



Government Procurement and Sales to State-Owned Enterprises in China

Challenges and Best Practices | September 2021



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Executive summary

The Chinese government has set its sights on reforming its several-trillion-dollar public procurement environment to offer greater transparency and equal treatment to foreign companies, building on improvements over the last decade. Despite these efforts, US companies still report significant challenges achieving fair and equal access to procurement opportunities in China compared to Chinese private and state-owned enterprises (SOEs). This suggests a disconnect between the encouraging rhetoric from the highest levels of the Chinese government and the procurement decisions made on the ground. These challenges are exacerbated by both deteriorating US-China relations and by China's failure to join the World Trade Organization's (WTO) Government Procurement Agreement (GPA), which requires countries to provide equal treatment to foreign and domestic suppliers when it comes to government procurement and sales to covered SOEs.

Key challenges

- **Domestic substitution:** Chinese government entities and SOEs have begun replacing foreign products and components with those of majority Chinese-owned companies headquartered in China. This is particularly prevalent in sensitive sectors, such as information and communication technology (ICT), health care, and advanced technology and equipment, though it is becoming more common in several other sectors. Some procuring entities explicitly state that they will not accept imported products in tender documents, while others informally express preferences for local brands during the bidding process.
- **Unclear domestic content requirements:** Under Chinese law, products that are made in China are eligible for preferential treatment in government procurement. However, China has not specified what kinds of products qualify as made in China, resulting in inconsistent treatment. For some government entities, domestic products can include goods manufactured by foreign-owned companies in China. For others, the term only includes goods affiliated with Chinese brands that are majority Chinese owned and headquartered in China.
- **Broad security criteria when evaluating bidders:** ICT and specialized equipment suppliers report that security factors weigh heavily in procurement decisions, which often disadvantages foreign companies. Government entities and SOEs in power generation, telecommunications, and other sectors increasingly prioritize security but do not have transparent standards or metrics to assess suppliers. It is difficult for foreign-invested enterprises (FIEs) to receive a competitive score, as Chinese customers consider them to carry inherent security risks.

Common strategies

- **Work with a local partner:** In many cases, USCBC members have found that joint ventures (JVs) with majority Chinese ownership are more likely to succeed in government procurement and sales to SOEs. FIEs across sectors use JV partners or local distributors to facilitate bidding and avoid the potential disadvantages that come with being a foreign brand.
- **Manufacture locally and receive certifications:** A strong local presence can improve customers' willingness to source from foreign suppliers and address some of their concerns about the long-term reliability of US companies. Most companies noted that expanding local research and development investment, manufacturing facilities, hiring, and tax contributions can be helpful. Companies also recommend pursuing certifications that label products as locally manufactured. These include industry certifications, such as cryptography and other security certifications for the ICT sector, as well as written endorsements from municipal and provincial governments. These certifications are only available for goods that are produced in China.
- **Raise issues with provincial leaders:** Many companies consider provincial government leaders to be their best resource. In some cases, when companies have raised issues of exclusion or unfair treatment as foreign brands, officials have addressed the issues with local customers and forced departments to retract unfair guidance.

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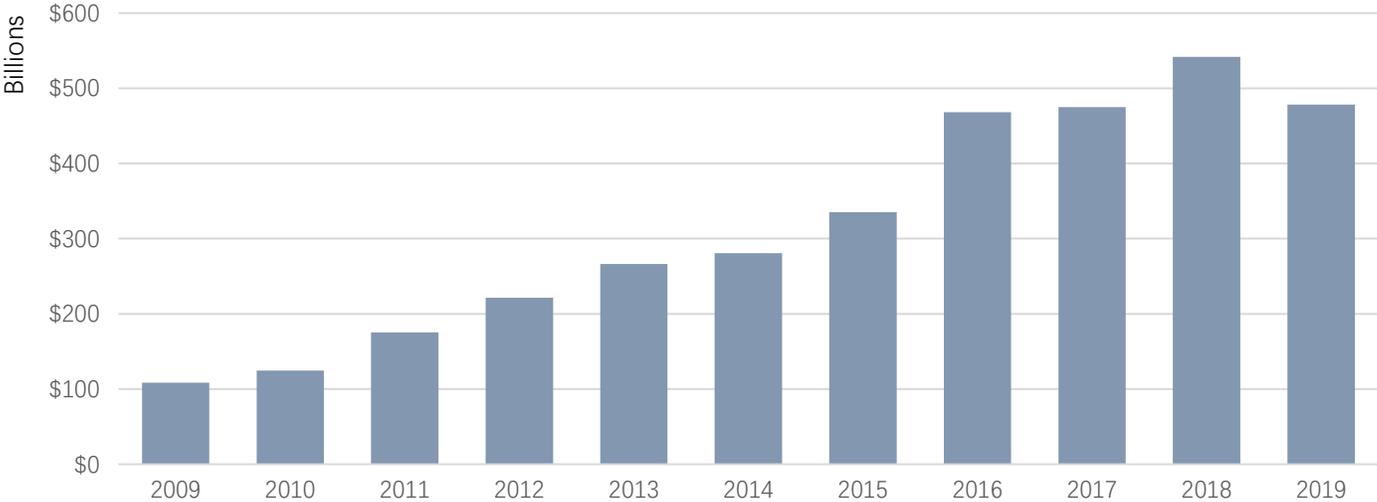
Introduction

Government procurement and sales to SOEs are important business segments to American companies trying to compete in China. While no estimate of market size is perfect, according to the Ministry of Finance, China's central government procurement market grew to \$478 billion in 2019. When including sales to SOEs, the value of the market is even higher; from 2019 to June 2020, central SOE procurement expenses totalled \$2.15 trillion.¹

Central government-owned and operated SOEs have vast economic capacity and are leaders in several global industries. Of the 124 Chinese companies listed on the Fortune Global 500 list, over 70 percent are SOEs. The Chinese government has considerable influence over SOEs' allocation of capital and commercial decisions, making its impact on SOE suppliers and competitors uniquely significant.²

Despite the Chinese government's efforts to make its procurement environment more transparent and equal for foreign companies, USCBC members still report significant challenges achieving equal access to and securing procurement opportunities in China. USCBC members have developed strategies to mitigate these challenges, though it is unclear how long these tactics will remain effective. This report is derived from interviews with 30 US companies across the ICT, health-care, energy, and manufacturing sectors as well as legal experts in government procurement.

