td>State Council</td>
<td>Establishes a unified urban and rural pension insurance fund consists of contributions by individuals, organizations, and government agencies.</td>
<td>None: Focuses on areas of the insurance industry that are entirely government-run, and where companies are not permitted to contribute.</td>
</tr>
</tbody>
</table>
### Amendment to the Measures on Insurance Company Equity Management

CIRC

States that insurance companies must fund additional equity investment from their own funds, and not from bank loans; and aims to further opens the insurance industry to the private capital while controlling systematic risk, especially risk linked to the banking sector.

None: Provides openings for private capital in the insurance industry -- but private capital does not likely include foreign investment.

## Securities and Private Equity

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>5/9/14</td>
<td>Opinions on Further Promoting Healthy Development of the Capital Market</td>
<td>State Council</td>
<td>Fosters a fair and open private equity market, removes administrative approvals from private equity issuance, calls for domestic securities and futures companies to invest in foreign markets, and aims to address illegal activities in the securities and futures market.</td>
<td>Moderate: Reduces administrative approvals for securities companies, and has a broader indirect impact for other companies in promoting a more open private equity market.</td>
</tr>
<tr>
<td>3/21/14</td>
<td>Regulations on the Preferred Stock Pilot Program</td>
<td>CSRC</td>
<td>Allows listed companies to issue preferred shares.</td>
<td>Limited: Only impacts companies listed on public exchanges in China.</td>
</tr>
<tr>
<td>4/25/14</td>
<td>Notice on Further Tightening Risk Control of Fund Management Companies and Subsidiaries</td>
<td>CIRC</td>
<td>Reduces the risk of specific client asset management business conduct by subsidiaries by banning certain business practices.</td>
<td>Limited: Increases supervision of financial institutions, but impact on foreign companies limited.</td>
</tr>
<tr>
<td>5/13/14</td>
<td>Opinions on Stimulating Innovation and Development in Securities Institutions</td>
<td>CSRC</td>
<td>Promotes the development of modern investment banks; supports development of new products in asset management, bulk stock, derivatives and private equity; and improves supervision.</td>
<td>Limited: Contains positive language about liberalizing trade, but does not include any substantive changes that would increase market access.</td>
</tr>
<tr>
<td>4/19/13</td>
<td>Rules for the Content and Format of Information Disclosure by Companies Offering Securities</td>
<td>CSRC</td>
<td>Sets new rules for the format and content of quarterly and semiannual reports by listed companies.</td>
<td>None: Constitutes process improvements with limited scope.</td>
</tr>
</tbody>
</table>
## VII. Pricing Reform and Competition Policy

### Pricing Reforms

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<thead>
<tr>
<th>Date</th>
<th>Title</th>
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<th>Summary</th>
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</thead>
<tbody>
<tr>
<td>8/8/13</td>
<td>Notice on Near-Term Energy Market Supervision Work</td>
<td>NEA</td>
<td>Promotes electricity market supervision, increases direct trading between power companies and consumers, and boosts cost and price supervision.</td>
<td>Moderate: Advances central government reforms to allow the market to play a greater role in determining energy prices.</td>
</tr>
<tr>
<td>9/30/13</td>
<td>Pricing Case Administrative Penalty Review Rules</td>
<td>NDRC</td>
<td>Provides instructions for price departments at all levels on the review process of administrative penalty cases, and further standardizes the pricing department’s authority in dealing with administrative punishment cases.</td>
<td>Moderate: Improves and standardizes the investigation process for pricing-related cases, signaling a step forward in improving transparency - even though changes are primarily process-oriented.</td>
</tr>
<tr>
<td>1/21/14</td>
<td>Revised Rules on the Handling of Whistleblowing for Illegal Pricing Behavior</td>
<td>NDRC</td>
<td>Allows whistleblowers to inform price authorities of illegal pricing behavior; where an alleged wrongdoer causes consumers to overpay due to its illegal pricing activities, the competent price authorities shall order the wrongdoer to refund the overpaid money to consumers before further administrative penalties are imposed.</td>
<td>Moderate: Promotes market-based pricing and efforts to crack down on illegal pricing behaviors, which could have both positive and negative impacts for foreign companies.</td>
</tr>
<tr>
<td>7/2/13</td>
<td>Announcement Setting On-Grid Nuclear Power Price</td>
<td>NDRC</td>
<td>Sets the benchmark on-grid nuclear power price at RMB 0.43 (US $0.07) per kWh for newly built reactors in China.</td>
<td>Limited: Represents a small step in reforming prices in one sector of the energy industry, but the impact is extremely limited.</td>
</tr>
<tr>
<td>11/15/13</td>
<td>Announcements on the Market Adjusted Price for the Charges of Mobile Communications Resale Services under the Pilot Program</td>
<td>MIIT, NDRC</td>
<td>Specifies that market prices will be used for local calls, long distance calls, roaming calls, short messages, multimedia messages, data and other resale services operated by resale enterprises under the pilot program and that the restriction of differential pricing for intranet and extranet upon resale enterprises will be cancelled.</td>
<td>Limited: Allows the market to play a greater role in pricing, but only for specific to telecom service providers in the mobile resale pilot program, which does not currently include any foreign companies.</td>
</tr>
<tr>
<td>4/15/14</td>
<td>Opinions on the Supply of Low-Cost Common Drugs</td>
<td>NDRC, MHRSS, NHFPC, MOF, CFDA</td>
<td>Improves price regulation and abolishes price ceilings on certain types of low-cost drugs.</td>
<td>Limited: Marks a significant change to a priority set of pricing policies, but impact limited to one sub-sector (common/low-cost drugs) of one industry (pharmaceuticals) that is dominated by domestic players.</td>
</tr>
</tbody>
</table>
1/16/14  **Guiding Opinions on the Online Handling of Cases Involving Administrative Penalties for Price-Related Violations**  
NDRC  
Makes price authorities with administrative law enforcement information platforms responsible for approving price activities, managing evidence, and handling other price-related tasks.  
None: Process-oriented guiding opinions, with no real impact on foreign companies.

### Competition Policy

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</thead>
</table>
| 8/28/13  | **Work Plan on Eliminating Regional Blockades and Breaking Up Industry Monopolies**  
MOFCOM, CBRC, CSRC, CIRC, and seven other ministries and agencies | Describes work to promote fairer, more market-based competition in general terms. | Limited: Describes planned work to increase pressure on regional monopolies and promote equal market access, but does yet not make any meaningful changes to policy. |                                             |

### VIII. Rule of Law/Legal and Judicial Reform

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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>10/30/13</td>
<td><strong>National People's Congress Legislative Plan</strong></td>
<td>NPC</td>
<td>Lays out 68 central government legislative priorities for the next five years, including the Anti-Unfair Competition Law, as well as three laws related to foreign-invested enterprises – the Wholly Foreign-Owned Enterprise, Cooperative Joint Venture, and Equity Joint Venture laws.</td>
<td>Significant: Lays out guidelines for China's key reforms over the next five years, including work to revise some core laws related to investment and operations. To date, the impact is largely aspirational.</td>
</tr>
</tbody>
</table>
| 10/1/13  | **Opinions on Continuing to Strengthen Government Information Transparency and Improve Government Credibility**  
State Council | Encourages government departments to better explain policies and regulations to the public in a timely and accurate manner, calling for government departments that deal with people’s livelihood and the macro-economy to hold at least one press conference every three months. It also stresses the need to make better use of government websites, hotlines and other forms of communication. | Moderate: Signals that the central government is serious about improving transparency, but focuses more on encouraging agencies to boost transparency than providing specific requirements to do so. |                                             |
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<tbody>
<tr>
<td>2/4/14</td>
<td>Opinions on Publishing Information Relating to Administrative Penalty Cases Involving Producing and Selling Counterfeits and Infringement of Intellectual Property Rights</td>
<td>State Council</td>
<td>Requires administrative enforcement agencies to proactively disclose information relating to administrative penalty cases involving counterfeiting and IPR infringement within 20 working days of an administrative decision.</td>
<td>Moderate: Improves IPR enforcement and transparency, though it does not address core issues of IPR protection.</td>
</tr>
<tr>
<td>11/22/13</td>
<td>Opinions on Further Strengthening the Administrative Law Enforcement Related to Commerce</td>
<td>MOFCOM</td>
<td>Takes various measures to increase transparency in law enforcement and administration.</td>
<td>Limited: Increases transparency in commercial law enforcement, but does not create new market openings or directly address a significant operational concern.</td>
</tr>
<tr>
<td>6/8/13</td>
<td>Announcement Implementing Effective Regulatory Documents and Abolishing Some Regulatory Documents</td>
<td>AQSIQ</td>
<td>Announces an AQSIQ review of more than 1,000 internal regulatory documents -- and the elimination of 58 of these as &quot;unnecessary.&quot;</td>
<td>None: Eliminates unnecessary regulatory documents, but only represents a process-oriented reform for AQSIQ.</td>
</tr>
<tr>
<td>5/4/14</td>
<td>Administrative Measures for Tendering and Bidding on Telecommunication Construction Projects</td>
<td>MIIT</td>
<td>Adopts public bidding for telecommunication construction projects in which a state-owned capital possesses a holding or leading position, stating that such bids are subject to a bid invitation process in accordance with the law.</td>
<td>None: No impact on foreign companies, as they are largely restricted from operating in this space.</td>
</tr>
</tbody>
</table>

**IX. Taxation and Budget**

**Taxation**

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
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</thead>
<tbody>
<tr>
<td>5/24/13</td>
<td>Announcement Implementing VAT Pilot Projects Nationwide in Transport and some Service Industries</td>
<td>SAT</td>
<td>Expands local value-added tax (VAT) reform pilot covering some transportation and services areas nationwide as of August 1, 2013.</td>
<td>Limited: Promotes some measure of tax reform for the transportation and a few service industries sector.</td>
</tr>
<tr>
<td>4/27/13</td>
<td>Announcement on Tax Exemption of Interest on Local Government Bonds</td>
<td>MOF, SAT</td>
<td>Eliminates two taxes on interest paid on local government bonds to make the bonds more attractive to domestic investors.</td>
<td>None: Focused on individual domestic investors with minimal changes.</td>
</tr>
</tbody>
</table>
### Budget/Debt Issues

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
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<th>Summary</th>
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</tr>
</thead>
<tbody>
<tr>
<td>1/10/14</td>
<td>Announcement on 2012 Central Budget Implementation and the Rectification of Other Issues Concerning Financial Revenue and Expenditure Audits Problem</td>
<td>NAO</td>
<td>Lays out direction of reform in several areas, including the government fund budget management, regional tax incentives adjustment, the state capital operating budget management, transfer payments management, etc.</td>
<td>Moderate: Clarifies that MOF will explicitly decouple regional development from tax incentives, a step towards addressing discriminatory tax policies.</td>
</tr>
<tr>
<td>1/24/14</td>
<td>Notice on Promoting Government Procurement of Services Related to Budget Management</td>
<td>MOF</td>
<td>Promotes government procurement of services related to budget management.</td>
<td>None: Internal process related policy that does not directly impact foreign companies.</td>
</tr>
</tbody>
</table>

