



European Chamber  
中国欧盟商会

European Business in China

# POSITION PAPER 2022/2023



## **European Union Chamber of Commerce in China**

[www.europeanchamber.com.cn](http://www.europeanchamber.com.cn)

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The *European Business in China Position Paper 2022/2023* represents the views of the European Union Chamber of Commerce in China. Our working groups, fora and more than 1,800 member companies have together compiled the latest assessments, concerns and recommendations of European businesses operating in China.

We hope that this position paper will promote constructive dialogue between Europe and China, at both the political and business levels. We look forward to continued improvement in business cooperation, to the benefit of both Europe and China.



**This icon**

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



**This icon**

indicates that the Key Recommendation is related to achieving carbon neutrality.



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## Message from the President

Although Europe and China already sit at opposite ends of a shared continent, it seems they are drifting further and further apart. The rest of the world has largely resumed pre-pandemic levels of ‘normality’, but China remains reluctant to open its doors.

Europe misses the deep level of engagement it had with China in areas such as arts and culture, sport and tourism; and being far removed from discussions on global matters, as well as unable to showcase its potential to foreign investors, is an immeasurable loss for China. The country’s ‘splendid isolation’ not only makes travelling in and out tedious, but also by inhibiting people-to-people exchanges—with China’s voice now almost exclusively virtual—it inevitably leads to less understanding of this great nation.

Inbound investment flows from the European Union (EU) are declining:<sup>1</sup> the bulk is contributed by a handful of large companies, and prevalent access barriers deter potential newcomers to the market.<sup>2</sup> The present mix of multinational companies and ‘hidden champions’<sup>3</sup> is stable, but there is increasing discrepancy between market potential and the actual market share of European companies. And while those already established in China are not looking to leave, they are increasingly weighing up the possibility of shifting planned or future investments to other markets that are perceived to provide greater reliability and predictability.<sup>4</sup>

At the same time, Chinese investment into Europe has long been on a downward trajectory and is now falling well short of its potential.<sup>5</sup> Yet the importance of the European market to Chinese investors is indisputable, as demonstrated most recently by Chinese energy storage giant CATL announcing it will invest euro (EUR) 7.34 billion to build a new battery plant in Hungary, its second in Europe.<sup>6</sup>

Trade could represent the means of strengthening ties between the two sides, but currently it is lopsided. The European market’s importance as a destination for Chinese exports is around double that of the Chinese market for Europeans.<sup>7</sup> This asymmetry looks likely to remain, as Chinese official customs data show that in the first seven months of 2022, China’s exports to the EU increased almost 20 per cent, whereas EU exports to China declined 7.5 per cent year-on-year.<sup>8</sup> In addition, while recent Chinese foreign trade data showed a renewed momentum in overall Chinese exports,<sup>9</sup> imports are still subdued and expected to remain so due to weak domestic demand and supply chain disruptions.<sup>10</sup>

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1 Garcia Herrero, Alicia, Dieu Nguyen, Trinh & Xu, Jianwei, *Natixis Asia M&A Monitor: Inbound Declined and Reshuffled, with Covid-19 and Geopolitics Boosting Bids to Southeast Asia*, Natixis, 18<sup>th</sup> August 2022, viewed 24<sup>th</sup> August 2022, <<https://www.research.natixis.com/Site/en/economics/latest-publications/publication/17DI9AWcu6cVogD9F2tquw%3D%3D>>

2 Between 2006 and 2015, the concentration of European foreign direct investment (FDI) in China was more or less evenly distributed between the top 10 investors and the rest. However, in the last four years, the top 10 investors contributed more than 70 per cent of European FDI in China. Kratz, Agatha, Barkin, Noah & Dudley, Lauren, *The Chosen Few: A Fresh Look at European FDI in China*, Rhodium Group, 14<sup>th</sup> September 2022, viewed 14<sup>th</sup> September 2022, <<https://rhg.com/research/the-chosen-few/>>

3 A hidden champion is a company that occupies a leading position in its global market without a high level of public awareness.

