



# Improving China's Licensing System: Recommendations for Key Sectors

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## Executive Summary

- US-China Business Council (USCBC) member companies have regularly highlighted administrative licensing as a primary concern for the China market. In USCBC's 2013 member company survey, members ranked administrative licensing as their third most significant concern.
- To help address these challenges, USCBC encourages China to commit to ensuring that foreign-invested and domestic firms are treated equally in all licensing processes throughout China. Ensuring equal treatment would guarantee US companies are able to fully participate and contribute to China's economy, and would help strengthen China's business environment and international competitiveness.
- There are an array of government approvals and licensing processes that qualify as "administrative licenses," many of which are specific to particular industries. This report does not seek to document problems and specific recommendations for every licensing process that a given company will face. Instead, it builds on interviews with member companies – particularly those in the manufacturing sector – to discuss broadly the types of problems that companies face and recommendations that cut across licensing processes. USCBC will continue to raise and make recommendations separately on more specific licensing issues, including those in the services sector.
- To help address other areas of concern in China's licensing process, USCBC has developed the following recommendations. USCBC recommends policymakers consider changes in four specific areas of the licensing process: information disclosure, expert panel reviews, approval timelines, and third-party recommendations.
- Documentation and information disclosure requirements for companies going through the licensing process can place companies' intellectual property – especially trade secrets – at risk of exposure. USCBC recommends that the government consult with companies to develop standardized documentation-disclosure requirements at all levels of government. Requirements should include procedures for the destruction of confidential and sensitive information that the company deems proprietary and has submitted in the licensing process.
- Expert panel reviews, such as those used in the environmental impact assessment review process, pose the risk of intellectual property loss for companies seeking to license products or invest in China. To create more security for companies going through the expert panel review process, USCBC recommends allowing greater input from applicants on experts nominated to the panel and instituting a formal process for applicants to dispute experts nominated to the panel from competing enterprises.
- Clear timelines that are consistently implemented help ensure transparency in any licensing process. Companies say that often, timelines are not followed in certain approval processes, creating significant delays in the process of investing in China. To improve transparency and predictability in government approvals, USCBC recommends that the government develop clear guidelines requiring agencies to provide more frequent and timely updates for applicants. If the agency misses a deadline, agencies should explain why the approval was delayed.
- Some companies have experienced strong pressure to use third-party consultants recommended by local government agencies in the licensing process. These recommendations raise ethical issues and compliance risks and can slow the licensing process. USCBC recommends that officials at all levels do not mandate the use of specific third-party entities in the licensing process.

China's leadership is prioritizing reforms to its administrative licensing system by streamlining, simplifying, and decentralizing aspects of its licensing and approvals processes. The US-China Business Council (USCBC) and its members recognize China's recent efforts in this area, and are supportive of China's objective to strengthen its licensing system. To assist policymakers in meeting these objectives, USCBC is pleased to offer this report on ways central and local governments can help improve China's approvals process to create a business-friendly environment that advances the local economy and saves valuable government resources.

Since the beginning of 2001, the Chinese government has announced several rounds of reforms, resulting in over 2,400 approvals cancelled or delegated to lower level authorities.<sup>1</sup> The government has since taken additional steps to decentralize and streamline existing administrative approvals as well as to limit new administrative approvals in the future. In March 2013, Premier Li Keqiang announced he would work to reform China's administrative approval system, and vowed to eliminate or decentralize around 500 items during his administration.<sup>2</sup> In September 2013, the government stated that the administrative licensing processes must be strictly controlled and that new licensing regimes should seek opinions from organizations, businesses, and citizens before being implemented.<sup>3</sup>

These steps suggest the government is making efforts to improve the commercial operating environment. USCBC appreciates these initiatives and encourages further openings in sectors relevant to foreign business. To support the Chinese government's efforts, USCBC has compiled recommendations for ways to help reduce some of the challenges in China's administrative licensing processes. These recommendations fall broadly into four categories: information disclosure, expert panel reviews, transparency and consistency in approval procedures and timelines, and third-party recommendations.