### Corruption, Bribery and Party Discipline

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
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<th>Summary</th>
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</thead>
<tbody>
<tr>
<td>8/13/13</td>
<td>Notice Banning Extravagant Official Galas</td>
<td>CCP Propaganda Department, MOF, MOC, NAO, SAPPRFT</td>
<td>Prohibits extravagant official galas and punishes those who organize such events. Restrictions the use of government funds to hold commercial celebrations or pay for expensive entertainment.</td>
<td>Moderate: Standardizes government behavior in line with international best practices, but the immediate impact is negative for the hospitality industry and may require changes in local government affairs practice.</td>
</tr>
<tr>
<td>12/13/13</td>
<td>Implementing Opinions on Rectifying Improper Practices in Procurement and Sales of Medicines and Medical Services</td>
<td>NHFPC, NDRC, MIIT, MOF</td>
<td>Enacts campaign against improper practices in pharmaceutical sales and medical service.</td>
<td>Moderate: Improves transparency in hospital procurement process, but will have a negative impact on companies with drug prescription incentive programs at hospitals.</td>
</tr>
<tr>
<td>1/23/14</td>
<td>Notice Implementing Opinion to Further Combat Corruption in Pharmaceutical Sales and Purchasing and Illegal Medical Practices</td>
<td>NHFPC, NDRC, MOF</td>
<td>Sets measures to tackle corruption in pharmaceutical sales and medical services practices in an effort reduce artificially high prices of some drugs.</td>
<td>Moderate: Could have an important impact, both positive and negative, for companies in the healthcare sector.</td>
</tr>
<tr>
<td>11/25/13</td>
<td>Regulations on Reducing and Addressing Waste by Party and Government Agencies</td>
<td>CCP, State Council</td>
<td>Requires agencies to reduce unnecessary government expenditures.</td>
<td>Limited: Promotes the central government's anti-corruption efforts, but does not have much direct impact for foreign companies.</td>
</tr>
<tr>
<td>Date</td>
<td>Policy Title</td>
<td>Agency</td>
<td>Description</td>
<td>Limited</td>
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</tr>
<tr>
<td>12/25/13</td>
<td>Provisions on Establishing a Commercial Bribery Blacklist in the Pharmaceutical Industry</td>
<td>NHFPC</td>
<td>Creates new mechanisms to expose companies in the pharmaceutical industry that engage in commercial bribery. All public medical institutions in China will be prohibited for a period of two years from purchasing drugs, medical equipment and medical supplies from enterprises included on the &quot;blacklist&quot; for more than two within five years.</td>
<td>The blacklist -- when created -- would limit corruption in the industry in line with international best practices. The blacklist would have an impact, both positive and negative, for companies in the healthcare sector and their operating practices.</td>
</tr>
<tr>
<td>12/31/13</td>
<td>Administrative Measures on Central and State Organ Travel</td>
<td>MOF</td>
<td>Requires government agencies to cut down on waste from business travel expenses incurred by government branches.</td>
<td>Advances government efforts to reduce corruption and excessive spending.</td>
</tr>
<tr>
<td>3/18/14</td>
<td>Opinions on Reducing and Addressing Waste by Party and Government Agencies</td>
<td>State Council</td>
<td>Charges officials and agencies with the goal of reducing wasted food for official activities.</td>
<td>Has no direct impact for foreign companies, though it may have an indirect impact for restaurant and hospitality companies.</td>
</tr>
<tr>
<td>4/1/14</td>
<td>Implementation Measures for the Anti-Corruption Punishment and Prevention Work Plan (2013-17)</td>
<td>SASAC</td>
<td>Lays out implementation measures for SASAC's anti-corruption work.</td>
<td>Addresses both anti-corruption efforts and reforms promoting more accountability by China's SOEs, but only an indirect impact for foreign companies.</td>
</tr>
<tr>
<td>4/28/14</td>
<td>Guidance on Anti-Money-Laundering of Securities Companies</td>
<td>SAC</td>
<td>Requires securities companies to establish and improve an internal anti-money laundering control system, which shall include but not be limited to a client identification and risk grading system, a block trade and suspicious transaction reporting system, a client identity materials and trade records retention system, a confidentiality system, and a publicity and training system.</td>
<td>Addresses corruption in the financial services sector, but applies only to securities companies in China.</td>
</tr>
</tbody>
</table>
## XI. Urban/Rural Issues

### Urbanization

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<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
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</thead>
<tbody>
<tr>
<td>3/16/14</td>
<td>New National Urbanization Plan (2014-2020)</td>
<td>State Council</td>
<td>Improves regulation of the migration of rural residents into urban areas, with a focus on sustainable infrastructure development and raising living standards.</td>
<td>Significant: Allows rural citizens broader access to urban social services. This could lead to increased domestic consumption—a step toward rebalancing China’s economy and creating market opportunities, and could also encourage controlled migration and provide access to new human resources for a range of foreign companies.</td>
</tr>
</tbody>
</table>

### Hukou/Household Registration Reform
None

### Other Urban/Rural Policies

<table>
<thead>
<tr>
<th>Date</th>
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</thead>
<tbody>
<tr>
<td>3/10/14</td>
<td>Opinions on Comprehensively Deepening Rural Reforms and Accelerating the Modernization of the Agricultural Industry</td>
<td>State Council</td>
<td>Assigns specific ministries and agencies responsibility for various aspects of rural reform, including food security, surveys of agricultural land and activities, better utilization of investment and financial capital, and promotion of agriculture-related services such as crop insurance.</td>
<td>Limited: No direct impact for foreign companies as the main target is government agencies, but some indirect impact depending on how projects and goals are implemented.</td>
</tr>
<tr>
<td>4/21/14</td>
<td>Pilot Project to Promote Comprehensive Rural Reform</td>
<td>SAC, MOFCOM</td>
<td>Establishes a set of standards for dealing with asset allocation, infrastructure projects, and services in rural areas.</td>
<td>Limited: Reforms limited to rural areas, with no indication of private or foreign participation.</td>
</tr>
<tr>
<td>9/10/13</td>
<td>Notice on Conducting New Rural Medical Cooperative Work in 2013</td>
<td>NHFPC, MOF</td>
<td>Expands pilot areas to allow urban and rural residents to use new rural cooperative fund to buy catastrophic insurance on the basis of the previous reforms.</td>
<td>None: Focused squarely on domestic-driven goals of improving China’s government-run social security system.</td>
</tr>
<tr>
<td>Date</td>
<td>Title</td>
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<td>Summary</td>
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<tr>
<td>9/13/13</td>
<td>Opinions on Accelerating the Development of the Pension Services Industry</td>
<td>State Council</td>
<td>Establish a government-supported, comprehensive pension service industry to cover urban and rural residents before 2020.</td>
<td>None: Focused squarely on domestic-driven goals of improving China's government-run social security system.</td>
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<td><strong>XII. Other</strong></td>
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</tr>
<tr>
<td>9/28/13</td>
<td>Opinions on Promoting the Development of Healthcare Services</td>
<td>State Council</td>
<td>Opens investment to private capital and promotes market-based pricing in the healthcare industry.</td>
<td>Limited: Opens some healthcare services to private investment by applying a &quot;negative list&quot; for private investment in these areas. While there should be some indirect impact from more market-oriented pricing for companies in this space, private capital does not likely include foreign investment.</td>
</tr>
<tr>
<td>11/22/13</td>
<td>Notice Launching Pilot Carbon Emissions Trade</td>
<td>Beijing Municipal Development and Reform Commission</td>
<td>Launches a pilot carbon trading platform in Beijing.</td>
<td>Limited: Promotes market-based emissions trading programs, but the geographic impact is limited, and details of how the regime would work are not yet released.</td>
</tr>
<tr>
<td>1/3/14</td>
<td>Administrative Measures on Non-Bidding Government Procurement Methods</td>
<td>MOF</td>
<td>Clarifies the circumstances that apply to three different kinds of non-bidding government procurement methods: competitive negotiation, single-source procurement and price inquiry.</td>
<td>Limited: Advances efforts to promote a more open, fair government procurement system, but minimal in terms of actual change.</td>
</tr>
<tr>
<td>3/12/14</td>
<td>Guiding Opinions on Promoting Pension Agency Liability Insurance Work</td>
<td>MCA, CIRC, National Office on Aging</td>
<td>Promotes the establishment of a liability insurance system for pension agencies.</td>
<td>Limited: Impact is limited to the insurance industry, with no clear market openings for foreign companies.</td>
</tr>
<tr>
<td>3/21/14</td>
<td>Opinions on Undertaking Further Work on Constructing an Agricultural Product Market System</td>
<td>MOFCOM</td>
<td>Promotes diversified development of retail market and strengthens the market’s ability to cultivate modern circulation enterprises.</td>
<td>Limited: Increases the market role in China’s agricultural sector, but limited to that sector.</td>
</tr>
<tr>
<td>4/8/14</td>
<td>Opinion on Comprehensive Reform to County-Level Public Hospitals</td>
<td>MOF</td>
<td>Encourages cross-provincial drug tendering to promote drug safety and lower drug prices.</td>
<td>Limited: Step forward in applying more transparent procurement practices, but does not directly provide new market access opportunities for foreign companies.</td>
</tr>
<tr>
<td>Date</td>
<td>Notice Title</td>
<td>Authority</td>
<td>Summary</td>
<td>Limitation</td>
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<tr>
<td>4/9/14</td>
<td>Notice on Issues Concerning the Implementation of Market Pricing for the Non-Public Healthcare Sector</td>
<td>NDRC, NHFPC, MHRSS</td>
<td>Encourages private capital to enter the healthcare sector, expand the supply of medical services, improve the efficiency of medical services, meet the needs of multi-level medical services, promote development of medical services and foster orderly competition of the healthcare sector.</td>
<td>Limited: Some indirect impact of market-oriented pricing for companies in this sector. While the notice also promotes the role of private capital in the healthcare sector, private capital does not likely include foreign investment.</td>
</tr>
<tr>
<td>4/29/14</td>
<td>Notice on Extending Preferential Tax Policies in Support of Entrepreneurship and Employment</td>
<td>MOF, SAT, MHRSS</td>
<td>Grants business startups and employers that are willing to hire the unemployment tax breaks as the Chinese central government looks to encourage employment amid the economic slowdown.</td>
<td>Limited: Scope only applies to small businesses, impact limited on MNCs.</td>
</tr>
</tbody>
</table>
# Appendix 3: Policy Announcements Related to the Shanghai Free Trade Zone

## I. Overall Reform

<table>
<thead>
<tr>
<th>Date</th>
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<tbody>
<tr>
<td>9/18/13</td>
<td>Notice on the General Plan for the China (Shanghai) Pilot Free Trade Zone</td>
<td>State Council</td>
<td>Outlines the general provisions for the Shanghai Free Trade Zone (SFTZ) and highlights sectors open to foreign investment.</td>
<td>Moderate: Opens multiple areas to foreign investment in financial services, logistics, and other professional services. Impact for many of these areas is limited to Shanghai. While this policy made few major policy changes, it prompted follow-up policies that have started to do so.</td>
</tr>
</tbody>
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## II. Foreign Investment

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<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>9/29/13</td>
<td>China (Shanghai) Free Trade Zone Foreign Investment Access Special Management Measures (Negative List) (2013)</td>
<td>Shanghai Municipal Government</td>
<td>Defines specific industry categories restricted to foreign investment, while allowing foreign investment in sectors that are not listed.</td>
<td>Moderate: List is a clear transition to a negative list approach in the FTZ, with coverage of a broad range of industries - but the negative list itself largely restates existing restrictions, and thus represents no major openings to date. In addition, the scope is limited to Shanghai only. To date, the impact is largely aspirational.</td>
</tr>
<tr>
<td>12/21/13</td>
<td>Decision to Temporarily Adjust Relevant Administrative Regulations and Documents in the China (Shanghai) Free Trade Zone</td>
<td>State Council</td>
<td>Reforms foreign investment management models, expands the opening up of service sector, and temporarily adjusts provisions relating to administrative approvals.</td>
<td>Moderate: Reduces administrative requirements for foreign companies establishing in the SFTZ and eases approval requirements for services companies. Impact limited to the SFTZ.</td>
</tr>
<tr>
<td>Date</td>
<td>Title</td>
<td>Agency/Agencies</td>
<td>Summary</td>
<td>Impact</td>
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</tr>
<tr>
<td>1/6/14</td>
<td>Decision on the China (Shanghai) Pilot Free-Trade Zone Interim Adjustments Regarding Administrative Regulations and the Administrative Examination and Approval and Special Management Measures</td>
<td>State Council</td>
<td>Adjusts regulations on foreign investment models, and promotes expansion of the services sector.</td>
<td>Moderate: Temporarily suspends approval requirements for companies registered in the SFTZ. Impact limited to the SFTZ.</td>
</tr>
<tr>
<td>4/9/14</td>
<td>Arbitration Rules for the China (Shanghai) Pilot Free Trade Zone</td>
<td>Shanghai International Economic and Trade Arbitration Commission</td>
<td>Specifies arbitration rules for dispute settlements in the SFTZ.</td>
<td>Moderate: Allows companies across sectors more freedom to select dispute settlement channels, but the scope is limited to the SFTZ.</td>
</tr>
<tr>
<td>1/6/14</td>
<td>Opinion on Further Opening up Value-Added Telecommunications Services in China (Shanghai) Pilot Free Trade Zone</td>
<td>MIIT, Shanghai Municipal Government</td>
<td>Further opens seven pilot value-added telecommunications business areas to foreign investors.</td>
<td>Limited: Step forward in increasing market access for foreign telecom companies, but the sectors and areas for openings do not address top company concerns.</td>
</tr>
</tbody>
</table>