Size of China's government procurement market



Source: Data from the Ministry of Finance

*USD value based on average annual exchange rates.

¹ Official statistics do not include the procurement spending of provincial- and municipal-level SOEs, as China's State-Owned Assets Supervision and Administration Commission does not release official procurement data for those levels.

² World Bank economists estimate that the SOE share of China's GDP ranges from 23 to 28 percent. According to the Center for Strategic and International Studies, total assets from China's 96 largest SOEs could exceed \$63 trillion.

Overview of procurement laws in China

China's government procurement system is underpinned by two laws—the Government Procurement Law and the Tendering and Bidding Law—both of which regulate the purchase of products using public funds. The Ministry of Finance enforces the Government Procurement Law, which took effect in 2003 and regulates government entities' procurement of goods, projects, and services. The National Development and Reform Commission administers the Tendering and

The tendering process



Bidding Law, which took effect in 2000 and applies to SOE procurement activities as well as procurement in construction and public works projects. Goods and services that are eligible for procurement are listed in procurement catalogs at different levels of government, depending on whether funding comes from central or local budgets.

Most procurement for government entities and SOEs follows public invitation tendering, during which procuring entities offer projects to all qualified bidders. Chinese laws on procurement and tendering clearly outline this process, though in practice, it may vary depending on the size of the bid, the industry involved, and the procuring entity.

"In government procurement, there should be no restrictions based on the ownership type of suppliers, nationality of investors, or the brands of products and services. Local governments will be supported in intensifying efforts to attract foreign investment."

-Readout of a 2019 State Council executive meeting

Revised and new laws

China issued a draft revision of the Tendering and Bidding Law in 2019 and a draft revision of the Government Procurement Law in 2020. The drafts, if passed in their current form, would toughen the transparency requirements of tender notices and align China's procurement framework more closely with global standards. The draft revised Government Procurement Law provides more information about different government procurement methods, procedures, and transparency requirements, most of which are consistent with language in the WTO's GPA, which is widely accepted as the global standard. However, companies remain concerned about "buy China" provisions that allow government entities to favor domestic products, the lack of a definition or domestic content threshold for these products, and unclear language around the equal treatment of FIEs.

In addition to these revisions, China enacted the Foreign Investment Law in 2020, which aims to address FIE participation in government procurement. Article 16 emphasizes that China will uphold fair competition for FIEs in government procurement activities and that FIE products manufactured in China will receive equal treatment. While some companies welcome this language, others say it leaves more to be desired, as it only ensures the equal treatment of FIEs if they produce goods in China, not if they source goods from abroad.

³ Examples of procuring agencies include China CNT International Tendering Corporation (a central government-affiliated procurement agency); Henan International Trade & Tenders Co., Ltd (a local government-affiliated procurement agency); and Shanghai Comservice Bidding Co., Ltd (a subsidiary of China Comservice, which is an SOE).

China's 2019 GPA bid

China's 2019 offer, though not public, reportedly improves on previous bids by expanding coverage of entities at various levels of government and increasing the number of SOEs and services subject to GPA compliance. The bid applies GPA commitments to all provinces and provincial-level municipalities (excluding autonomous regions), increases access to defense-related procurement, and adds 16 SOEs and 36 local colleges and universities to China's coverage.

However, many obstacles to China's accession remain, including inadequate coverage of SOEs and the inclusion of transitional measures that would delay the full implementation of its commitments after formal accession.

Slow progress joining the GPA

Currently, Chinese government and state-owned entities are not bound by GPA rules to provide equal treatment to foreign goods in government procurement despite committing to joining the arrangement as part of its accession to the WTO.

Accession to the GPA would require China to maintain open, fair, and transparent conditions for foreign competition in procurement for all entities, goods, and services to which China allows access in its coverage schedule. It would also provide Chinese companies equal treatment in GPA signatories' procurement markets. It would further require China to establish domestic review systems that allow companies to challenge violations of domestic procurement legislation or GPA provisions and would allow other countries to raise GPA violations against China through the WTO's dispute settlement mechanism.