USCBC's recommendations are based on conversations with representatives from member companies in the manufacturing sector that are deeply involved in the licensing process in China and can offer valuable input based on their experience. These recommendations address many of the broad challenges and themes that companies face in the licensing process, but there are many other areas in which foreign-invested companies face significant licensing issues. Companies in a variety of sectors – including not only industries requiring product approval, but also services sectors such as banking, insurance, legal, express delivery, and telecommunications – also face sector-specific licensing issues that present challenges in their ability to compete in and serve the China market. To help further address these challenges, USCBC encourages China to commit to ensuring that foreign-invested and domestic firms are treated equally in all licensing processes throughout China. Ensuring equal treatment would guarantee US companies are able to fully participate and contribute to China's economy, and would help strengthen China's business environment and international competitiveness.

## Information Disclosure

### Background

USCBC and its members appreciate the government's recognition of the importance of transparency in the administrative licensing process. Recent announcements provide good examples of this recognition: the Ministry of Environmental Protection's [Guidelines on Opening Government Information Related to Environmental Impact Assessments](#) (建设项目环境影响评价政府信息公开指南) and the National Development and Reform Commission's [Government Information Publicity Implementing Measures](#) (国家发展和改革委员会政府信息公开实施办法) require government agencies to inform companies of how approvals are evaluated and decisions made. These rules also allow the public to petition for the release of licensing information that the rules do not explicitly required for disclosure.

Despite these positive steps, companies are still vulnerable to potential loss of intellectual property, particularly trade secrets, during the licensing process. While the government allows companies in some cases to identify what information is classified as trade secrets in certain licensing processes, risk of trade secret exposure still exists. For example, the government may disclose trade secret information if it determines it is

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<sup>1</sup> "China Cuts Government Intervention to Push Reforms." April 27, 2013. [http://usa.chinadaily.com.cn/china/2013-04/27/content\\_16454676.htm](http://usa.chinadaily.com.cn/china/2013-04/27/content_16454676.htm)

<sup>2</sup> "China cuts, readjusts 2,497 administrative approval items: report." June 25, 2013. <http://english.peopledaily.com.cn/90785/8298930.html>

<sup>3</sup> "State Council Decision to Cancel and Decentralize 75 Administrative Approvals." September 25, 2013. [http://www.cs.com.cn/xwzx/hg/201309/20130925\\_4154846.html](http://www.cs.com.cn/xwzx/hg/201309/20130925_4154846.html)

in the “public interest” to do so.<sup>4</sup> Furthermore, companies have said that in some cases authorities have requested information that is not directly related to the licensing process, even though Chinese law forbids approval authorities from requesting such information.<sup>5</sup> This risk that sensitive information will be disclosed publicly creates a strong disincentive for companies to introduce and use cutting-edge technology in China. As such, China may lose out on valuable investments and innovative activities that could further spur economic growth and industry advancement.

## Case Studies

Several examples illustrate how information disclosure in the licensing process presents risk for loss of intellectual property. One company that submitted its safety assessment to an approval agency was required to provide specific temperature and pressure information for its process equipment, not the temperature and pressure ranges that are generally required during approval processes in most other countries. This information would make it easier for a competitor to learn details about a production process the company considered to be a trade secret. In this instance, general information about temperature and pressure ranges, rather than the specific data, would have likely provided sufficient information to evaluate the safety assessment. Generally, companies are concerned that providing information that is outside the scope of international standards in licensing puts their trade secrets at risk of exposure or theft. In response, companies may halt current projects or withhold future investments.

In another example, one company’s conceptual design package was required to include all prior approvals in its submission, including proof of compliance with occupational health standards and a power supply plan. These prior approvals had no direct relation to the office’s analysis and approval, and contained proprietary information. Requiring resubmission of these documents increased the opportunities for such information to be exposed at multiple steps in the licensing system. Eliminating the requirement that companies repeatedly submit information will ease companies’ concerns over disclosure, reduce paperwork, and ease burdens on agency staff.