### III. Administrative Licensing and Approval Reform

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>10/1/13</td>
<td>Decision on Temporarily Adjusting Relevant Local Laws and Regulations in the China (Shanghai) Free Trade Zone</td>
<td>Shanghai People's Congress</td>
<td>Suspends local regulations on foreign investment in the SFTZ for three years.</td>
<td>Moderate: Suspends local regulations on foreign investment in the Shanghai Free Trade Zone. Impact is broad and touches on a top foreign company issue -- but is limited only to Shanghai.</td>
</tr>
<tr>
<td>10/21/13</td>
<td>China (Shanghai) Pilot Free Trade Zone Enterprises Registration and Management Provisions</td>
<td>Shanghai Industry and Commerce Bureau</td>
<td>Specifies the registration procedures for foreign companies in the SFTZ.</td>
<td>Moderate: Simplifies and shortens approval process for foreign companies -- but only in the SFTZ.</td>
</tr>
<tr>
<td>4/30/14</td>
<td>Measures on Commitment Mechanisms for Inspection Agency Validation and for Measurement Certification</td>
<td>Shanghai Administration of Quality and Technology Supervision</td>
<td>Simplifies the administration approval process for inspection agencies.</td>
<td>Limited: Eases the approval process for companies but in a very limited sector.</td>
</tr>
</tbody>
</table>
IV. Institutional Reforms
None

V. Role of the State and the Market

SOE Reform
None

Private Capital

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
<th>Impact</th>
</tr>
</thead>
</table>

VI. Financial Reforms

Banking/Interest Rates

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>9/29/13</td>
<td>Notice on Banking Supervision Issues in China (Shanghai) Pilot Free Trade Area</td>
<td>CBRC</td>
<td>Allows qualified private investors to set up private banks, financial leasing companies, consumer finance companies and other financial institutions in the SFTZ.</td>
<td>Moderate: Permits foreign-invested banks to carry out business in the FTZ, but direct impact limited to the banking sector.</td>
</tr>
<tr>
<td>9/29/13</td>
<td>Circular on Regulation of the Banking Sector in China (Shanghai) Pilot Free Trade Zone</td>
<td>CBRC</td>
<td>Supports the establishment of non-banking finance companies in the SFTZ; allows foreign-invested banks to carry out business in the SFTZ; encourages private capitals to participate in the banking industry of the SFTZ; and encourages cross-border service and financing in the SFTZ.</td>
<td>Moderate: Provides market openings for foreign banks to operate in the SFTZ, and encourages cross-border investment in financial services and offshore business. Direct impact for the banking sector; indirect impact for others.</td>
</tr>
</tbody>
</table>
### Exchange Rate/Foreign Exchange

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>2/18/14</td>
<td>Implementing Opinions for Shanghai Payment Agencies Carrying Out Cross-Border RMB Payment Services in Shanghai</td>
<td>PBOC</td>
<td>Allows offshore RMB borrowing in the SFTZ.</td>
<td>Moderate: Allows companies registered in the SFTZ to use RMB in cross-border transactions, and eases the review process for RMB settlement.</td>
</tr>
<tr>
<td>2/21/14</td>
<td>Opinions on Promoting Cross-Border RMB Business in the SFTZ</td>
<td>PBOC</td>
<td>Clarifies operational details for conducting cross-border business in RMB through the SFTZ.</td>
<td>Moderate: Promotes internationalization of the RMB and eliminates approvals for lenders operating within the SFTZ.</td>
</tr>
</tbody>
</table>

### Insurance

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>9/29/13</td>
<td>Eight Measures to Support SFTZ</td>
<td>CIRC</td>
<td>Strengthens insurance in China by encouraging foreign-invested specialized health insurance institutions, the development of cross-border RMB-denominated insurance business, outbound investment by health insurance institutions in the SFTZ, development of shipping insurance, fostering of social organizations, and innovation in insurance products.</td>
<td>Moderate: Carries high importance for insurance industry, with specific mention of openings for foreign-invested specialized health insurance institutions setting up in the FTZ.</td>
</tr>
</tbody>
</table>
## Securities and Private Equity

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>9/29/13</td>
<td><strong>Certain Measures to Support SFTZ</strong></td>
<td>CSRC</td>
<td>Allows the founding of an energy trading center in Shanghai; permits qualified individuals and entities in the SFTZ to invest in domestic and foreign securities and future markets; allows foreign parent companies invested in the SFTZ to issue RMB bonds in the domestic market; permits securities and futures institutions to set up specialized subsidiaries in the SFTZ; and allows securities and futures institutions to carry out over-the-counter (OTC) transactions.</td>
<td>Moderate: Creates market openings for companies in various sectors to participate financially in the SFTZ. Though the opportunities are only offered in Shanghai, many of these services (such as participating in bond markets) can be done nationwide from Shanghai, broadening the impact.</td>
</tr>
</tbody>
</table>

### VII. Pricing Reform and Competition Policy
None

### VIII. Rule of Law/Legal and Judicial Reform
None

### IX. Taxation and Budget

<table>
<thead>
<tr>
<th>Date</th>
<th>Title</th>
<th>Agency/Agencies</th>
<th>Summary</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/2/13</td>
<td><strong>Circulars on Issues Concerning Policies for Enterprise Income Tax on Outbound Investment with Non-Monetary Assets or Asset Restructuring Transactions in the China (Shanghai) Pilot Free Trade Zone (FTZ)</strong></td>
<td>MOF, SAT</td>
<td>Allows enterprises registered in SFTZ to pay enterprise income tax (EIT) in installments over five years dating from confirmation of gains from the transfer of non-monetary assets.</td>
<td>Moderate: Broad sector impact on companies, but limited only to one area of operations and applicable only to companies registered to the SFTZ.</td>
</tr>
</tbody>
</table>
**Notice on Tariff Policies for Imports in the China (Shanghai) Pilot Free Trade Zone**

**Exempts producers in the SFTZ from import duties when they import required machinery, equipment and other goods. However, the imported goods of consumer service enterprises and other enterprises, as well as goods that legal and administrative regulations and relevant provisions explicitly excluded are not included in this duty-exempt category.**

**Limited:** Provides tax exemptions for a subset of companies, but does not apply to all industries -- and only applies to companies producing in the SFTZ.

| 10/24/13 | Notice on Tariff Policies for Imports in the China (Shanghai) Pilot Free Trade Zone | MOF, GAC, SAT | Exempts producers in the SFTZ from import duties when they import required machinery, equipment and other goods. However, the imported goods of consumer service enterprises and other enterprises, as well as goods that legal and administrative regulations and relevant provisions explicitly excluded are not included in this duty-exempt category. |

**X. Corruption, Bribery and Party Discipline**
None

**XI. Urban/Rural Issues**
None

**XII. Other**
None
### Appendix 4: Abbreviations for Chinese Government Agencies

This list includes the full names for the Chinese official ministries, agencies, and organizations listed in Appendices 2 and 3.

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>CBRC</td>
<td>China Banking Regulatory Commission</td>
</tr>
<tr>
<td>CCP</td>
<td>Chinese Communist Party</td>
</tr>
<tr>
<td>CFDA</td>
<td>China Food and Drug Administration</td>
</tr>
<tr>
<td>CIRC</td>
<td>China Insurance Regulatory Commission</td>
</tr>
<tr>
<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
</tr>
<tr>
<td>GAC</td>
<td>General Administration of Customs</td>
</tr>
<tr>
<td>MCA</td>
<td>Ministry of Civil Affairs</td>
</tr>
<tr>
<td>MEP</td>
<td>Ministry of Environmental Protection</td>
</tr>
<tr>
<td>MHRSS</td>
<td>Ministry of Human Resources and Social Security</td>
</tr>
<tr>
<td>MIIT</td>
<td>Ministry of Industry and Information Technology</td>
</tr>
<tr>
<td>MLR</td>
<td>Ministry of Land Resources</td>
</tr>
<tr>
<td>MOC</td>
<td>Ministry of Culture</td>
</tr>
<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>MOFCOM</td>
<td>Ministry of Commerce</td>
</tr>
<tr>
<td>MOHURD</td>
<td>Ministry of Housing and Urban-Rural Development</td>
</tr>
<tr>
<td>MOST</td>
<td>Ministry of Science and Technology</td>
</tr>
<tr>
<td>NAO</td>
<td>National Audit Office</td>
</tr>
<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
</tr>
<tr>
<td>NEA</td>
<td>National Energy Administration</td>
</tr>
<tr>
<td>NHFPC</td>
<td>National Health and Family Planning Commission</td>
</tr>
<tr>
<td>NPC</td>
<td>National People’s Congress</td>
</tr>
<tr>
<td>PBOC</td>
<td>People’s Bank of China</td>
</tr>
<tr>
<td>SAC</td>
<td>Standardization Administration of China</td>
</tr>
<tr>
<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
</tr>
<tr>
<td>SAIC</td>
<td>State Administration of Industry and Commerce</td>
</tr>
<tr>
<td>SAPPRT</td>
<td>State Administration of Press, Publication, Radio, Film and Television</td>
</tr>
<tr>
<td>SASAC</td>
<td>State-Owned Assets Supervision and Administration Commission</td>
</tr>
<tr>
<td>SAT</td>
<td>State Administration of Taxation</td>
</tr>
</tbody>
</table>

Executive Summary

Transparency— including solicitation of public feedback during the creation of new laws and regulations, open government decision-making, and the ability to access information—is consistently cited as a top concern for US-China Business Council (USCBC) member companies in USCBC’s annual membership survey on China’s business environment. As part of efforts to monitor this issue, USCBC conducts an annual review of selected PRC government agencies’ records in increasing transparency in their rule-making processes. This year’s report, covering January to December 2013, shows that China continues to significantly lag in its commitments and implementation in promoting regulatory transparency. The National People’s Congress (NPC), China’s legislative body, and the State Council, the equivalent of the United States’ cabinet, have made high-level commitments to improve regulatory transparency. In 2008, the NPC announced that it would solicit public comments on most draft laws and amendments it reviews. The State Council pledged in 2008, 2011, and 2012 to release drafts of all trade- and economic-related administrative regulations and departmental rules for 30-day public comment periods.

- USCBC analysis of the NPC, the State Council, and selected government agencies shows varying levels of compliance with these transparency commitments and that all agencies need considerable improvement.
- The NPC continues to have a mixed, though slightly improved record of posting draft laws for comment for a full 30-day period. Sixty-six percent of laws passed over a recent twelve-month period had been published to the NPC website for comment at some point during their drafting process.
- The State Council posted less than 10 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. During the twelve-month period tracked in this report, the seven agencies tracked—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)—posted a small fraction of relevant documents for comment on either the SCLAO or their respective agency websites: Less than 10 percent of regulations to the SCLAO site and less than 17 percent of additional regulations to their agency sites.
- Part of the challenge of tracking transparency lies with the lack of clarity about what regulations fall under China’s commitments. USCBC’s report uses two filters for including regulations in the report: A “narrow” interpretation that includes only those documents explicitly labeled as State Council or departmental administrative regulations in other legal documents, and a “broad” interpretation that includes other regulations that appear to function as State Council or departmental administrative regulations.
- Among the small percentage of regulations that are posted for public comment in line with State Council’s commitments, however, the majority is posted for at least the full 30-day period, and the average comment period for administrative regulations and departmental rules posted for public comment on either the SCLAO or agency websites exceeded 24 days.