GPA parties and observers

Parties			Observers		Observers negotiating accession
Armenia	Greece	Norway	Afghanistan	Malaysia	Albania
Aruba	Hong Kong, China	Poland	Argentina	Mongolia	Brazil
Australia	Hungary	Portugal	Bahrain	Panama	China
Austria	Iceland	Republic of Korea	Belarus	Pakistan	Georgia
Belgium	Ireland	Republic of Moldova	Cameroon	Paraguay	Jordan
Bulgaria	Israel	Romania	Chile	Philippines	Kazakhstan
Canada	Italy	Singapore	Colombia	Saudi Arabia	Kyrgyz Republic
Chinese Taipei	Japan	Slovak Republic	Costa Rica	Seychelles	North Macedonia
Croatia	Latvia	Slovenia	Côte d'Ivoire	Sri Lanka	Oman
Cyprus	Liechtenstein	Spain	Ecuador	Thailand	Russian Federation
Czech Republic	Lithuania	Sweden	India	Turkey	Tajikistan
Denmark	Luxemburg	Switzerland	Indonesia	Vietnam	
Estonia	Malta	Ukraine			
Finland	Montenegro	United Kingdom			
France	The Netherlands	United States			
Germany	New Zealand				

Source: [WTO](#)

So far, China's bids to join the GPA have been deemed inadequate by GPA members, including its most recent in October 2019. As a result, it remains difficult to address concerns regarding companies' treatment in the procurement environment from a legal standpoint.

SOE procurement and WTO commitments

While China is not a member of the GPA, it is subject to WTO rules and commitments related to SOE procurement. During its accession to the WTO, China committed that all SOEs would make purchases and sales based solely on commercial considerations, and that foreign companies interested in selling to SOEs would be subject to non-discriminatory terms and conditions. China also promised that it “would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises,” including on “the value or country of origin of any goods purchased or sold.” Domestic content requirements, instructions for SOEs to favor domestic products, and other efforts to interfere with procurement decisions that are otherwise made along commercial lines may be incompatible with the core WTO principle of national treatment.

China has repeatedly emphasized these commitments, most recently in negotiations with the European Union. The EU-China Comprehensive Agreement on Investment (CAI) requests that covered entities, including SOEs, conduct purchases on a commercial basis, maintain transparency in procurement, and apply “treatment no less favorable” to goods or services from EU entities.

Common issues and key challenges for companies

USCBC members are generally satisfied with procedural reforms in procurement, as well as greater levels of transparency and limited corruption in tendering. However, they note persistent concerns around implementation, suggesting that there is a disconnect between high-level reforms and statements promoting a fairer procurement environment and actual procurement decisions, which are often made at the local level.

Domestic substitution

According to nearly all of the companies interviewed for this report, deteriorating US-China relations is a key obstacle to procurement market access. Government entities and SOEs increasingly voice the same concerns to USCBC members: 1) they are not sure if buying US products is politically in their best interest, and 2) if they buy from US suppliers, they cannot be assured of continued access to the product given fluctuating US sanctions and export control policies.

In response to supply chain concerns, the Chinese government has increased its drive toward self-sufficiency in core technologies and encouraged local government entities and SOEs to prioritize domestic substitutes wherever possible. For the purposes of this report, “domestic” or “Chinese” brands refer to those that are majority Chinese owned and headquartered, and “domestic” or “made in China” products refer to products produced by Chinese brands.

This trend of domestic substitution has disproportionately impacted US suppliers in sensitive sectors, including ICT, medical devices, and specialized equipment. For a few high-tech products, including advanced logic semiconductors and airplane engines, China cannot fully replace foreign suppliers yet, but US companies anticipate that they will face similar challenges with domestic substitution as local competitors eventually emerge.

Preferences to “buy China” are sometimes explicit in tendering documents, with customers indicating that they will not accept imported products. For example, as of 2019, central government procurement lists for software do not include imported [products](#) but only those from JVs or majority Chinese-owned companies. In other cases, preferences for Chinese brands only become clear during procurement negotiations. For instance, according to public [reporting](#), the Ministry of Industry and Information Technology and the Ministry of Finance have circulated local content requirements that public hospitals, SOEs, and government agencies across China must consult before purchasing certain medical equipment and testing machinery. The list includes 315 products and requires between 25 and 100 percent local content for each item.

Inconsistent implementation across provinces

Despite efforts to standardize procurement rules, companies report that local governments often apply them inconsistently across provinces. Central and western regions show greater tendencies to exclude foreign bidders and develop technical specifications with specific local bidders in mind. In addition, these regions are more likely to prioritize low-cost goods at the expense of often higher-quality domestic and foreign products.

In some cases, local tenders require certifications that are not available to foreign companies. For instance, specialized industrial equipment manufacturers note that some recent tenders require bidders to obtain a certificate from the China Machinery Industry Federation (CMIF) demonstrating that their technology is locally developed. After contacting CMIF, they are told that the certification is not available to foreign brands unless they are part of a JV in which the Chinese partner has majority ownership.

Unclear definition of domestic or made in China products

Under the Government Procurement Law, government entities must prioritize domestic products, but China has not yet provided an official definition of this term (本国货物 or 本国产品). It is worth noting, however, that in 2010, the Ministry of Finance, the National Development and Reform Commission, and the General Administration of Customs jointly [released](#) draft administrative measures on government procurement that define “domestic products” as final products that are manufactured in China and for which the share of domestic production costs exceeds 50 percent. China has not released a final version of this regulation.

Given the lack of an official definition, interpretations of the term “domestic product” vary across procuring entities. Some treat all locally manufactured products as domestic, regardless of whether the manufacturer is an FIE or a Chinese company. Others only consider a bidder’s products to be domestic if the company is a Chinese brand, meaning they produce in China with majority-Chinese ownership.

While many US companies manufacture a significant share of their product components in China, conduct research and development in China, form JVs with local companies, and hire Chinese employees, they are increasingly viewed as foreign brands in procurement projects. US companies are unsure whether China will issue an inclusive definition for domestic products or continue to omit one, allowing government entities flexibility to support local players. Others worry that China will release a definition with a high domestic content threshold, which would exclude foreign companies that source most components from outside China.