## Recommendations

To improve China’s licensing and approval system and deter trade secret disclosures, USCBC recommends that relevant Chinese government agencies:

- Allow companies applying for licenses and approvals to identify trade secrets and sensitive intellectual property in disclosures to government agencies, and require those agencies to destroy this information within a defined time period after completion of the licensing review. Alternatively, should this information need to be retained, the government should prohibit the dissemination of proprietary details in public disclosures and inter-agency government inquiries. The government should also institute specific consequences to punish those who violate these measures.
- Ensure that foreign and domestic companies are treated equally in all administrative licensing processes, particularly those requiring trade secret disclosures. For example, the [Interim Provisions for Trade Secret Protection among Central-Level State-Owned Enterprises](#) (中央企业商业秘密保护暂行规定) provides centrally administered state-owned enterprises protection from public disclosure of any trade secret that brings them economic or practical benefit. Adding language to provide similar protections for all companies in China – foreign and domestic – and enforcing those provisions will help attract foreign companies to China and promote investment in its market.
- Standardize documentation disclosure requirements throughout the licensing and approval processes at all levels of government. Requirements should be objective and specify what should be disclosed to avoid unnecessary disclosure and delay. Clarifying disclosure requirements will also prevent local-level authorities from requesting information beyond the scope of the license application under review.
- Eliminate the requirement that applicants include all information previously submitted for prior approvals in new applications. Instead, request that applicants provide proof of approval.

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<sup>4</sup> Regulations of the PRC on the Disclosure of Government Information, Article 10; Regulations of the People’s Republic of China on Open Government Information. Article 23, 2008.

<sup>5</sup> PRC Administrative Licensing Law. Article 31, 2004.

- Seek input from companies to understand and define “essential” information. Such exchanges can help approval authorities gain a deeper understanding of intellectual property and define what information is necessary to make informed decisions about licensing. This information can then be used to develop standard templates for key licensing processes. Together, these steps will help regulators create a more efficient licensing system while meeting regulatory needs.
- Adopt international best practices to evaluate new and existing regulations – such as the regulatory impact assessment (RIA) used by the United Kingdom, New Zealand, Russia, and Mexico. Using the RIA or a similar assessment will enable regulators to better understand how current or proposed regulations will affect industry and government. In particular, for Chinese regulations that propose collecting information from companies, such assessment would enable authorities to fully consider whether information is necessary to carry out regulatory goals and how collecting such information might impact companies.<sup>6</sup>
- 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.
- Establish best practices for local and municipal authorities to ensure compliance with existing regulations limiting disclosure.
- Conduct regular professional training for personnel at all levels of government that are involved with licensing and approval processes to better protect trade secrets and ensure familiarity with the issues and consequences of intellectual property disclosure.

## Expert Panel Reviews

### Background

Current regulations require expert panels to be convened for inspection, testing and quarantine of equipment, facilities, products, and articles that directly concern public security, health, and safety of life and property.<sup>7</sup> Some USCBC members are concerned that these panels may expose the company’s technology through the licensing review process.

Companies have three major concerns about expert panel reviews. First, the government has the authority and tendency to nominate panelists who work at Chinese companies in competition with the applicant. Second, reports submitted to review panels often include detailed information about project costs and revenue, capacity and equipment, raw material and energy requirements, and other confidential operational details. Many companies consider this type of information to be a trade secret. Therefore, providing such information to anyone outside the company – including competitors and government officials – is extremely problematic, as companies risk losing competitive advantage, profits, and sensitive technology as a result of exposure. Third, companies indicate that experts are given unlimited authority to ask for information from companies, even when this information has little or no relation to the panel’s decision. While companies are willing to work with regulators to share information that is necessary and directly related to the licensing process, sharing this information with panel members who are also competitors creates a significant – and unnecessary – commercial handicap.