USCBC recommends that the PRC government ensure that all administrative regulations and departmental rules are posted on the designated SCLAO information website comment page for a full 30-day public comment period. The office should also consider going further by posting for a longer comment period of 60 or 90 days. For additional recommendations, see page 8.
China’s record of regulatory transparency — soliciting public feedback on new laws and regulations, open government decision-making, and the public’s ability to access information — continues to be a top concern for US-China Business Council (USCBC) member companies. Since 2009, USCBC has monitored the drafting and issuance of relevant PRC laws and regulations to determine whether they have been posted for comment on the websites of the National People’s Congress (NPC), State Council Legislative Affairs Office (SCLAO), and other government agencies for a 30-day period. USCBC then publishes a detailed report summarizing the results. This is the sixth report USCBC has issued on China’s transparency efforts since 2009 and covers the 12-month period from January to December 2013.

This year’s report shows that China continues to fall short in meeting its commitments in promoting regulatory transparency.

- The NPC continues to have an inconsistent record of making draft laws available for public comment on its website for a full 30-day period. For example, 66 percent of laws passed over the recent 12-month period had been published to the NPC website for comment at some point during the drafting process.

- The State Council and other selected government agencies show varying levels of compliance with bilateral transparency commitments, and USCBC analysis shows that all agencies need considerable improvement. The State Council posted less than 10 percent of its own administrative regulations and departmental rules for public comment on the SCLAO website. Other government agencies did no better, posting only a small fraction of relevant documents for comment on either the SCLAO or their respective agency websites. Less than 20 percent of relevant documents were posted to either the SCLAO site or a government agency website.

**Detailed Methodology**

USCBC’s analysis has focused on areas in which the central government has stated, either on its own or through bilateral agreements, its intentions to improve transparency, including:

- Compliance with the NPC Standing Committee’s April 2008 announcement that, to promote open participation in its legislative process, it would solicit public comments on most draft laws and amendments it reviews (www.npc.gov.cn/npc/flcrazqyj/2008-04/22/content_1464905.htm);

- Adherence to the June 2008 Strategic Economic Dialogue (SED IV) commitment to “publish for public comment all trade and economic-related administrative regulations and departmental rules” for at least 30
days on the SCLAO information website comment pages (www.treasury.gov/initiatives/Documents/sedjointfactsheet.pdf);  

- Compliance with the State Council’s 2010 directive to “strengthen” compliance with its transparency commitments (www.gov.cn/zwgk/2010-11/08/content_1740765.htm);  

- Adherence to the May 2011 Strategic & Economic Dialogue (S&ED) commitment requiring that “all proposed trade- and economic-related administrative regulations and departmental rules be published” for at least 30 days on the SCLAO website (www.treasury.gov/press-center/press-releases/Pages/TG1172.aspx);  

- Compliance with SCLAO’s April 2012 Interim Measures on Draft Laws and Regulations for Public Comment that states that relevant draft regulations should “in general” be released for a 30-day comment period (www.chinalaw.gov.cn/article/cazjgg/201204/20120400367358.shtml); and  

- Other efforts to increase transparency, including policies implemented in accordance with the State Council’s Regulations on the Disclosure of Government Information (www.gov.cn/zwgk/2007-04/24/content_592937.htm) issued in May 2008.

As in previous years’ reports, this report tracks the drafting and issuance of relevant laws and regulations by the NPC, SCLAO, and government agencies to assess China’s compliance with its transparency commitments. These agencies were selected because they play key roles in formulating trade-related regulations that are important for US companies doing business in China. USCBC also monitored key subsidiary agencies such as the National Energy Administration (NEA) under the National Development and Reform Commission. The agencies examined are:

- National Development and Reform Commission (NDRC), including the NEA and State Administration of Grain (SAG)  
- Ministry of Commerce (MOFCOM)  
- Ministry of Finance (MOF)  
- Ministry of Industry and Information Technology (MIIT)  
- General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), including the Standardization Administration of China (SAC) and the Certification and Accreditation Administration of the People’s Republic of China (CNCA)  
- State Administration of Industry and Commerce (SAIC), including the China Trademark Office (CTMO)  
- Ministry of Human Resources and Social Security (MOHRSS)

To compile data for this report, USCBC staff conducted regular, detailed reviews of relevant agency websites on a fixed schedule. USCBC also monitored other government websites, press sources, and a broad mix of information channels to identify measures that directly or indirectly related to business concerns in China.

Chinese regulations do not provide explicit guidance as to what documents formally constitute the “trade and economic-related administrative regulations and departmental rules” cited in China’s June 2008 SED IV and May 2011 S&ED transparency commitments. While these commitments did not formally define which regulatory documents would fall under these rules, other PRC laws and regulations provide clues as to what types of regulations and departmental rules should be included.²

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1 SCLAO posts documents for public comment on several websites, including yijian.china law.gov.cn/lisms/action/guestLoginAction.do (State Council documents); bmyj.china law.gov.cn/lisms/action/guestLoginAction.do (ministry-level documents); and www.chinalaw.gov.cn/article/cazjgg/ (most laws posted at the above and links to their respective comment pages).  
2 These regulations include the PRC Constitution (www.gov.cn/gongbao/content/2004/content_62714.htm), the 2001 Regulations on the Procedures for the Enactment of Administrative Regulations (www.law-
For the purposes of this report, USCBC used two separate filters:

- A “narrow” interpretation that includes only those documents explicitly labeled as State Council or departmental administrative regulations, such as “provisions” (规定), “regulations” (条例), and “measures” (办法); and

- A “broad” interpretation that includes regulations that fall under the “narrow” interpretation as well as other administrative regulations that appear to function as State Council or departmental administrative regulations, such as “opinions” (意见), “notices” (通知), and “catalogues” (目录).

For categories of administrative regulations and departmental rules and a full list of the types of documents included under these categories, see Appendix 1.

**Findings**

**Implementation of NPC Transparency Commitments**

The NPC’s compliance with the transparency measures outlined in April 2008 has been inconsistent, but improved slightly this year compared to last year. Out of nine laws (including amendments) passed during the 12-month period covered in this update, six (66.7 percent) were posted to the NPC website for comment at some point during the drafting or revision process, and all but one—the amended PRC Consumer Protection Law—were posted for 30 days. This is an improvement from the 40 percent compliance during USCBC’s previous mid-March to mid-November 2012 tracking period, but remains low.

These percentages also represent lower figures than in years past. Until 2011, USCBC scorecards consistently showed that the NPC released most draft laws for a 30-day comment period at least once during their standard three rounds of NPC Standing Committee review. We encourage the NPC to return to a consistent record of legislative transparency.

**Implementation of State Council Transparency Commitments**

Efforts by China’s central government agencies to solicit comments on draft rules and regulations continue to be insufficient. No agency posted more than one-third of relevant regulations for comment in 2013. USCBC analysis of the State Council and seven key government agencies that fall under the State Council over this 12-month tracking period continues to show a poor record in complying with China’s transparency commitments.

The State Council posted only a small portion of its own administrative regulations and departmental rules for public comment through SCLAO: Less than 10 percent of relevant documents under the “broad” definition and less than 27 percent under the “narrow” definition (see Table 1). Concerningly, both figures are lower than percentages in the previous tracking period, which were 13.6 and 27.3 percent, respectively.

**Table 1: State Council’s Administrative Regulations and Departmental Rules Posted for Public Comment**

<table>
<thead>
<tr>
<th>Government Agency and Tracking Period</th>
<th>“Broad” Definition</th>
<th>“Narrow” Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Posted to SCLAO</td>
</tr>
<tr>
<td>State Council (including SCLAO) January to December 2013</td>
<td>62</td>
<td>6 (9.7%)</td>
</tr>
</tbody>
</table>

...and the 1990 Decision on the Registration of Regulations and Rules (www.law-lib.com/law/law_view.asp?id=6358)
Other government agencies posted an even smaller proportion of their regulations to one of the relevant SCLAO comment websites, with the majority of agencies tracked posting less than 10 percent of relevant rules and regulations covered under the “broad” definition. Under the “narrow” definition, the compliance rate remains very low (see Table 2). USCBC uncovered a considerable number of relevant trade and economic-related items—more than 500 in this tracking period—not released for comment on relevant SCLAO websites (see Appendix 1).

These agencies did no better in posting relevant rules and regulations to their own websites. In general, agencies posting draft rules and regulations to the SCLAO website also posted to their own websites, but some posted additional draft regulations to their respective agency websites only. While doing so does not meet the requirements of the State Council’s commitment, it provides some measure of transparency for stakeholders. Those numbers, however, were also quite small—ranging from zero to 32.5 percent of regulations—indicating that the majority of regulations not posted to a SCLAO website were not posted for public comment anywhere (see Table 2).

Table 2: Selected Government Agencies’ Administrative Regulations and Departmental Rules Posted for Public Comment

<table>
<thead>
<tr>
<th>Government Agency</th>
<th>“Broad” Definition</th>
<th>“Narrow” Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Posted to SCLAO</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Development and Reform Commission (NDRC)</td>
<td>125</td>
<td>0 (0.0%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ministry of Commerce (MOFCOM)</td>
<td>65</td>
<td>4 (6.2%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ministry of Finance (MOF)</td>
<td>173</td>
<td>2 (1.2%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ministry of Industry and Information Technology (MIIT)</td>
<td>135</td>
<td>0 (0.0%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ)</td>
<td>114</td>
<td>2 (1.6%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State Administration of Industry and Commerce (SAIC)</td>
<td>35</td>
<td>2 (5.7%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ministry of Human Resources and Social Security (MOHRSS)</td>
<td>30</td>
<td>2 (6.7%)</td>
</tr>
</tbody>
</table>

Among the small percentage of regulations that had been posted for public comment in line with China’s commitments, however, the majority were posted for or close to the full 30-day period. For those regulations posted for public comment on either the SCLAO or agency websites, the average comment period exceeded 24 days (see Table 3).

NDRC, MIIT, and MOHRSS compliance worsened overall. These agencies generally posted fewer documents in this tracking period than in the period tracked in USCBC’s 2013 transparency scorecard. While MOFCOM, MOF, AQSIQ, and SAIC also posted fewer documents to the SCLAO website, the documents posted for comment to their agency websites remained the same or increased. For example, MOFCOM posted 40 percent

3 Items posted to the SCLAO website may also have been announced and posted on one or more agency websites for comment; for example, one or more agencies may post jointly-released regulations to their websites.
of regulations under the “narrow” definition to its own website, compared with zero in the previous tracking period. Even though the number of regulations posted to SCLAO remained low, this may indicate a slightly positive trend that certain agencies may be gradually posting more documents for comment to their own websites.

These low numbers suggest that the main problem is that ministries and agencies do not post their relevant regulations at all, much less to the SCLAO website. Even though the adjusted means all exceed 24 days, the length of comment periods can vary significantly, with some regulations open for comment for as few as 7 or 11 days. Greater scrutiny of overall ministry and agency compliance is necessary to provide additional perspective and improve China’s transparency compliance. For methodology and sources, see Appendix 2.