Other countries use domestic content requirements to determine whether a product qualifies as domestic. For instance, the United States [defines](#) a domestic product as one in which “the cost of its components mined, produced, or manufactured in the United States exceeds 55 percent of the cost of all its components.”

Sensitive industries: ICT, health care, and technical equipment

ICT procurement challenges

When it comes to procurement, companies in the ICT sector have suffered the greatest impacts from US-China tensions. Many have lost contracts with government entities and SOEs over the last few years because of strongly weighted security criteria in the bidding process, concerns about US export controls, and China’s efforts to promote technological self-sufficiency.

Domestic substitution (buy China)

In conversations with SOE customers, many USCBC members have discovered detailed, nonpublic plans to replace foreign products with domestic alternatives in the ICT sector during the 2020–2022 period. According to customers, the central government has issued instructions to local government entities and SOEs in sectors related to national security, including aerospace, health care, and energy, requiring them to gradually devote a higher share of their procurement budget to ICT products from domestic brands. Reports of these plans are particularly troubling, as they suggest that domestic preferences, unequal treatment, and support for Chinese brands have moved behind the scenes. This could make raising these issues with Chinese authorities or the WTO more difficult, as companies lack public evidence and Chinese officials can simply deny the problems exist.

In the short term, government entities appear more willing to purchase US technology when there is no viable domestic alternative, including advanced logic semiconductor chips. However, even advanced semiconductor companies are wary, as they may be vulnerable to domestic substitution in the long run.

Opaque assessment criteria

Most tenders are now publicly available online, and bidders can view their own scores as well as those of their competitors during the tendering process. However, some companies note that the scoring process is opaque. Most bidders are assigned scores based on their technical quality, adherence to specifications, and perceived security, but USCBC member discussions indicate that there are no standard evaluation criteria and that weighting can vary by customer.

As in other sectors, ICT products must receive several certifications to be competitive in government procurement, including an energy efficiency certification from the China Energy Conservation Program and an environmental production label, the latter of which certifies that a product's manufacturing, use, and disposal adhere to environmental protection requirements. Companies report that these certifications and quality assessments are often not the problem when it comes to market access. The real challenge is whether a company's product meets security requirements, which are ambiguous.

According to USCBC members, a growing number of government entities and SOEs require what is termed as "secure and controllable" technology, for which there is no official definition or criteria. Testing a product's security usually entails additional assessments and certifications, including being scored under the cybersecurity Multi-Level Protection Scheme, also known as "MLPS 2.0," a grading scale that assesses the level of risk that a company's ICT infrastructure poses to China's national security. A higher score indicates greater risk.

Additionally, despite the fact that cybersecurity legislation, including the Cybersecurity Law and the Cybersecurity Review Measures, does not explicitly cite national origin as a defining factor in

products' security profiles, companies note that many procuring entities assume that US companies are de facto security risks.

As a result of these factors, it has become increasingly difficult to sell software and ICT equipment to SOEs in the telecommunications and energy sectors, which are considered sensitive to China's national security. Some hardware companies have easier access to SOE procurement in financial services, medical services, and universities.

When selling to SOEs, especially telecom operators, companies report that security considerations often account for nearly half of a bidder's total score during the evaluation process. Companies note that, in some cases, security considerations are the most weighted criteria, which ultimately leads US companies to lose bids despite offering competitive prices and high technical specification scores. When companies ask customers for a rationale, the customer often cannot justify the decision based on evaluation criteria and the recommendations of expert evaluation committees alone. One company mentioned that during a tender in which they ranked first on all comprehensive metrics but still lost the bid, the customer said that the expert committee had not made the decision, implying that the government or another third party had influenced the outcome.

Health care: Medical devices and consumables

Many USCBC members sell medical technology, equipment, and consumables to hospitals, research labs, centers for disease control, China Customs, food and drug regulators, and the Ministry of Ecology and Environment as well as local government entities that conduct medical research and development. These companies highlight discrimination against imported products and the growing number of tenders that touch on national security or sensitive areas as among their key procurement challenges.

Exclusion of imported products

The State Council's 2016 [guide](#) on what is called China's healthy development emphasizes that government procurement should prioritize domestic products so long as they meet basic requirements. It also states that China should increase the allocation of domestic equipment in public medical institutions. Healthcare companies note increasingly explicit language in some tendering documents indicating that government entities will not purchase imported products. In other cases, customers are required to provide additional documentation to justify their purchase of imported products, which many consider burdensome.

A growing number of cities and provinces, including Beijing, Shanghai, Zhejiang, Guangdong, and Sichuan, have released guidelines urging hospitals to purchase Chinese-made medical equipment. Some have begun releasing semiannual lists of imported equipment eligible for government procurement and for which there are no viable domestic alternatives. These lists become narrower

each year, with Guangdong's falling from [132](#) to [46](#) items from 2019 to 2021 and Zhejiang's from [215](#) to [195](#) over the same period.

Even when imported medical equipment is eligible for procurement, some localities require hospitals to submit applications and file for permission before they can proceed. For instance, in [Guangdong](#), if a hospital would like to procure a product appearing on the provincial list of eligible imported equipment, it must first submit an electronic application via Guangdong's government procurement platform, receive approval from a provincial budget unit, and file with the provincial finance department. Procurement offices must submit a wide range of materials to justify their choices, including the opinions of government procurement experts, budget approval documents, minutes from procurement-focused internal meetings, and detailed comparisons of domestic and imported products' technical parameters and functional performances. Such administrative burdens alone put foreign companies at a competitive disadvantage compared to their domestic competitors.