4 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, p. 12, 20<sup>th</sup> June 2022, viewed 23<sup>rd</sup> August 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

5 In 2021, completed Chinese FDI in Europe increased 33 per cent to EUR 10.6 billion (bn), from EUR 7.9bn the previous year. 2020 and 2021 were the lowest and second lowest years respectively for Chinese investment in Europe since 2013. Kratz, Agatha, Zenglein, Max J., Sebastian, Gregor & Witzke, Mark, *Chinese FDI in Europe – 2021 Update*, Rhodium Group & Mercator Institute for China Studies, p. 3, April 2022, viewed 23<sup>rd</sup> August 2022, <<https://rhg.com/wp-content/uploads/2022/04/MERICs-Rhodium-Group-COFDI-Update-2022-2.pdf>>

6 *CATL announces its second European battery plant in Hungary*, Contemporary Amperex Technology Co Limited (CATL), 12<sup>th</sup> August 2022, viewed 23<sup>rd</sup> August 2022, <<https://www.catl.com/en/news/983.html>>

7 In 2021, EU imports from China reached their highest annual value of EUR 472bn, with China being the largest partner for EU imports of goods. Meanwhile, EU exports to China totalled EUR 223bn. *China-EU - international trade in goods statistics*, Eurostat, February 2022, viewed 23<sup>rd</sup> August 2022, <[https://ec.europa.eu/eurostat/statistics-explained/index.php?title=China-EU\\_-\\_international\\_trade\\_in\\_goods\\_statistics](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=China-EU_-_international_trade_in_goods_statistics)>

8 *Imports and Exports by Country (Region) of Origin/Destination*, General Administration of Customs, 18<sup>th</sup> August 2022, viewed 8<sup>th</sup> September 2022, <<http://english.customs.gov.cn/Statics/87f10777-75bf-47fa-a98d-a2abdc2424a8.html>>

9 *China Exports YoY*, Trading Economics, July 2022, viewed 30<sup>th</sup> August 2022, <<https://tradingeconomics.com/china/exports-yoy>>

10 *Between Shocks and Stimulus, China Economic Update*, World Bank, p. 36, June 2022, viewed 23<sup>rd</sup> August 2022, <<https://documents1.worldbank.org/curated/en/099640106102210762/pdf/P17579708f26d5018098840f1ad978bb54b.pdf>>



Widespread regulatory barriers—both visible and invisible—continue to constrain the ambitions of European companies operating in the Chinese market. Puzzling COVID-related quarantine and even disinfection rules for imported parcels and goods act as an additional dampener. Challenges will only intensify as firms face increasing scrutiny from EU stakeholders, governments, non-governmental organisations and media over a range of issues. One major topic that came under the spotlight recently was Russia's invasion of Ukraine, which subsequently raised questions over whether China could take similar actions against Taiwan and what the impact might be on companies' global operations.<sup>11</sup>

A diversification debate is also intensifying. With China staying largely closed, European companies see the need to make their global supply chains more resilient. This presents opportunities to other emerging markets that are ready to welcome new investment and jobs,<sup>12</sup> and has seen companies evaluate reshoring, nearshoring or 'friend-shoring'<sup>13</sup> as possible solutions. Meanwhile, China's push both for increased 'self-reliance'<sup>14</sup> and 'buy China'<sup>15</sup> are only easing the country into deeper isolation at a time when its economy would benefit from getting back on the path towards opening up.

The European Chamber needs China to fulfil its huge economic potential. To that end, we put forward 967 constructive recommendations in this position paper based on the expertise of our member companies in our 35 working groups and sub-working groups. The extensive number of issues raised demonstrates European companies' commitment to staying and improving the business environment. However, they also serve as a reminder that action is needed from Chinese decisionmakers to alleviate the 'promise fatigue' still being suffered by European investors.