Table 3: Length of Time State Council and Government Agency Administrative Regulations and Departmental Rules Are Posted for Public Comment

<table>
<thead>
<tr>
<th>regulations posted</th>
<th>total regulations</th>
<th>adjusted mean</th>
<th>non-adjusted mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Council Regulations Posted to SCLAO</td>
<td>6</td>
<td>29.7 days</td>
<td>30.8 days</td>
</tr>
<tr>
<td>Agency Regulations Posted to SCLAO</td>
<td>12</td>
<td>29.9 days</td>
<td>32.6 days</td>
</tr>
<tr>
<td>Agency Regulations Posted to Agency Websites</td>
<td>26</td>
<td>24.3 days</td>
<td>33.1 days</td>
</tr>
</tbody>
</table>

Challenges to Tracking Transparency

Tracking the transparency performance of the State Council and selected agencies is complicated by several factors. First, PRC government commitments—such as the 2008 SED IV agreement—do not define key terms, such as “trade and economic-related” or “administrative regulations and departmental rules.” This allows multiple interpretations of the commitments and multiple ways of measuring compliance. Furthermore, the 2011 S&ED commitment states that posting rules and regulations is “subject to limited exceptions,” but does not provide clarification on what these exceptions are.

Second, SCLAO’s April 2012 Interim Measures on Draft Laws and Regulations for Public Comment states that draft regulations should “generally” be released for a 30-day comment period (Article 6), but exempts “emergency or special circumstances” as well as “regulations involving state secrets, national security, the exchange rate, and monetary policy that are not suitable for public comment” (Article 3). While it is possible that some regulations not released for public comment fall into these exempt categories, they are unlikely to cover all of the regulations analyzed by USCBC. SCLAO’s 2012 measures do not provide clarification on the scope and definition of these exceptions.

Third, the URLs to which some administrative items are initially posted may move or expire after a short time, especially those posted on agency websites, which may make it difficult to locate regulations later. Broken URLs hinder the effectiveness of government efforts to improve transparency.

Fourth, some draft administrative items, including amendments to laws and draft regulations, may undergo more than one comment period. These drafts are not always posted publicly, but instead may be circulated to select stakeholders in government, industry, and academia. In these cases, the public comment periods can vary in length and may only last a few days. This manner of solicitation does not meet Chinese government commitments to transparency and potentially limits the perspectives the Chinese government can receive.

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4 USCBC found that a number of documents had been posted for longer than 30 days, skewing the figure for the average number of days posted for comment. To present a more accurate average, USCBC adjusted the data to treat documents posted for comment for more than 30 days as documents posted for comment for exactly 30 days.

5 This number excludes duplicate regulations released jointly by multiple ministries that may be included separately in Table 2.
Finally, no centrally maintained, public record of items that have been released for comment exists. The only way to verify whether laws and regulations issued for implementation were published for comment is to check the SCLAO and departmental websites regularly for the release of new documents, and compile these into a database. This makes it nearly impossible for anyone—public and private sector alike—to track transparency in a comprehensive fashion, and very difficult without a significant time commitment. While some draft items may be released for comment on ministry or agency websites only, it is difficult to locate new regulations without checking websites regularly, especially if documents are not posted to the SCALO site or covered in the Chinese press.

Because of these factors, USCBC tracks the activity of PRC agencies that are most relevant to US industry concerns, but recognizes that such lists may not be all-inclusive due to the nature of China’s transparency challenges.

Recent Developments in PRC Transparency

The PRC government has continued to emphasize its commitment to increasing transparency through various statements and regulations, despite its uneven implementation of existing commitments. Some recent developments pertaining to information disclosure include:

- **PRC agencies’ general solicitation of comments to revise existing laws or regulations** Some PRC agencies this year have called for public comments or recommendations for the revision of existing laws. The call for suggestions prior to the internal drafting process may indicate that, in some areas, the PRC government is receptive to comments early in the drafting process. For example:
  
  - The former State Food and Drug Administration (SFDA) in June 2013 stated it was soliciting public comments and recommendations for revision of the PRC Food Safety Law with a comment deadline of 27 days. After soliciting initial recommendations, the newly established China Food and Drug Administration (CFDA) issued the Revised Draft PRC Food Safety Law for public comment on October 29.
  
  - MOFCOM in December 2013 stated it was accepting comments for revision of three laws pertaining to foreign investment vehicles: PRC Laws on Wholly Foreign-Owned Enterprises, Sino-Foreign Equity Joint Ventures, and Sino-Foreign Contractual Joint Ventures. MOFCOM did not specify a deadline for public feedback.

  Neither SFDA’s nor MOFCOM’s initial announcements included the draft regulations themselves. The decision to solicit public comments earlier in the revision process of laws or regulations—prior to release of a draft—may, however, be a potentially positive trend in agencies’ recognition of the importance of regulatory transparency.

- **State Council call for better government communication with the public** The State Council indicated at a meeting in September 2013 that it aimed to improve the procedures by which government information is disclosed, including making government economic and social policy more transparent and allowing the public to be aware of and supervise government activities, though did not provide further implementation details. After the meeting, an official statement said that government departments at all levels should hold more media briefings to better respond to public concerns, explain important policies and regulations to the public, and make better use of official websites and hotlines to communicate with the public and disclose government information.

  (www.gov.cn/ldhd/2013-09/18/content_2491161.htm)

- **NDRC measures on government information disclosure** NDRC in November 2013 issued the Implementing Measures on Government Information Disclosure, which indicated that the central government will take steps to make government information more accessible and available to the public,
which would be applicable to documents including directives (令), announcements (公告), plans (规划),
budget reports (预算报告), and administrative licensing items.
(www.gov.cn/zwgk/2013-11/20/content_2531119.htm)

- **State Council opinion on government information disclosure**  The State Council in October 2013
  acknowledged that “compared with public expectations,” there are still localities and departments for
  which information disclosure is insufficient. The opinion called for the timely release of polices and
  regulations on government websites and the improvement of services for public comment solicitation.
  (www.gov.cn/zwgk/2013-10/15/content_2506664.htm)

- **NDRC five-year plan for strengthening rule of law**  NDRC in February 2014 issued a Plan for
  Establishing Rule of Law within the Agency, which aims to promote statutory limitations to power,
  standardize operations, increase openness and transparency, and improve accountability and efficiency.
  Specific to regulatory transparency, NDRC indicated it would increase transparency in the legislative
  process and the public comment process for draft regulations.
  (www.ndrc.gov.cn/zcfb/zcfbtz/2013tz/P020140210624179039558.pdf)

**USCBC Recommendations**

USCBC welcomes the State Council’s requirements for agencies to solicit public comment on all administrative
documents, and offers the following recommendations for improving the process and increasing public
participation:

- Ensure that all administrative regulations and departmental rules are posted on the designated SCLAO
  information website comment page for the full 30-day comment period. As the USCBC 2014 Board
  Priorities Statement (www.uschina.org/reports/priorities-thu-05302013-1325) notes, a longer comment
  period of 60 or 90 days would be preferable and result in better comments for the consideration of
  government regulators and contribute to improved legislative and regulatory outcomes.

- Publish a clear definition of the documents covered under the State Council’s transparency commitments
  that specify the inclusion of documents such as catalogues, measures, standards, and opinions, which often
  affect industry significantly. The lack of such a definition creates challenges for companies and regulators
  alike. In this report, USCBC examines regulations under both a narrow definition as well as a broader
  definition that includes administrative regulations that appear to function as State Council or departmental
  administrative regulations. None of these regulations are explicitly included in any State Council
  definition.

- Explain in detail, and within the bounds of confidentiality, the economic methodology and rationale that
  underpin administrative reviews and decision-making by central government bodies, including
  antimonopoly merger reviews, countervailing duty and antidumping investigations and case rulings, and
  decisions made based on “national economic security” considerations to allow greater transparency in
  these processes.

- Create a more organized and comprehensive web-based database of laws and regulations that have been
  released for comment in order to facilitate annual reviews of progress in transparency from an
  authoritative source.
Appendix 1: Categories for Relevant Administrative Regulations and Departmental Rules

Administrative regulations and departmental rules may include a variety of documents:

- Articles 89 and 90 of the PRC Constitution (www.gov.cn/gongbao/content/2004/content_62714.htm) note that the State Council is responsible for drafting and releasing “administrative regulations” (行政法规), “decisions” (决定), and “orders” (命令). The State Council is also responsible for changing or cancelling relevant regulations released by ministries and agencies, including “orders” (命令), “directives” (指示), and “rules” (规章).

- Article 4 of the 2001 Regulations on the Procedures for the Enactment of Administrative Regulations (www.law-lib.com/law/law_view.asp?id=16619) states that State Council administrative items may be titled “regulations” (条例), “provisions” (规定), and “measures” (办法).

- Article 2 of the 1990 Decision on the Registration of Regulations and Rules (www.law-lib.com/law/law_view.asp?id=6358) states that departmental administrative items may be titled “provisions” (规定), “measures” (办法), “rules” (细则), and “general rules” (规则).

The following numbers are estimates based on the US-China Business Council’s (USCBC) detection of administrative items released on the websites of the National Development and Reform Commission, Ministry of Commerce, Ministry of Finance, Ministry of Industry and Information Technology, General Administration of Quality Supervision, Inspection and Quarantine, State Administration of Industry and Commerce, and Ministry of Human Resources and Social Security that were not posted tithe SCLAO website for public comment. These include two categories:

- A “narrow” category, which includes only those documents explicitly labeled as State Council or departmental administrative regulations.

- A “broad” category that also includes administrative regulations that appear to function as State Council or departmental administrative regulations, but are not included in the State Council definition.

### Terms Used for Administrative Items Circulated or Issued by Key Ministries but Not Released for Comment on the SCLAO Comment Pages, January to December 2013

<table>
<thead>
<tr>
<th>“Narrow” definition of terms specified in PRC law as administrative regulations and departmental rules</th>
<th>Number issued</th>
<th>Other titles used for administrative items and departmental rules covered under the “broad” definition</th>
<th>Number issued</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provisions (规定)</td>
<td>27</td>
<td>Opinions (意见)</td>
<td>74</td>
</tr>
<tr>
<td>Decisions (决定)</td>
<td>8</td>
<td>Notices (通知)</td>
<td>181</td>
</tr>
<tr>
<td>Orders (命令)</td>
<td>0</td>
<td>Guides (指引)</td>
<td>1</td>
</tr>
<tr>
<td>Regulations (条例)</td>
<td>11</td>
<td>Standards (标准)</td>
<td>4</td>
</tr>
<tr>
<td>Measures (办法)</td>
<td>65</td>
<td>Catalogues (目录)</td>
<td>23</td>
</tr>
<tr>
<td>Directives (指示)</td>
<td>0</td>
<td>General Rules (通则)</td>
<td>3</td>
</tr>
<tr>
<td>Rules (细则)</td>
<td>6</td>
<td>Requirements (条件)</td>
<td>4</td>
</tr>
<tr>
<td>General Rules (规则)</td>
<td>12</td>
<td>Measures (方法)</td>
<td>1</td>
</tr>
<tr>
<td>Rules (规章)</td>
<td>0</td>
<td>Other</td>
<td>176</td>
</tr>
<tr>
<td>Total</td>
<td>129</td>
<td>Total</td>
<td>467</td>
</tr>
</tbody>
</table>
Appendix 2: Information Sources

US-China Business Council (USCBC) staff check a range of sources for PRC economic and trade-related regulations to conduct a detailed review of State Council Legislative Affairs Office (SCLAO) and agency websites on a fixed schedule. When compiling regulations, USCBC notes the date issued, comment period (if applicable), total days open for comment (if applicable), where it was posted, whether the document was jointly released, and the category to which the item belongs (see Appendix 1). Prior to calculating total regulations, mean and adjusted means, and totals in each category, USCBC conducts regular reviews to check for accuracy of regulations included in the analysis.

National People’s Congress (NPC)
USCBC tracks laws passed by the NPC and posted on the NPC’s website (www.npc.gov.cn/npc/xinwen/node_12488.htm). In addition to ascertaining which and how many laws were passed in a given period, USCBC looks at which drafts of these laws were posted for comment on the NPC’s public comment portal (www.npc.gov.cn/npc/flcazyj/node_8176.htm) at any point during the drafting process.

Consequently, USCBC is able to track which draft laws are posted for comment and which draft laws were not posted for comment. For the laws the NPC passes during USCBC’s tracking period, USCBC notes whether they were previously issued for comment at any point during their drafting process.