One example of how the government has sought to avoid such conflicts of interest is found in the PRC Bidding and Tendering Law, which regulates procurements related to the public interest in China. The law provides that those with an interest in a given project are ineligible to serve on the project’s bid assessment committee and will be replaced if they have already joined.<sup>8</sup> The government should continue to enforce provision and create a similar rule for expert panel reviews. Ensuring that a similar provision is used throughout China will help address companies’ concerns about trade secret exposure and create a more hospitable investment environment in China.

<sup>6</sup> Regulatory Impact Analysis. Organization for Economic Co-operation and Development. 2012. <http://www.oecd.org/gov/regulatory-policy/ria.htm>

<sup>7</sup> PRC Administrative Licensing Law. Article 28. 2004.

<sup>8</sup> PRC Tendering and Bidding Law of The People’s Republic Of China. Article 27. January 2000.

## Case Studies

After one company submitted its environmental impact assessment (EIA) report for consideration, the local government named a competitor to the expert review panel. The expert was a vice president of a domestic company in the same sector as the company that was seeking approval. The competing executive said he wanted a stake in the company's new project. To persuade the company to agree, he questioned parts of the project from his position on the panel. As a result, the project was delayed, putting the project at risk and slowing the employment and tax benefits that the project was expected to bring to the local community and government.

Another company said that an expert on a panel reviewing its EIA report required that the company disclose operating details on a particular technology system nearly a year after the EIA was approved. The approval agency told the company that this disclosure could affect future projects planned in the region. The panel challenged the performance of the company's technology, which had already met US Environmental Protection Agency standards for use in the United States, and said that the technology would not function as the company had said it would. In its place, the panel directed the company to install a more complex, unproven, and costly system. To address expert concerns and demonstrate the value of the technology, the company was required to provide the panel with design details, which it considered trade secrets.

## Recommendations

The Chinese government should consider additional steps to ensure trade secret information is protected during expert panel reviews and that competitors are not named to expert panels. To do this, USCBC recommends that relevant government agencies:

- Enforce existing laws preventing individuals with a conflict of interest in a given project from serving on an expert panel. Where no such provisions exist, establish rules prohibiting the naming of experts with clear conflicts of interest to applicants' expert panels and requiring those with a conflict of interest to be removed.
- Institute a formal process for applicants to dispute experts nominated to the panel where conflicts of interest exist. This process should include a set timeline for consideration, review, and resolution of the dispute to minimize disruptions in the investment process.
- Allow greater input from applicants on experts nominated to panels. Provide updated and complete lists of approved experts to companies and allow them to nominate a certain number of experts to the panel.
- Institute clear guidelines on making requests for sensitive company information. Policies should require experts to support information requests with substantiated facts, commercial experience, and sound science. Create clear and formal processes for managing such requests, including a set timeline in which requests must be made and for companies to respond.
- Draft and enforce regulations that require government officials – and those acting in a government capacity, such as expert panelists – to keep confidential all data collected during and after regulatory reviews and product approvals. Expert panelists should be required to return or destroy all data collected during their work on an expert panel. Regulations should outline specific consequences when such provisions are violated.
- Work with provincial and local governments to provide clear information to officials, industry, and the public via regulations, public seminars, or other means about the rules governing certification, selection, use, and operating conduct for expert panels. This information should include obligations for experts to withdraw from a particular case based on a conflict of interest. Work with officials at all levels to set clear expectations for the qualifications and conduct of members in the pool of experts who are available to serve on panels.

## Transparency and Uniformity in Approval Procedures and Timelines

### Background

USCBC companies greatly appreciate central and local government websites that clearly outline the application materials needed in different licensing processes. Making these requirements and timelines for

approval easily accessible is a hallmark of many advanced economies and an important indicator of regulatory transparency, and helps companies efficiently move forward in the investment process.