Slow public posting of tenders

Under the Government Procurement Law, procuring entities must post tenders in public locations and maintain a minimum 20-day bidding period from the initial release of tendering documents to the bid deadline. According to some companies, procurement processes sometimes take as little as two weeks from the time that the tender is posted to the conclusion of negotiations. In these cases, most companies only become aware of an opportunity after negotiations have concluded. This does not happen very frequently in product segments in which FIEs have a large market share and are likely to be contacted to participate, but it can limit procurement opportunities for companies with smaller market shares focused on commoditized products.

Standards setting

When public hospital procurement offices develop procurement requirements, they often solicit input or suggestions from industry before posting a tender. Some companies have expressed

Case study: Regulator terminates procurement negotiation at last minute

In some cases, companies have nearly concluded negotiations with public hospitals only to be rejected by regulators. One medical device supplier was in the final stages of selling a large quantity of imported instruments to a public hospital directly under the administration of the National Health Commission (NHC) when negotiations were abruptly terminated. The hospital had applied for permission from the NHC's finance department, but its request was rejected. The foreign supplier consulted with the municipal commerce bureau and filed a complaint using a recently established official complaint channel for FIEs, but officials argued that no stakeholder had violated Chinese law. The company returned to the hospital to see whether the procurement head would be willing to initiate a lengthy appeals process, but the hospital did not want to make the effort. A majority-owned Chinese company ultimately won the bid.

concern that by the time they are asked to comment, many of the rules have already been determined, as offices meet in advance with Chinese companies. A procurement office might have three rounds of meetings with industry stakeholders and invite Chinese companies to participate in the first and second round, while only inviting FIEs to join the final round.

Health care: Pharmaceuticals and high-value medical consumables

For the most part, the procurement of pharmaceuticals and high-value medical consumables follows a different set of rules distinct from China’s Government Procurement Law. China regulates these goods under its Primary Healthcare and Health Promotion Law as well as regulations from specific government departments. In the past, these regulations were issued by the NHC, but they are now issued by the National Healthcare Security Administration (NHSA).

Over the last decade, China has pursued an aggressive strategy of price cuts for these goods through centralized and provincial volume-based procurement (VBP) schemes. Originally known as “4+7,” reflecting the number of cities in which the Chinese government piloted them, VBPs were adopted on a national scale in 2019. During centralized VBP rounds, there is a single public tender for a commonly used treatment, and the winning bidder supplies all of China’s public hospitals. China completed its fifth VBP round for drugs in 2021, and it conducted its first round of nationwide VBP for high-value medical consumables (coronary stents) in 2020. The State Council has emphasized [plans](#) to standardize and further centralize VBP. Provinces have also begun to organize alliances in which they come together to negotiate prices with bidders.

VBP, along with another program, the National Reimbursement Drug List (NRDL), have significantly lowered prices, but they come at a cost to foreign companies and Chinese patients.

Timeline of China’s national volume-based procurement



Source: Data from the National Healthcare Security Administration

Issues with VBP and NRDL

Most companies express concern about China's over-fixation with price. Under VBP, the lowest price traditionally wins the bid. In most cases, this means that the set price is extremely low—regardless of products' innovative qualities, research and development costs, or clinical outcomes—usually falling below companies' bottom lines. Likewise, in order to be included in the NRDL, companies face pressure to lower prices. Under this kind of price competition, many foreign companies are forced to withdraw from the China market. The Chinese government publicly releases the final prices and average price cut for drugs newly added to VBP and NDRL each year, which constrains companies' abilities to negotiate in other markets. These forces also stifle incentives for companies to produce innovative treatments.

Over the course of five rounds of centralized VBP for pharmaceuticals, covered drugs have [seen](#) an average price cut of over 50 percent. In 2020, when China conducted centralized VBP for coronary

The National Reimbursement Drug List

In China's general health-care system, NHSA and Ministry of Human Resources and Social Security are responsible for listing drugs on the NRDL in order for them to be eligible for reimbursement under national basic medical insurance schemes. Roughly 60 [percent](#) of the entire Chinese drug market is reimbursed through these schemes. Each year, China highlights therapeutic areas it wants to address and releases a list of which drugs it is considering for inclusion. The NHSA then negotiates with individual companies to determine the lowest price it is willing to consider. During the most recent round of negotiations, companies conceded to an [average](#) 50 percent price cut.

stents, companies were forced to reduce their price by an [average](#) of 93 percent, with an even higher reduction for imported products (95 percent). Some suppliers were unwilling to cut prices to this degree because it would be unsustainable and would pressure them to lower prices in other markets. Now, there is virtually no incentive for manufacturers to invest further in quality or technology upgrades for coronary stents because the products will not yield profit in China. This may result in lower quality products and treatments available to the Chinese public.

When conducting VBP for drugs, China targets pharmaceuticals that are off-patent and have generics in the market. Before evaluating drugs based on their price, China subjects generics to a conformity test to ensure that their quality is comparable to those of patented drugs. In

contrast, consumables do not face a similar conformity test. Companies argue that for consumable-focused VBP, there is no distinction between more and less advanced products, in spite of significant variation in quality within product categories. FIEs would prefer that VBP take quality into greater consideration, particularly for consumables, and conduct separate rounds of procurement for products with different applications and levels of quality.

Other concerns across manufacturing

Manufacturers of specialized industrial equipment and machinery reiterated concerns similar to those in the ICT and health-care sectors, including inconsistent treatment across provinces and an unclear definition of “domestic products.” However, some companies raised additional issues that have impacted their experience in government procurement and sales to SOEs.