Jörg Wuttke  
President  
European Union Chamber of Commerce in China

<sup>11</sup> Sevastopulo, Demetri & Edgecliffe-Johnson, Andrew, *Executives seek briefings on Taiwan war risk*, *Financial Times*, 12<sup>th</sup> July 2022, viewed 25<sup>th</sup> August 2022, <[https://www.ft.com/content/8c753573-b2d7-42a9-810f-25ab37eb0099?utm\\_source=substack&utm\\_medium=email](https://www.ft.com/content/8c753573-b2d7-42a9-810f-25ab37eb0099?utm_source=substack&utm_medium=email)>

<sup>12</sup> Garcia Herrero, Alicia, Dieu Nguyen, Trinh & Xu, Jianwei, *Natixis Asia M&A Monitor: Inbound Declined and Reshuffled, with Covid-19 and Geopolitics Boosting Bids to Southeast Asia*, Natixis, 18<sup>th</sup> August 2022, viewed 24<sup>th</sup> August 2022, <<https://www.research.natixis.com/Site/en/economics/latest-publications/publication/17DI9AWcu6cVogD9F2quw%3D%3D>>

<sup>13</sup> These are all terms related to the reshaping of supply chains to fix weaknesses and increase economic resilience. Reshoring is the act of bringing manufacturing from a remote location to the company's home country; nearshoring is the act of bringing manufacturing nearer to the point of use; friend-shoring is the act of relocating manufacturing to a country that is considered a trusted partner to the company's home country.

<sup>14</sup> Wu, Wendy, Wang, Orange & Cai, Jane, *'Two sessions' 2022: self-reliance highlighted as China's top economic priority amid turbulent geopolitical times*, *SCMP*, 6<sup>th</sup> March 2022, viewed 25<sup>th</sup> August 2022, <<https://www.scmp.com/economy/china-economy/article/3169405/self-reliance-chinas-top-economic-priority-turbulent>>

<sup>15</sup> Zipser, Daniel, Seong, Jeongming & Woetzel, Jonathan, *Five consumer trends shaping the next decade of growth in China*, *McKinsey*, 11<sup>th</sup> November 2021, viewed 25<sup>th</sup> August 2022, <<https://www.mckinsey.com/cn/our-insights/our-insights/five-consumer-trends-shaping-the-next-decade-of-growth-in-china>>

## ABOUT THE EUROPEAN UNION CHAMBER OF COMMERCE IN CHINA

FOUNDED IN

2000

BY 51 MEMBER  
COMPANIES

The European Union Chamber of Commerce in China (European Chamber) was founded in 2000 by 51 member companies that shared a goal of establishing a common voice for the various business sectors of the EU and European businesses operating in China. It is a member-driven, non-profit, fee-based organisation with a core structure of 34 working groups and fora representing European business in China.

34

WORKING  
GROUPS AND  
FORA

The European Chamber has more than 1,800 member companies in seven chapters operating in nine cities: Beijing, Nanjing, Shanghai, Shenyang, South China (Guangzhou and Shenzhen), Southwest China (Chengdu and Chongqing) and Tianjin. Each chapter is managed at the local level by local boards reporting directly to the Executive Committee.

MORE THAN

1,800

MEMBER  
COMPANIES

The European Chamber is recognised by the European Commission and the Chinese authorities as the official voice of European business in China. It is also recognised as a foreign chamber of commerce by the Ministry of Civil Affairs. The European Chamber is part of the growing network of European Business Organisations (EBOs), which connects European business associations and chambers of commerce from 42 non-EU countries and regions around the world.

### Mission Statement

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

- 1 Ensure greater market access and a level playing field for European companies operating in China;
- 2 Improve market conditions for all businesses in China;
- 3 Facilitate networking and communication among members and stakeholders;
- 4 Provide specific, relevant information to its members on how to do business in China; and
- 5 Update its members on economic trends and legislation in China.