SCLAO
USCBC tracks items posted on the State Council’s website (www.gov.cn), as well as SCLAO’s websites (www.chinalaw.gov.cn/article/cazjgg/201204/20120400367358.shtml and www.chinalaw.gov.cn/article/fgkd/xfg/).

Ministries and Agencies
USCBC tracks items released by key government agencies on their individual websites. As each agency may organize data differently, USCBC conducts in-depth reviews of pages where relevant items may be posted, including announcement, policy, laws and regulations, and public comment pages, if any. For the agencies examined in this report, USCBC tracks documents posted to these websites and checks whether they were posted for comment at any point during the drafting process.

National Development and Reform Commission (NDRC)
<table>
<thead>
<tr>
<th>Policy releases (政策发布)</th>
<th><a href="http://www.ndrc.gov.cn/zcfb/default.htm">www.ndrc.gov.cn/zcfb/default.htm</a></th>
</tr>
</thead>
<tbody>
<tr>
<td>Announcements (发展改革委公告)</td>
<td><a href="http://www.ndrc.gov.cn/zcfb/zcfbgg/2012gg/default.htm">www.ndrc.gov.cn/zcfb/zcfbgg/2012gg/default.htm</a></td>
</tr>
<tr>
<td>Notices (通知)</td>
<td><a href="http://www.ndrc.gov.cn/zcfb/zcfbtz/default.htm">www.ndrc.gov.cn/zcfb/zcfbtz/default.htm</a></td>
</tr>
<tr>
<td>Development plans (发展规划)</td>
<td><a href="http://www.ndrc.gov.cn/fzgh">www.ndrc.gov.cn/fzgh</a></td>
</tr>
</tbody>
</table>

Ministry of Commerce (MOFCOM)
<table>
<thead>
<tr>
<th>Policy releases (政策发布)</th>
<th><a href="http://www.mofcom.gov.cn/b/b.html">www.mofcom.gov.cn/b/b.html</a></th>
</tr>
</thead>
<tbody>
<tr>
<td>Seeking public comments (征求意见)</td>
<td><a href="http://www.mofcom.gov.cn/au/au.html">www.mofcom.gov.cn/au/au.html</a></td>
</tr>
<tr>
<td>Commerce-related legislation (商务法规)</td>
<td><a href="http://www.mofcom.gov.cn/swfg/swfg.html">www.mofcom.gov.cn/swfg/swfg.html</a></td>
</tr>
</tbody>
</table>

Ministry of Finance (MOF)
<table>
<thead>
<tr>
<th>Policy releases (政策发布)</th>
<th><a href="http://www.mof.gov.cn/zhengwuxinxi/zhengcefabu/">www.mof.gov.cn/zhengwuxinxi/zhengcefabu/</a></th>
</tr>
</thead>
<tbody>
<tr>
<td>Notices and announcements (通知公告)</td>
<td><a href="http://www.mof.gov.cn/zhengwuxinxi/bulenggonggao/">www.mof.gov.cn/zhengwuxinxi/bulenggonggao/</a></td>
</tr>
<tr>
<td>Collection of comments (意见征集)</td>
<td><a href="http://www.mof.gov.cn/gongzhongcanyu/yijianzhengji/">www.mof.gov.cn/gongzhongcanyu/yijianzhengji/</a></td>
</tr>
</tbody>
</table>
Appendix 3: Chinese Academy of Social Sciences Report on PRC Rule of Law and Government Transparency

The Chinese Academy of Social Sciences (CASS) on an annual basis evaluates the transparency of ministries directly under the State Council, including ad hoc organizations, institutions, state bureaus, departments related to foreign affairs, and departments that have direct responsibility for the well-being of PRC citizens. The evaluation was conducted by a combination of phone, mail, and self-surveys by ministries. Its most recent report was released in spring 2014.

CASS ranked ministries on a scale of 1 to 100 points. Points were based on five criteria: Government information disclosure catalogues (20 points), government information disclosure guidelines (20 points), disclosure portals and implementation (20 points), annual reports on information disclosure (20 points), and budget information disclosure (20 points). Selected rankings for ministries and agencies that the US-China Business Council (USCBC) regularly tracks are listed below.

Selected Ministry and Agency Transparency Rankings, 2013

<table>
<thead>
<tr>
<th>State Council Ministry or Agency</th>
<th>Rank</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ministry of Education</td>
<td>1</td>
<td>65.08</td>
</tr>
<tr>
<td>State Administration of Work Safety</td>
<td>2</td>
<td>64.03</td>
</tr>
<tr>
<td>National Development and Reform Commission</td>
<td>3</td>
<td>63.45</td>
</tr>
<tr>
<td>Ministry of Commerce</td>
<td>4</td>
<td>61.63</td>
</tr>
<tr>
<td>General Administration of Quality Supervision, Inspection and Quarantine</td>
<td>5</td>
<td>60.73</td>
</tr>
<tr>
<td>Ministry of Industry and Information Technology</td>
<td>14</td>
<td>54.98</td>
</tr>
<tr>
<td>Ministry of Human Resources and Social Security</td>
<td>25</td>
<td>51.75</td>
</tr>
<tr>
<td>Ministry of Finance</td>
<td>30</td>
<td>49.98</td>
</tr>
<tr>
<td>State Administration of Industry and Commerce</td>
<td>35</td>
<td>47.45</td>
</tr>
</tbody>
</table>

CASS also ranked local governments on a scale of 1 to 100 points. These points were based on six criteria: government information disclosure catalogues (20 points), government information disclosure guidelines (15 points), disclosure portals and implementation (20 points), annual reports on information disclosure (15 points), housing demolition information disclosure (15 points), and food safety information disclosure (15 points).

### Provinicial-Level Government Transparency Rankings, 2013

<table>
<thead>
<tr>
<th>Local Government</th>
<th>Rank</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tianjin</td>
<td>1</td>
<td>71.75</td>
</tr>
<tr>
<td>Anhui</td>
<td>2</td>
<td>71.44</td>
</tr>
<tr>
<td>Jiangsu</td>
<td>3</td>
<td>71.23</td>
</tr>
<tr>
<td>Guangdong</td>
<td>4</td>
<td>69.79</td>
</tr>
<tr>
<td>Hainan</td>
<td>5</td>
<td>68.45</td>
</tr>
<tr>
<td>Fujian</td>
<td>6</td>
<td>66.70</td>
</tr>
<tr>
<td>Zhejiang</td>
<td>7</td>
<td>63.43</td>
</tr>
<tr>
<td>Guizhou</td>
<td>8</td>
<td>59.96</td>
</tr>
<tr>
<td>Beijing</td>
<td>9</td>
<td>58.80</td>
</tr>
<tr>
<td>Chongqing</td>
<td>10</td>
<td>58.33</td>
</tr>
</tbody>
</table>

### City Government Transparency Rankings, 2013

<table>
<thead>
<tr>
<th>Local Government</th>
<th>Rank</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chengdu, Sichuan</td>
<td>1</td>
<td>73.90</td>
</tr>
<tr>
<td>Guangzhou, Guangdong</td>
<td>2</td>
<td>72.19</td>
</tr>
<tr>
<td>Ningbo, Zhejiang</td>
<td>3</td>
<td>70.65</td>
</tr>
<tr>
<td>Fuzhou, Fujian</td>
<td>4</td>
<td>68.53</td>
</tr>
<tr>
<td>Hefei, Anhui</td>
<td>5</td>
<td>66.70</td>
</tr>
<tr>
<td>Nanjing, Jiangsu</td>
<td>6</td>
<td>66.28</td>
</tr>
<tr>
<td>Wuxi, Jiangsu</td>
<td>7</td>
<td>65.55</td>
</tr>
<tr>
<td>Suzhou, Jiangsu</td>
<td>8</td>
<td>65.10</td>
</tr>
<tr>
<td>Zhuhai, Guangdong</td>
<td>9</td>
<td>64.60</td>
</tr>
<tr>
<td>Dalian, Liaoning</td>
<td>10</td>
<td>61.90</td>
</tr>
</tbody>
</table>

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6 CASS’s rankings includes provinces (省) and the four centrally-administered municipalities (直辖市) — Beijing, Shanghai, Tianjin, and Chongqing. It does not include any of China’s autonomous areas (自治区) — Inner Mongolia, Xinjiang, Tibet, Ningxia, or Guangxi — or either of its two specially administered regions (特别行政区) — Hong Kong and Macao.
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;
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- 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
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.

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

- 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.
USCBC 2013 China Business Environment Survey Results:
Tempered Optimism Continues Amid Moderating Growth, Rising Costs, and Persistent Market Barriers

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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.
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).

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).

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).
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 (JCCCT), 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 on the top 10, including market access in legal services,¹ improving enforcement of intellectual property rights (IPR),² and increasing imports of foreign goods and services into China.³ In addition, USCBC’s board of directors’ statement of priorities provides additional recommendations on issues of importance to US companies.⁴ 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).
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— independent 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).

**Challenge #3 [tie]**  
Administrative Licensing

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**Progress on Issue in Past Year: Unchanged**  
Rank in 2012: 2  
Rank in 2011: 2  
Rank in 2010: 2  
Rank in 2009: 1  
Rank in 2008: 1 (tie)  
Rank in 2007: 2  
Rank in 2006: 2

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**Fig. 17**  
What types of problems has your company experienced?

- Product approval delays: 52%  
- Business license delays: 49%  
- Operation expansion delays: 44%  
- Routine activity delays: 39%  
- Foreign investment delays: 28%  
- Other: 7%

Multiple responses allowed.

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**Fig. 18**  
At what level(s) of government did you experience these problems?

- Central: 65%  
- Provincial: 58%  
- City, county, or district: 52%  
- Investment zone officials: 10%

Multiple responses allowed.
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 Statement5 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.

Fig. 19  Are your domestic competitors experiencing the same problems?

Yes 48%
No 52%

Fig. 20  Are there laws or regulations in place that specify differential treatment for domestic competitors?

Yes 33%
No 67%

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).
**Challenge #5**

**IPR Enforcement**

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).
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.7

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,8 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**

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.\(^9\) 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.

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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.”

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.

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.11

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).
Respondent Profile

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).

![Respondents' locations](chart1.png)

![Type of business operations in China](chart2.png)
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

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**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.

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**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.
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**

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<tr>
<th>Trade Secret</th>
<th>Trademark</th>
<th>Patent</th>
<th>Copyright</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2011</strong></td>
<td>34%</td>
<td>29%</td>
<td>26%</td>
<td>10%</td>
</tr>
<tr>
<td><strong>2012</strong></td>
<td>36%</td>
<td>27%</td>
<td>26%</td>
<td>6%</td>
</tr>
<tr>
<td><strong>2013</strong></td>
<td>40%</td>
<td>29%</td>
<td>26%</td>
<td>8%</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 2: What Aspect of Trade Secret Protection in China Is of Greatest Concern?**

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Concerns</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enforcing agreement</td>
<td>38%</td>
</tr>
<tr>
<td>Lack of legal framework</td>
<td>26%</td>
</tr>
<tr>
<td>Lack of regulatory clarity</td>
<td>12%</td>
</tr>
<tr>
<td>Lack of employee understanding</td>
<td>6%</td>
</tr>
<tr>
<td>Gathering evidence for trade secrets cases</td>
<td>3%</td>
</tr>
<tr>
<td>Getting evidence admitted in enforcement proceedings</td>
<td>3%</td>
</tr>
<tr>
<td>Other</td>
<td>12%</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:
  o 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
  o 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.
  o 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 increase 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.
  o 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 inventors.