Local protectionism and regional champions

Companies have found that in some cases, local competitors based in the province or region where a tender has been issued have a distinct advantage during the bidding process. In tendering documents, local government entities occasionally release technical specifications favoring certain local companies. In some cases, procuring entities have told FIEs that participating in tenders is not worth the effort if certain large local competitors also plan to bid. This problem is not limited to western and less developed provinces but occurs across China, with companies citing examples in Shanghai and Sichuan, among other locations.

Chinese competitors invoking buy China

Some companies note that they have little insight into procurement decisions and that Chinese-branded competitors are beginning to invoke self-sufficiency and buy China rhetoric to deter customers from purchasing foreign products. In some cases, companies have been rejected at the last moment, with customers failing to provide substantive information to justify their decision.

During a recent bidding experience, an equipment and automated solutions manufacturer learned that they had won a bid with a government customer. After a few days, however, the customer informed them that the decision was no longer valid, as they had found some product defects. The customer did not indicate what flaws they had encountered. The FIE discovered that a majority Chinese-owned competitor had approached the customer and successfully convinced them that the Chinese company was a more appropriate fit.

Selling to SOEs: Different treatment by SOE type

Some companies report that their experiences selling to SOEs vary depending on the customer's industry and whether it is owned by the central, provincial, or municipal government. It is often more difficult for companies to deal with centrally administered SOEs, while provincial and municipal SOEs are more flexible in how they define domestic products. This also varies by sector. As previously mentioned, SOEs in technology, aerospace, health care, and other sensitive sectors have a greater tendency to favor domestic brands during procurement. In some cases, Chinese SOEs justify treating FIEs' products as domestic if they manufacture in China and have a significant local presence.

Data security

Manufacturing companies whose products include automation features or require data collection to operate properly often encounter issues surrounding data security when selling to government entities and SOEs. If companies want to provide an automated system inside an SOE facility, they need to create unique localized solutions and establish localized data servers to ensure data remain within the facility. Because data security is a top concern for SOEs in sensitive sectors, local storage of data is a common requirement. A few companies acknowledge that even a commitment from an FIE to keep all related data inside China by using local cloud computing services like Alibaba Cloud or Tencent Cloud is still insufficient.

Unconventional payment methods

During negotiations, some large SOE customers have made clear that if FIEs want to do business with them, they have to be willing to accept commercial bonds as partial payment. A few companies note that this is an acute issue and that they can only receive full payment when bonds reach maturity. One company adds that it receives 60 to 70 percent of payments through their preferred banks and 30 to 40 percent through SOE bonds, though greater shares of payments are coming from commercial bonds over time.

Common responses to procurement challenges

Across industries, FIEs have found creative solutions to avoid exclusion or discrimination during government procurement.

Form JVs or merge with local players

Many companies have established JVs in which their local Chinese partner is a majority owner, pursued dual branding (with China-specific branding for products marketed with their local partner), and considered listing China-based business units on Chinese stock exchanges in order to stay competitive in local procurement projects. Companies have [found](#) that they have a distinct advantage in SOE and government procurement when operating as a JV, as their products are more likely to be considered domestic. A few specialized equipment manufacturers that exited their China JVs targeting public procurement are now beginning to reassess given challenges competing with local companies for government and SOE business.

Partner with local players

Some foreign companies recommend forming JVs with local SOEs or their subsidiaries, which may have preexisting relationships with local government customers or may be customers themselves. Procuring entities are more likely to assign certain parts of procurement projects to their own subsidiary and leave other aspects open to public bidding. This is not a common arrangement, but companies note that it can be effective in sensitive industries like power generation. SOEs feel more comfortable purchasing from their own subsidiaries because they can guarantee delivery, enjoy reliable access to technology, and bypass the public bidding process.

Purchase local distributors

Some companies purchase local distributors in China. Many customers are willing to source products and technology from US companies despite pressure to favor domestic goods, and this arrangement gives them the political cover to do so. In many cases, the FIE parent provides technology, equipment, and solutions but relies on the local distributor for its Chinese branding. These distributors can act as proxies during procurement negotiations and when signing contracts with local government entities and SOEs in sensitive sectors. When distributors participate in tenders on behalf of FIEs, government and SOE customers often recognize their American ownership but still prefer negotiating with the local brand. In some cases, the FIE manages pre-contract communications and negotiations and only brings in the local distributor to sign the contract. This has been an especially useful strategy for FIEs selling to government and SOE customers in sensitive industries or providing services related to sensitive issues, such as data centers.

Similarly, some healthcare equipment suppliers have considered working with local manufacturers through China's Market Authorization Holder system to maintain their public procurement customers. Under this framework, a company can maintain ownership of its products but delegate production to a local contract manufacturer. This could allow them to benefit from local treatment in procurement and avoid additional layers of approval required in certain provinces for imported medical devices. Several companies, however, warn of the potential for technology transfer under this model.

No guarantee of success

It is worth noting that the benefits of working with a local partner are limited. For one, a partnership can place constraints on products that may weaken effectiveness or increase costs. It also does not guarantee that products in sensitive sectors will meet government security requirements. A few companies in the ICT sector invested in local content suppliers and used more domestic components in an effort to meet secure and controllable requirements, but they found that the costs of doing so far outweighed the benefits. These companies created products with solely domestic components, but they were ultimately less efficient, more expensive, and not considered secure enough to be listed on central procurement lists. Some hardware suppliers note

that even if they were to develop a product with a Chinese operating system or Chinese chips, the product would not likely be considered secure and controllable because of its mere association with a US brand.