OPERATING IN

9

CITIES

### Principles

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



## Executive Summary

### Ideology trumps the economy

Over the last year, there has been a significant shift in focus at the headquarters (HQs) of European companies when evaluating China. Where discussions once centred primarily on investment opportunities, they are now focussed on building supply chain resilience, the challenges of doing business, managing the risk of reputational damage and the importance of global compliance. How did China, the architect of the greatest economic growth story in history, lose its allure as an investment destination so quickly?

After China embarked on its programme of reform and opening up in the late 1970s,<sup>1</sup> its economy came to be guided predominantly by pragmatic principles, as state planners sought to ensure stability. Immense economic returns followed, and reforms facilitated significant inflows of foreign direct investment (FDI), with international companies recognising the country's enormous market potential and its increasingly stable business environment.<sup>2</sup> However, China is now having to confront mounting internal and external challenges that seem to have drawn the government's attention away from its reform agenda.

One of the most immediate internal challenges the country faces is justifying its stringent COVID policy at the expense of economic growth and stability. Mass lockdowns and strict quarantines saw China's economy slump in 2022. China's National Bureau of Statistics reported 0.4 per cent year-on-year growth for the second quarter, the lowest since the first quarter of 2020 when China closed down almost completely and its economy contracted for the first time in nearly three decades.<sup>3</sup> In July 2022, the unemployment rate reached 19.9 per cent among 16- to 24-year-olds;<sup>4</sup> and the Purchasing Managers Index (PMI) employment index was 48.6 per cent for manufacturing and 46.7 per cent for services, down 0.1 and 0.2 percentage points respectively from the previous month.<sup>5</sup> Other significant internal challenges include China's debt crisis, which has been exacerbated by the COVID-19 pandemic as lending accelerated to help businesses recover;<sup>6</sup> the unravelling of the real estate sector, with property sales forecast to drop by around 30 per cent in 2022;<sup>7</sup> demographic headwinds,<sup>8</sup> and stalling consumption growth.<sup>9</sup> On top of this, local government finances are being drained as they remain under pressure to continue with the continuous mass testing of their citizens in the pursuit of 'zero COVID'.<sup>10</sup>

1 China's accession to the World Trade Organization (WTO) in 2001 saw it abolish, revise or introduce more than 2,300 national laws and nearly 200,000 local regulations, which led to further market opening: *China and the World Trade Organization*, State Council Information Office of the People's Republic of China, June 2018, viewed 25<sup>th</sup> July 2022, <[http://english.www.gov.cn/archive/white\\_paper/2018/06/28/content\\_281476201898696.htm](http://english.www.gov.cn/archive/white_paper/2018/06/28/content_281476201898696.htm)>; and *China's Economic Rise: History, Trends, Challenges, and Implications for the United States*, Congressional Research Service, 25<sup>th</sup> June 2019, viewed 25<sup>th</sup> July 2022, <<https://sgp.fas.org/crs/row/RL33534.pdf>>

2 Schuman, Michael, *China's 'Very Dangerous Trajectory'*, *The Atlantic*, 21<sup>st</sup> June 2022, viewed 21<sup>st</sup> July 2022, <<https://www.theatlantic.com/international/archive/2022/06/china-xi-jinping-power-zero-covid/661228/>>

3 Sorkin, Andrew Ross, Giang, Vivian, Gandel, Stephen, Hirsh, Lauren, Livni, Ephrat & Gross, Jenny, *China's Shuddering Economic Engine*, *The New York Times*, 15<sup>th</sup> July 2022, viewed 16<sup>th</sup> August 2022, <<https://www.nytimes.com/2022/07/15/business/dealbook/chinas-shuddering-economic-engine.html>>