The Chinese government has stated its intent to streamline licensing processes to facilitate investment in its economy. As a part of these efforts, regulators should consider the benefits of consistently and accurately listing all documents required in a given licensing process on agency websites. Currently, Chinese central government laws include provisions to ensure flexibility in unforeseen future developments in licensing.<sup>9</sup> Such flexibility could allow for unclear provisions or documentation requirements, which add costs to both companies and government agencies, and ultimately puts a strain on the overall economy.

Many municipal governments require “other documents required by government authorities,” beyond clearly defined application materials. Additional requirements from local governments can lengthen approval times and add cost for both companies and the government to clarify what constitutes “other documents” and ensure that applications meet requirements. In addition, unclear documentation requirements can lead companies to provide too much or too little information, which lengthens the application process and burdens both companies and government stakeholders. Often in these situations, companies feel they have to provide sensitive information for the application to be approved.

Vague or unclear requirements can also lead to inconsistencies across jurisdictions. Without clear guidance, authorities sometimes misinterpret information, forms, and materials are required in the licensing application, meaning the application process for the same license could be radically different in different jurisdictions. This unnecessarily complicates the licensing process, and causes confusion among companies seeking to invest in China. Unclear documentation requirements can also contribute to abuse of local authority when the power to interpret application requirements, or to grant the license itself, is concentrated in one individual.

Clear approval timelines are a key part of a transparent and efficient approval system. USCBC members across different industries appreciate that Chinese regulations stipulate that no administrative approval can take longer than 60 days, at the latest, from receipt of an application to approval. If an approval is delayed, the government is supposed to provide the applicant an explanation for the delay.<sup>10</sup> However, numerous licensing processes are excluded from that time limit, including public hearings, bid invitations, auctions, inspections, testing, quarantines and expert evaluations.<sup>11</sup> For example, the recent [Notice on the Acceptance and Review of Administrative Licensing regarding Securities Investment Fundraising Applications](#) (证券投资基金募集申请行政许可受理及审核情况公示) makes clear that expert panel reviews are exempt from licensing timelines. Regulations such as this can greatly extend the licensing review process and reduce the accountability of license approval authorities.

## Case Studies

As an example of how the lack of transparency affects companies in different areas of the licensing process, one company noted that they were asked by a local tax bureau to bring proper documentation to complete their tax filing, but were not given a complete list of materials needed to complete the filing. Because of that oversight, a government representative was forced to meet with the company representative more than five times in a three-week period. Each time the official checked their paperwork and found something new missing. The lack of clear process demanded extensive company time, while also wasting a substantial amount of government time.

In another example, a company seeking to expand its production in China informed the local branch of the General Administration of Quality Supervision, Inspection and Quarantine that the company needed to import a specific piece of machinery from the United States. The agency required the company to provide a machine production invoice that had been reviewed and verified by the Chinese embassy in the United States. Though the company had previously undergone the application process in other locations in China, this was the first time such verification was required.

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<sup>9</sup> PRC Administrative Licensing Law. Article 15. 2004.

<sup>10</sup> PRC Administrative Licensing Law. Article 42. 2004.

<sup>11</sup> PRC Administrative Licensing Law. Article 45. 2004.

Several companies also provided examples showing the importance of clear timelines. In one instance, a USCBC company experienced problems with their approval timelines at the national level when it sought to convert its China subsidiary from a joint venture to a wholly-foreign owned entity. In the process, the company submitted its documents to a central-level agency for review and approval. However, the company waited more than six months to hear back about the status of the application; agency officials did not provide a reason for the delay, despite the company's weekly outreach. To make progress on this issue, the company sought meetings to engage the agency directly. The agency agreed to meet with the company. In the meeting, the agency attributed the delay to personnel changes. After the meeting, the agency quickly approved the application.