In addition to these issues, working with local partners can lead to intellectual property (IP) infringement and technology transfer. Some USCBC members suggest that FIEs face a difficult tradeoff when partnering with local companies—they can either maintain access to the procurement market or maintain full control of their IP. In some cases, USCBC members' JV partners have requested that new products and formulations be branded under the JV or Chinese partner's name. Some local partners insist that contract terms remain vague, with limited to no language on the protection of IP for future product developments.

The trajectory of the US-China relationship may also impact the long-term effectiveness of these strategies. If US-China tensions further deteriorate, local government entities and SOEs may avoid all direct and indirect sourcing of technology from US suppliers. At the same time, as Chinese companies become increasingly sophisticated, the advantages of working with a foreign company could diminish.

Raise issues directly with provincial government leaders

Companies receive varied responses when they raise procurement issues with different levels of the Chinese government. In some cases, officials deny that there are problems, but in others, provincial government leaders take earnest steps to address company concerns.

One company said that guidance to buy from Chinese brands often comes from a specific local government department, such as the provincial or municipal health security department, while provincial government leaders are kept out of the loop. In some cases, when companies have raised issues regarding exclusion or unfair treatment as a foreign brand, provincial government leaders have addressed the issue with local customers and forced departments to retract unfair guidance. One company stated that provincial leaders are their best resource, as they often worry about local incidents that could subject them to scrutiny from the central government.

Bypass public bidding

In addition to partnering with SOE subsidiaries, some US companies take advantage of other opportunities to bypass public bidding and highlight their technological superiority over local competitors. USCBC members note that many SOEs have special budgets for scientific and innovation projects over which they have greater autonomy in selecting suppliers. According to USCBC members, these projects are well suited to FIEs, as they require more advanced or specialized products, are often less sensitive to price and security considerations, and face less government oversight and pressure than public bids.

Form non-JV relationships

When forming a JV or absorbing local distributors is impractical for companies, many try other non-equity relationships to strengthen their competitiveness. Several companies recommend signing strategic cooperation agreements with customers, engaging in joint projects with Chinese universities and research institutes, and becoming more active in Chinese standards-setting technical committees. Any kind of alliance that allows companies to build relationships with potential customers or local players can be beneficial.

Manufacture locally

When procuring entities confront American companies about their reliability, FIEs often cannot guarantee that US export controls and other US policies will not interrupt supply chains, but they can highlight their local operations and commitment to the China market. They emphasize two points: 1) Chinese government leaders have explicitly encouraged government entities and Chinese companies to continue doing business with US firms, and 2) they maintain a strong local presence in China, with significant cumulative research and development spending, investment, local manufacturing, local hires, and tax contributions. A willingness to negotiate contracts in the renminbi can also increase customers' willingness to source from foreign suppliers.

Additionally, it can be helpful for suppliers to have a business presence in the same locality as their government and SOE customers. According to some companies, local government entities tend to be more interested in supporting local bidders rather than those from far-afield provinces.

Companies note, however, that local manufacturing and a strong local presence is beginning to carry less weight in government and SOE procurement compared to brand origin (foreign or Chinese).

Obtain industry certifications

Some companies recommend obtaining industry certifications that label products as "locally manufactured." These include written endorsements from municipal and provincial governments, industry certification bodies, and, for the ICT sector, cryptography and other security certifications.

When customers say that they prioritize buying made in China products, they sometimes mean that they prefer products manufactured domestically. If a company can prove that it produces most of its content locally, then it can in some cases enjoy the same treatment as a product from a Chinese brand. Many USCBC companies have taken advantage of this, including one manufacturer of health-care equipment in Tianjin that asked the provincial government to provide a written endorsement certifying that their products are locally made. A small number of other provinces and cities, including Beijing, have similar endorsement policies.

Worst case scenario: Rebalance portfolio

For some FIEs, large SOEs and government entities were once some of their largest customers. Now, they are trying to readjust their customer base, selling more to private companies and less to government entities and SOEs in sensitive industries. For instance, some manufacturers of automated systems and specialized equipment are shifting greater attention to customers in nonsensitive industries like food and beverage.

Prospects going forward

It is unclear to what extent the procurement environment will change over the coming years. Much will depend on whether China joins the GPA with meaningful concessions, how China pursues a strategy of technological self-sufficiency, and whether US-China relations improve.

- **GPA accession:** China's current bid to join the GPA is unlikely to succeed. GPA members want China to provide more meaningful access to SOE procurement and remove references to special treatment that are traditionally reserved for developing countries. China may be reluctant to make these concessions and offer equal treatment across procurement, as this could disrupt certain domestic priorities. In its draft revised Government Procurement Law, China lists "supporting innovation" as a key goal of government procurement. China wants to support Chinese brands—particularly those in technology and advanced manufacturing—and government procurement is a key vehicle for doing so.
- **Technological self-sufficiency:** So long as self-reliance and supply chain security remain high priorities for China, offsetting political concerns enough for the procurement environment to substantially improve will be difficult. The Chinese government seemingly wants to reduce government entities' and SOEs' reliance on foreign technology and ensure that domestic substitutes are available in case those entities and SOEs are cut off from foreign suppliers.
- **US-China relations:** Should US-China relations further deteriorate, sourcing from US suppliers could become more politically sensitive for SOEs and government entities. Current workarounds such as bidding through a local partner might not be sufficient over the long term to address customer concerns.