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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ADVANCING INNOVATION: Recommendations for China’s High- and New-Technology Enterprise (HNTE) Program
September 2013

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.
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/zfxsgk/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 publically 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.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/zctg/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. www.cqpp.gov.cn/portal/documentView.do?method=view&id=478226

• 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. www.cqfzb.gov.cn/Pro_General/ContentShow.aspx?ProID=49&myid=8655

• 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. zfxz.cq.gov.cn/zfxsgk/.jsp/view/infview.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. zfxz.cq.gov.cn/zfxsgk/.jsp/view/infview.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/gdpmsPortal.jsp/article_content.jsp?articleId=4028708332b5d20e0132f752ffde0c92

• In late 2011, the Guangdong provincial government released a circular that is believed to order 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. (Full link not available, but referenced in zwgk.gd.gov.cn/007335807/201204/t20120405_311243.html)

• On January 9, 2012, the Chaohzhou 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 Chaohzhou 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/GBTJ/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.
  fjz.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.zhcz.gov.cn/ljc/zdt/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/zwgkzwcj/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/xsgk/sdfxfg/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.  
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.jsce.gov.cn/pub/jsce/zfzxgk/zfxxgkml/zfcg/11/2011/12/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/zhengfuxinxiigongkai/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/xxgk/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 xxgk.xz.gov.cn/xzxxgk/nrglIndex.action?catalogID=ba5a42a118c5c8140118c5ef68980046&type=2&messageID=ff80808135a7cd0135ebc1c7f604a2)

**Jiangxi**


   [Link inactive, but formerly available at www.ncinfo.gov.cn/Newsite/content_detail.asp?id=40904]

**Liaoning**


   [Link inactive, but formerly available at 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.

   [Link inactive, but formerly available at www.ccgp-shenyang.gov.cn/syzfcgweb/Notice_view.aspx?news_id=335]

**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 xxgk.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.

   [Link inactive, but formerly available at govinfo.nlc.gov.cn/nxfz/xxgk/dwkqrzgwqk/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.

   [Link inactive, but formerly available at xn--xcr7j123e.xn--fqs8s/article/dfxx/dfzx/vx/201202/20120200360611.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/zfgc/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
  www.tjzfxgk.gov.cn/tjep/ConInfoParticular.jsp?id=33352
Xinjiang
- On November 23, 2011, the Bayingolin Mongol autonomous prefectural 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. Regulatory changes must be complete by December 13, 2011, and reported to the Bayingolin Legislative Office.

- On November 30, 2011, the Xinjiang Science and Technology Bureau released a circular announcing that it would halt implementation of the 2009 Xinjiang Provisional Indigenous Innovation Product Accreditation Management Rules as of December 1, 2011.

- 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)

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

- 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

- 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)

- 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

- 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

- 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
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

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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.

<table>
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<tr>
<th>Overview of Selected Agencies involved in SEI Policy Creation</th>
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<tr>
<td><strong>Central-Level Agency</strong></td>
<td><strong>Provincial-Level Equivalent</strong></td>
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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 |
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>
</tbody>
</table>
| State Intellectual Property Office (SIPO)| Local SIPO can be referred to as “intellectual property bureau” (IPB) or “intellectual property administration” (IPA) | • Focuses on emphasizing protecting intellectual property rights (IPR) within the SEIs  
• Coordinates with other agencies to protect IPR in SEI policy implementation |

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
• 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/120130307_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 Xiaoqiang 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.
Links with Government Procurement

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.


**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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<th>New energy</th>
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<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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<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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<td>- Explore and use biomass energy according to local conditions.</td>
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<th>New materials</th>
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<td>- Develop new materials such as rare earths, high-performance membrane materials, special glass, functional ceramics, and semiconductor lighting materials;</td>
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<td>- Develop advanced structural materials, such as high-quality special steel, new-mode alloy material, and engineering plastics;</td>
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<tr>
<td>- Develop high-performance fiber and composite materials, such as carbon fiber, aramid fiber, and ultra-high molecular weight polyethylene; and</td>
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<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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<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>
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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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| 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. |
<p>| 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 |</p>
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<th>Provinces/Cities</th>
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| Hunan            | 7              | Replaces new-energy vehicles with cultural innovation | 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 | Aims to allocate RMB 500 million (USD $80.4 million) annually. | 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. | N/A |

Hubei also introduced the IPR Protection Work Responsibility Breakdown Plan for SEIs in July 2012 to emphasize that provincial agencies have specific responsibilities to protect IP. In addition, SEI IP protection has been listed as an annual work priority for involved agencies, including the provincial DRC and EITC. This is an unusual example among all researched provinces and municipalities, as IPR protection is now linked to local department performance indicators and given priority.
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<tr>
<td>Jiangsu</td>
<td>10</td>
<td>• Adds new medicine to biotechnology</td>
<td>Jiangsu DRC</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. To be included in the enterprise list, an enterprise must be an international brand and own indigenous independent IP.</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>
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<td>• Under next-generation IT, adds software, and places specific emphasis on the Internet of things, cloud computing, smart grid, and marine engineering equipment</td>
<td>Jiangsu STC, EITC manages energy efficiency and environmental protection, Internet of things and cloud computing, next-generation IT and software, advanced equipment manufacturing, and marine engineering equipment</td>
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<td>Jiangxi</td>
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<td>• Re-divides SEIs into:</td>
<td>Jiangxi EITC, DRC, and STC have various roles in SEI promotion</td>
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<td>o Photovoltaic cells</td>
<td>New energy is supervised by Jiangxi DRC</td>
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<td>o New-energy vehicles and batteries</td>
<td>Jiangxi EITC administers the remaining SEIs and established a new internal division – “emerging industry division” – to manage SEI work</td>
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<td>o Energy efficiency lights and photoelectricity</td>
<td>The Jiangxi Culture Department oversees the cultural and creative industries</td>
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<td>o New materials: metals</td>
<td>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.</td>
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<td>o New materials: non-metals</td>
<td>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.</td>
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<td></td>
<td>o Biomedicine and new medicine</td>
<td>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.</td>
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<td>o Wind power and energy saving technology</td>
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<td>o Aviation manufacturing</td>
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<td>• Adds “green” food and agriculture, as well as the cultural and creative industries</td>
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<td>Provinces/Cities</td>
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| Shandong        | 6              | • Does not include new-energy vehicles  
• Combines new energy with energy efficiency and environmental conservation  
• Adds new medicine to biotechnology  
• Adds marine development  
Established an SEI special working commission in order to push forward SEI development.  
Aims to invest no less than RMB 1 billion ($160.7 million).  
Shandong DRC released the first “SEI Major Programs Catalogue” in 2010 detailing 10 methods to encourage private sectors to develop SEI.  
Shandong’s 12th FYP on SEIs identifies priorities for each SEI. | | |
| Shanghai        | 7              | Same as the central government  
• 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  
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.”  
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. | | |
| Shanxi          | 9              | Adds coalbed methane and modern coal-to-chemicals  
Shanxi DRC leads the SEI interagency coordination working group  
• 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)  
N/A  
SEI development is closely related to the Shanxi government’s strategy of developing the energy sector, especially coal. | | |
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</table>
| 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)  
  o IT will receive 25 percent of funding  
  o High-end equipment manufacturing and new materials industries should each receive 20 percent of funding  
  o New energy should receive 15 percent of funding  
  o 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. |
<p>| 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 |</p>
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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  

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10. Hunan General Outline for Accelerating Strategic Emerging Industries Development
   http://www.hnfgw.gov.cn/hgzh/zdzxgh/12493.html
11. Jiangsu Province 12th FYP to Develop Strategic Emerging Industries
12. Jiangsu Special Funds on Software and Integrate Circuit Industries
    http://www.taiwan.cn/flfg/dffgdgzz/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/u26ai3090.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/xcgh/dfghzc/gdxgzh/t20120328_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
Licensing Challenges and Best Practices in China
January 2014

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 significant concern in the China market. 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.

¹ In USCBC’s 2013 Membership Survey, 33 percent of respondents stated that Chinese regulations mandate different treatment for domestic enterprises in China, while 52 percent of respondents said domestic companies were not experiencing the same licensing problems as foreign companies. “USCBC 2013 China Business Environment Survey Results: Tempered Optimism Continues amid Moderating Growth, Rising Costs, and Persistent Market Barriers.” US-China Business Council. October 2013. http://uschina.org/sites/default/files/USCBC%20%20%942013Member%20Survey.pdf
most significant concern in the China market. Prior to that, administrative licensing has ranked as the first or second greatest concern each year since 2006. That licensing has fallen in rank since 2010 suggests China’s efforts to address licensing-related issues may be having some effect in improving the licensing system; however, that the issue has remained one of companies’ top three concerns indicates that the situation has not improved significantly.

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 pertaining to certain licensing processes.

Since 2001, the Chinese government cancelled or delegated to lower level authorities 2,400 approvals.\(^2\) 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.\(^3\) 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.\(^4\)\(^5\) Though these 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.

\(^3\) CPC Central Committee’s Decision on Several Major Issues in Comprehensively Deepening Reform. Third Plenum of the Eighteenth China Communist Party Central Committee. November 15, 2013.
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 breaks.

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. 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.7

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

project economics, major unit operations, equipment lists, equipment specifics, capacity, and raw material and energy use. 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 competitors 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. 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 publicly-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.

February 11, 2014

The US-China Business Council (USCBC) supports a strong, mutually beneficial commercial relationship with China. The relationship has made many positive strides over the past three decades, thanks to the collaborative work of the governments, business communities, and other stakeholders in both countries.

This is the third priorities statement issued by USCBC’s board of directors. While progress has been made on a number of the previous statements’ recommendations, more work needs to be done on other issues and new concerns continue to arise that require the attention of both governments in order to fully develop commercial ties, resolve issues, and bring greater benefit to each country’s economy, companies, employees, and citizens.

As highlighted in last year’s statement, we encourage both governments to develop a broader, long-term strategic vision of the bilateral economic and commercial relationship. Both governments should explore an economic liberalization framework that would comprehensively address opportunities and challenges in the relationship, rather than approach them incrementally. Areas to address include investment, tariff and non-tariff barriers, services, agriculture, innovation and technology, and intellectual property protections.

USCBC calls upon the US and Chinese governments to work together on the following priority recommendations and issues in the commercial relationship, and lends its full support to achieving the goals listed below.

Further Solidify the Foundation for Mutually Beneficial Commercial Relations

- **Maintain a robust and effective bilateral dialogue** The United States and China have established a robust annual schedule of bilateral meetings at all levels of government that supports expanded economic and commercial relations and resolves issues of concern. The United States and China should enhance this dialogue structure, which includes the US-China Strategic and Economic Dialogue (S&ED), the US-China Joint Commission on Commerce and Trade (JCCT), the US-China Innovation Dialogue, and the US-China Investment Forum, so that it continues to reflect the level of engagement appropriate for the world’s two largest economies and provides opportunities to resolve the numerous issues that both American and Chinese companies see as impediments to strengthening the strategic economic relationship and drive growth and job creation in both economies. The frequent ad-hoc meetings at the presidential level should be formalized into an annual summit, building on the success of the 2013 presidential meeting in Sunnylands, California.
Promote a level playing field for foreign and domestic companies in China  USCBC applauds the Chinese government’s desire to expand opportunities for “private capital” and non-state-owned entities in China, reform state enterprises, and increase competition to spur economic rebalancing. We encourage the inclusion of “foreign capital” in these expanded opportunities and openings.  

China’s policymakers should also consider eliminating terminology such as “foreign-invested enterprises.” Continued use of this term invites differential treatment for various types of domestic enterprises versus others, based solely on ownership. Government regulators should act independently and transparently, and ensure that all domestic enterprises – including foreign-invested enterprises – are treated equally and allowed to compete fairly. Efforts to build “national champions” in certain sectors should not include measures that discriminate against other domestic legal persons.

Address cybersecurity threats to commerce  USCBC is pleased that the US and Chinese governments at the highest levels have agreed to cooperate to curb cybersecurity attacks on companies. We encourage the two governments to step up their efforts to stop commercial-focused cyber intrusions, regardless of source, through all appropriate channels.

Further reduce business visa barriers  Modern international business requires company executives and employees to travel around the world to establish relationships, build customer bases, and manage business operations. The United States and China should facilitate trade and investment between our countries by offering reciprocal five-year, multiple-entry visas for business travelers.