## Recommendations

To ensure application requirements are publically available, applications meet local authorities' needs, and to promote predictability in the licensing system, USCBC recommends that relevant Chinese government agencies:

- Work with local government agencies to standardize licensing processes nationally to ensure a consistent application process across jurisdictions. All application requirements should be published in full on local government websites and available in hard copy at those agencies' offices.
- Align central, provincial, and local regulations to ensure unified regulations across levels of government and agencies.
- Encourage local government agencies to eliminate requirements for "other documents" on government websites and publications; replace with specific and detailed application requirements to ensure approval authorities receive all information necessary to evaluate and approve applications on the first submission.
- Ensure governments at all levels abide by laws requiring authorities to communicate at one time any additional materials required from companies for consideration of their applications.
- Ensure time limits are clearly articulated at the outset of the project and for each stage, including public hearing, bid invitation, auction, inspection, testing, quarantine and expert evaluation.
- Provide a report explaining why the approval was delayed. The approval authority should also set a new time limit that is commensurate with the government's reason for the delay.
- Promote transparency in the licensing system by requiring that agencies provide more frequent and timely updates the status of applications. This will allow applicants to better plan and update investment timelines as needed.
- Provide regular training to local approval authorities on best practices in managing approval timelines and in delivering regular updates on application status to companies. Increase accountability by developing reviews to monitor transparency and timelines, such as annual reviews among provinces and municipalities to track average timelines for application approvals.

## Third-Party Recommendations

### Background

Companies in all industries work with tax, environmental, legal, and other third-party consultants throughout the licensing process. Depending on the approval being sought, many USCBC members have said that local government regulators often recommend or, at times, mandate the use of specific, third-party consultants.

Current Chinese laws provide differing requirements for how government should manage third-party recommendations. For example, the Administrative Licensing Law stipulates that an administrative agency considering a license application may not require any applicant to purchase services or commodities, or make other unreasonable requests, as a condition for receiving the license.<sup>12</sup> Further, the Tendering and Bidding Law forbids any approval authority from imposing certain products or service providers on the tenderer.<sup>13</sup> Despite this, many USCBC companies felt a great deal of pressure from local government officials to use government-recommended service providers. Several companies noted that if they chose not to use a government-approved entity recommended to them, they ran the risk of licensing delays and strained

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<sup>12</sup> PRC Administrative Licensing Law. Article 27. 2004.

<sup>13</sup> PRC Tendering and Bidding Law. Article 12.1999.

government relations. In the end, pressure to use government-recommended service providers could create opportunities for corruption.

### Case Study

As one example of how such recommendations cause problems, one company – to gain approval of its product – was required by officials to employ a recommended agent to assist in paperwork preparation. Though the company has been in China for several decades and is familiar with the document preparation process, the company felt it had no choice but to comply. However, the company discovered that the recommended agent was primarily a courier: once the company prepared the paperwork, the agent simply delivered it to the government, offering little value for the company. Regardless, the local government has refused to accept submissions from the company directly, adding additional costs for the company.

### Recommendations

To ensure companies can choose qualified and trusted third-party providers, USCBC recommends that policy makers:

- Ensure that governments at all levels do not mandate use of specific third-party entities in the licensing process.
- In instances where the use of a third-party service provider is required, allow the company to choose its own service provider, including international service providers licensed to undertake that work.
- If a company asks the local authority for a list of local service providers, provide a list of three or more qualified third-party vendors for company consideration.

### Conclusion

Administrative licensing is an essential part of effective governance to ensure compliance with laws and public health and safety. At the same time, the efficiency and transparency of the licensing system can have a significant impact on companies' willingness to invest in an economy. Ongoing reforms to simplify the administrative licensing process show that the Chinese government understands the positive commercial benefits that increased transparency and efficiency will have on promoting new business development.

In addition to these steps designed to ensure full adoption at the local level, USCBC recommends additional measures to create a more predictable and efficient licensing system that protects sensitive company information, ensures fair and equitable treatment, and simplifies overall processes that investors are required to undertake in the licensing system. Taking such steps will help create a more reliable licensing system in China that facilitates the creation of new businesses, contributes to economic growth and development, and helps China meet its policy and investment objectives.