Appendix: Catalog of related policies

Legislation	Effective date
Tendering and Bidding Law	First passed by the National People's Congress in August 1999 and became effective in January 2000. The National Development and Reform Commission released a revised version for public comment in December 2019. The law applies to SOE procurement activities as well as procurement in construction and public works projects.
Government Procurement Law	First passed by the National People's Congress in June 2002 and became effective in January 2003. The State Council passed minor revisions in December 2014. The Ministry of Finance issued a second revised version for public comment in December 2020. The law regulates government entities' procurement of goods, projects, and services.
Foreign Investment Law	Passed by the National People's Congress in March 2019 and became effective in January 2020. The law targets China's foreign investment regime and dictates: "The State ensures that foreign-invested enterprises participate in government procurement activities through fair competition in accordance with law. Government procurement is to give equal treatment to products manufactured by, or services provided by, foreign-invested enterprises in mainland China."
Implementing regulations	Effective date
Administrative Measures for the Tendering of Goods and Services in Government Procurement	First issued by the Ministry of Finance in August 2004 and became effective in September 2004. The Ministry released a revised version in July 2017 that became effective in October 2017 and released a second revision for public comment in May 2021. The measures aim to standardize government procurement behavior and supplement the Government Procurement Law and the Tendering and Bidding Law.
Administrative Measures for Government Procurement of Imported Products	Issued by the Ministry of Finance in December 2007 and became effective immediately. The measures supplement the Government Procurement Law and apply to activities in which government entities purchase imported products. They define "imported products" as those that enter the territory of China after customs declaration, inspection, and clearance, and are produced abroad.

Implementation [Regulations](#) for the Tendering and Bidding Law of China

Passed by the State Council in November 2011 and became effective in February 2012. China released revised versions in March 2017, March 2018, and March 2019. The regulations standardize and offer additional guidance on tendering and bidding activities.

Administrative [Measures](#) for Non-Bidding Methods of Government Procurement

Issued by the Ministry of Finance in October 2013 and became effective in February 2014. The measures provide additional rules and administrative guidance on non-bidding methods of government procurement, including competitive negotiations, sole-source procurement, and requests for quotations.

Implementation [Regulations](#) for the Government Procurement Law of China

Passed by the State Council in December 2014 and became effective in March 2015. The regulations offer additional guidance on enforcement of the Government Procurement Law.

[Measures](#) for Challenges and Complaints in Government Procurement

Issued by the Ministry of Finance in January 2018 and became effective in March 2018. The measures replaced the Complaint Handling [Measures](#) for Government Procurement Suppliers, which the Ministry of Finance issued in August 2004. The measures standardize the complaint handling process for suppliers involved in government procurement and supplement the Government Procurement Law and its implementation regulations.

Implementation [Measures](#) for the Foreign Investment Law

Passed by the State Council in December 2019 and became effective in January 2020. The measures state: “The government and relevant departments must not obstruct or restrict foreign-invested enterprises’ free entry into the government procurement market. Government procurers and procurement agents must not exhibit differential or discriminatory treatment of foreign-invested enterprises in areas such as the publication of government procurement information, the inspection of supplier requirements and credentials, and bid evaluation criteria. They must not restrict suppliers on the basis of unreasonable requirements such as ownership structure, organizational structure, stock structure, investor nationality, or service branding; and must not offer different treatment to goods produced in China and services provided by foreign-invested enterprises in China (compared to those goods produced and those services provided by domestic enterprises).”

Administrative [Measures](#) for the Release of Government Procurement Information

Issued by the Ministry of Finance in December 2019 and became effective in March 2020. These measures replaced the Administrative [Measures](#) for the Announcement of Government Procurement Information, which were introduced in August 2004. The measures standardize the release of information around government procurement, attempt to increase the level of transparency in

procurement announcements, and offer clarifications on both the Government Procurement Law and its implementation regulations.

Administrative [Measures](#) for Government Procurement of Services

Issued by the Ministry of Finance in January 2020 and became effective in March 2020. The measures address government procurement of services and supplement the Budget Law, the Government Procurement Law, and the Contract Law.

Secure and controllable policies	Release date
Cybersecurity Law	Passed by the National People's Congress in November 2016. The law calls for the promotion of secure and controllable products and services.
Cybersecurity Review Measures (Provisional)	Released by the Cyberspace Administration of China in May 2017. The measures call for the promotion of secure and controllable standards and legislate that ICT product and service suppliers be assessed on their security and level of trust. All references to security and controllability were removed in the final version.
Secure and Controllable Evaluation Index for Information Technology Products: General Principles	Released by TC260 in November 2017. This voluntary standard provides basic indicators to assess the general security and controllability of information technology products.
Secure and Controllability Evaluation Index for Information Technology Products: CPUs	Released by TC260 in November 2017. This voluntary standard provides indicators to assess the security and controllability of CPUs.
Secure and Controllability Evaluation Index for Information Technology Products: OS	Released by TC260 in November 2017. This voluntary standard provides indicators to assess the security and controllability of operating systems.
Secure and Controllability Evaluation Index for Information Technology Products: Office Suite	Released by TC260 in November 2017. This voluntary standard provides indicators to assess the security and controllability of office suite software.
Secure and Controllability Evaluation Index for Information	Released by TC260 in November 2017. This voluntary standard provides indicators to assess the security and controllability of general computers.

Technology Products: General
Purpose Computers

**Imported product
catalogs (examples)**

Regulatory authority

Imported Product [Catalog](#) for
Guangdong's Provincial Health
Institutions (2021)

Released by the Health Commission of Guangdong

Imported Product [Catalog](#) for
Provincial Government
Procurement in Zhejiang 2021–
2022 (Medical Equipment)

Released by the Department of Finance of Zhejiang

Imported Product [Catalog](#) for
Provincial Government
Procurement in Sichuan 2021–
2022 (Medical Equipment)

Released by the Department of Finance of Sichuan