China’s APEC Host Year  Recognizing China’s leadership role in APEC 2014, USCBC encourages an ambitious agenda that delivers action-oriented outcomes, enhances private sector involvement in policy setting discussions, and tangibly promotes an open investment and trade environment in the Asia-Pacific region. Progress in food security, health care, remanufacturing, infrastructure, supply chain connectivity, good regulatory practices, energy policy, and investment present China with real opportunities to lead APEC toward achieving genuine and substantive progress in 2014.

Ensure Fair and Open Investment Environments that Create Jobs

Pledge to openness  The United States and Chinese governments should jointly reaffirm the principle that foreign direct investment is good for economic development, employment, innovation, competition, consumers, and public welfare. Government reviews of prospective investments in either country should be free from political interference and limited to legitimate national security concerns.

Begin reducing foreign ownership restrictions in China  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. These restrictions inhibit foreign investment in key sectors and prevent the full economic benefits of foreign investment from being realized. Given China’s desire to invest more in the United States, reducing or eliminating these ownership restrictions faced by American investors in China would be a positive way to build broader support for Chinese investment in the United States.

Key sectors in which foreign ownership restrictions need to be reduced include agriculture and food, automotive, financial services, cloud computing, data centers, health
insurance and hospitals, energy exploration and development, refining and petrochemicals, audiovisual and other media industries, and energy-intensive industries.

- **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. Finalizing a meaningful BIT should be a top priority for both governments in 2014. USCBC welcomed the July 2013 US-China Strategic and Economic Dialogue agreement to negotiate a BIT that incorporates national treatment provisions that apply to both new and existing investments (“pre-establishment”), and a “negative list” approach that covers all investments except those specifically excluded in the agreement. Additionally, it is important for China to take proactive steps to reduce investment barriers in the near-term, even while the two sides are negotiating a BIT. Reducing ownership restrictions upfront and demonstrating a commitment to treat domestic and foreign investors equally will build strong support in the United States for a BIT.

  The “negative list” format adopted in the Shanghai Free Trade Zone (SFTZ) is a positive first step in expanding opportunities for foreign investment. The initial SFTZ “negative list” maintains current restrictions on foreign investment stipulated in the 2011 Catalogue Guiding Foreign Investment. We encourage the Chinese government to quickly move to reduce the negative list and extend its application across China.

- **Encourage Chinese investment in the United States** The job-creation benefits of foreign direct investment underscore the importance of bringing more Chinese investment into the United States. The US government and private sector organizations like USCBC should continue to demystify for Chinese investors the rules for investing in the United States and work with state and local governments to spread best practices for attracting Chinese investment. The US and China should continue sub-national dialogues on investment involving governors, mayors, and respective business communities.

**Reduce Trade Barriers and Enforce Globally Accepted Trade Rules**

- **Continue to use World Trade Organization (WTO) cases to settle trade disputes** China’s WTO entry in 2001 introduced a neutral, third-party dispute settlement mechanism for dealing with commercial issues that cannot be resolved by good-faith bilateral negotiations. Both countries should use this channel to resolve trade disputes in a non-politicized manner.

- **Ensure that government decisions are not politicized** Government reviews and decision making in areas such as investment security reviews, government procurement decisions, administrative licensing, and trade remedies such as anti-dumping and countervailing duties cases must be fact-based, shielded from political pressures, and non-retraliatory. Mergers and acquisitions reviews must be efficient and avoid delays that negatively impact the proposed transaction.

- **Increase the use of transparent, internationally harmonized standards for goods and services sold in China’s market** The use of internationally harmonized standards in China is one of the best ways to ensure that Chinese consumers have access to a wide range of choices in the latest products and services and that Chinese products and services are accepted and competitive internationally. To more effectively align with international standards, China should use global standards as the basis for Chinese standards wherever practical and adopt a more science-based, fair, equal, transparent, and market-led approach to standards setting and development that is open to all companies regardless of nationality, including domestic, foreign-invested and foreign-based manufacturers.
• **Remove non-tariff barriers to trade** China’s market has a variety of trade-limiting regulations that should be removed, including discriminatory import licensing restrictions on chemicals and agricultural products (such as cotton and fertilizer); limitations on express delivery services (including China’s failure to fully grant US firms’ longstanding permit applications and geographic restrictions inconsistent with China’s international commitments); duplicative local domestic testing requirements that require many imported goods to be tested and certified by domestic laboratories regardless of whether they have already undergone similar tests internationally; and discriminatory regulatory and reimbursement policies affecting medical products. Domestic and foreign-invested companies should be treated equally under the Construction Machinery key imported components duty exemption, for example for large excavators (30 tons and above).

• **Further improve China’s Tariff Rate Quota (TRQ) system** TRQ quota levels have not been adjusted since China’s WTO accession 2001 and do not meet increasing demand for agricultural commodities. We recommend that the Chinese government regularly review TRQ levels according to market demand and establish a more transparent TRQ allocation system. We also recommend reducing the number of agricultural commodities subject to TRQs so that demand can more efficiently be met by the market.

• **Accelerate sensible US export control reforms** Export controls are an important part of ensuring the security of the United States. The Obama administration should continue its reform efforts that will ensure US security is not undermined while eliminating unnecessary licensing controls on products no longer a threat to US security. Such reforms will boost US exports and help support and create jobs. The United States should move forward more quickly with modifications of non-controversial items even as more difficult reform vetting continues. Those modifications should include items that can be delisted for countries such as China because they are available on the open market from non-US sources.

• **Expand trade liberalization through international trade agreements** The United States and China are both working to open international markets for their countries’ businesses through international negotiations such as expansion of the Information Technology Agreement (ITA), the negotiation of the Trade in Services Agreement (TISA), and through regional trade agreements such as the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP). Efforts to conclude these sector-specific and regional agreements should be accelerated and supported, given their potential for greatly expanding international trade. The United States and China should work collaboratively to ensure comprehensive, high-standard, commercially-meaningful outcomes of these negotiations, including the ITA, where a minimal negative list of excluded products and technologies would demonstrate a commitment to openness and benefit all parties.

**Ensure Competitive Neutrality and Improve Transparency**

• **Ensure equal treatment in licensing** For each of the past eight years, USCBC’s annual survey of its membership has highlighted licensing barriers as one of the top market access barriers in China. These include business licenses, branch licenses, product approval licenses, import licenses, and other licenses and permits in sectors such as banking, healthcare, insurance, express delivery, construction, legal and value-added telecommunications services (such as data centers). In many cases, Chinese companies are able to receive these licenses without the same restrictions or delays faced by foreign companies and foreign-invested companies.
• **Broaden reform of government approvals and licensing** The State Council has announced a number of rounds of reform to government licensing and approvals in recent months, eliminating or decentralizing various business approvals. USCBC acknowledges these reform efforts and encourages the State Council and other Chinese government agencies to extend and expand efforts to streamline many of the burdensome and duplicative licensing and approval processes in ways that help both domestic and foreign companies contribute more to the Chinese economy. China should also improve its implementation of the 2003 Administrative Licensing Law, which provides guidelines for government on administrative licensing and rules on those processes including actively enforcing provisions that require agencies to accept and act upon applications within specific timelines.

• **Ensure equal treatment in government procurement for all legal entities in China, regardless of ownership** China should finalize the draft Implementation Regulations of the Government Procurement Law and the draft Administrative Measures for Government Procurement of Domestic Products to ensure that goods and services provided by all legal entities in China are treated equally during procurement processes, regardless of ownership. These two regulations require additional modifications to address information technology products and other areas before they are finalized and implemented. If revised, the rules would roughly parallel similar rules applied to Chinese companies in the United States.

• **Join the Government Procurement Agreement (GPA) in 2014** China should join the WTO’s GPA under meaningful terms, such as expanding the sectors and levels of government that are subject to the agreement. If China can address these and other points and join the GPA in 2014, many of each side’s concerns with “Buy American” and “Buy Chinese” procurement practices will be positively addressed.

• **Further improve rule-making transparency** China’s central government has improved rule-making transparency over the past several years, but further improvements are needed. 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 comment 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.

• **Ensure a level playing field in third-country markets** The United States and China should expand their discussions on international guidelines for export financing to include more sectors and conclude a meaningful agreement in 2014, as pledged at the 2013 Strategic and Economic Dialogue. The US Export-Import Bank should offer financing that is competitive with terms that Chinese companies may enjoy from China’s Ex-Im Bank.

• **Implement transparent and effective environmental regulations** China is in the process of updating its environmental regulatory policies to address the significant challenges it faces from its rapid industrialization. We support these efforts to ensure manufacturer compliance with implemented standards and in particular applaud efforts by China’s government to improve engine emission compliance. We recommend that regulations be implemented with an appropriate lead time of three to four years, to allow companies to sufficient time to meet all of the new standards. The central government should also address and rectify regional regulations that may be different from national standards. For example, fuel quality regulations should match the relevant nationwide emission level.
Provide Consistent, Strong Intellectual Property Rights (IPR) Protection

- **Continue to strengthen enforcement of IPR in China** Stronger IPR protection is increasingly in China’s own interest as it seeks to develop an innovative economy. It is also critically important to US companies that do business with China. China should continue to expand efforts devoted to IPR enforcement by various means, including increasing funding, personnel, and training devoted to IP enforcement; upgrading and expanding 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; strengthening internal market monitoring, its system of responding to reports of IP theft, and its process of monitoring exports; and increasing its engagement with the US government and private sector on IP enforcement issues.

- **Adopt a stronger deterrent against IP infringement** China should follow up on its 2012 S&ED commitment and adopt the WTO-consistent deterrent of criminal penalties in cases of commercial-scale infringement, and broaden the use of higher penalties and stronger deterrents against all types of IPR infringement, including patent, copyright, trademark, and trade secrets violations.

- **Improve enforcement against online counterfeiting and piracy** Internet platforms are 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. China should increase enforcement of Internet-related IP rights by drafting regulations to cover 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.

- **Strengthen trade secrets protection** Protection of trade secrets has become an increasingly important issue and was the IP area of greatest concern in USCBC’s 2012 and 2013 member company surveys. China can take positive steps to encourage innovation by expanding its efforts to address trade secrets concerns, including the development of a Trade Secrets Law, broader use of judicial procedures on preliminary injunctions and evidence preservation orders, and reducing the high evidentiary burden that plaintiffs face during trade secrets cases.

- **Protect IPR and technology during government review processes** China should 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.

Adhere to Mutually Beneficial Innovation Policies

- **Fully implement China’s pledge to delink its innovation and government procurement policies** This issue impedes China’s ability to become a global innovative economy and also negatively impacts the level playing field for American companies in the China market. Progress has been made following the November 17, 2011 State Council directive to local governments to halt implementation of any measures that link innovation and government procurement. However, not all provinces have publicly complied with the directive, and new measures at the provincial and local level continue to be issued. Further efforts to ensure full compliance are encouraged.

- **Follow internationally proven, effective innovation incentives** In place of discriminatory government procurement preferences, China should pursue several other policy approaches that would more effectively promote innovation:
• Revise criteria in the existing High- and New-Technology Enterprise (HNTE) program that currently require IP ownership in China or a five-year global exclusive license to allow legally acquired, non-exclusive licensee or usage rights, or exclusive license rights in China only. These revisions would positively impact company decisions about where to locate innovation activity.
• Ensure equal access to government-funded innovation programs, including its programs to allow all domestic enterprises, including foreign-invested enterprises, to participate in programs to develop China’s Strategic Emerging Industries (SEIs). Such access would ensure that these programs succeed by encouraging all interested companies to develop these technologies. An open environment would also ensure that Chinese companies benefit by being connected to a global innovation network, which could further spur SEI innovation.
• In addition, the United States and China should fully adhere to internationally accepted policies on promoting effective, non-discriminatory, and market-driven innovation such as those agreed to under the auspices of APEC.