4 Cheng, Evelyn, *China's consumer and factory data miss expectations in July*, *CNBC*, 14<sup>th</sup> August 2022, viewed 16<sup>th</sup> August 2022, <<https://www.cnbc.com/2022/08/15/chinas-consumer-and-factory-data-miss-expectations-in-july.html>>

5 *Purchasing Managers Index for July 2022*, National Bureau of Statistics of China, 2<sup>nd</sup> August 2022, viewed 16<sup>th</sup> August 2022, <[http://www.stats.gov.cn/english/PressRelease/202208/t20220802\\_1886994.html](http://www.stats.gov.cn/english/PressRelease/202208/t20220802_1886994.html)>

6 Lee, Yen Nee, *These charts show the dramatic increase in China's debt*, *CNBC*, 13<sup>th</sup> July 2021, viewed 2<sup>nd</sup> August 2022, <<https://www.cnbc.com/2021/06/29/china-economy-charts-show-how-much-debt-has-grown.html>>

7 Cheng, Evelyn, *China's property sales are set to plunge 30% - worse than in 2008, S&P says*, *CNBC*, 27<sup>th</sup> July 2022, viewed 2<sup>nd</sup> August 2022, <<https://www.cnbc.com/2022/07/27/chinas-property-sales-set-for-a-worse-plunge-than-in-2008-sp-says.html>>

8 Woo, Ryan & Yao, Kevin, *China demographic crisis looms as population growth slips to slowest ever*, *Reuters*, 11<sup>th</sup> May 2021, viewed 9<sup>th</sup> August 2022, <<https://www.reuters.com/world/china/china-2020-census-shows-slowest-population-growth-since-1-child-policy-2021-05-11/>>

9 Wang, Orange. & Ip, Cyril, *China's consumption growth surprises analysts, and outlook for exports and property market remains uncertain*, *SCMP*, 15<sup>th</sup> November 2021, viewed 9<sup>th</sup> August 2022, <<https://www.scmp.com/economy/china-economy/article/3156130/chinas-consumption-growth-surprises-analysts-and-outlook>>

10 Li, Lyric & Shepherd, Christian, *Costly, scandal-ridden mass testing is China's latest 'zero covid' bet*, *The Washington Post*, 13<sup>th</sup> June 2022, viewed 16<sup>th</sup> August 2022, <<https://www.washingtonpost.com/world/2022/06/13/china-covid-testing-companies/>>

The main external challenges facing the country include rising geopolitical tensions, stemming primarily from the trade war with the United States (US), and a growing number of calls from several countries for China to address alleged human rights abuses, with changes in consumer demand and increasing global regulations having played their part in this regard. Companies operating in China are facing more public pressure to demonstrate a greater degree of transparency in their operations to avoid reputational damage in their home markets. Due to new and emerging legislation,<sup>11</sup> they must now demonstrate that their supply chains, both up- and downstream, are free of forced labour in order to uphold corporate pledges and maintain their licence to operate, as well as to remain globally compliant.

In the past, China would have confronted these challenges with the same kind of pragmatism that accelerated so much of its development over the decades; however, the sheer scale of them, combined with the pressure to provide sustainable economic growth, has made the current situation more precarious. While China believes that its system of governance will prevail over what it perceives to be a relative decline of US-led liberal democracies, it first needs to ensure that it can weather the current geopolitical storm. To do so, Beijing has turned more inward to increase its level of self-reliance, as described in its 14<sup>th</sup> Five-year Plan,<sup>12</sup> and is trying to ensure that the principles it espouses are accepted by and embedded within its population. China's move away from the rest of the world—embodied by the restrictions imposed under its COVID-19 policy—indicates that, at the moment, ideology is trumping the economy.<sup>13</sup>

If China persists with such an approach, the business environment will continue to become more challenging. For example, COVID-related restrictions have already had a crippling effect on the attraction and retention of foreign and Chinese talent. The ever-changing visa and work permit procedures, and extreme limitations on travel in and out of China, have provided additional impetus to the exodus of foreign nationals from the European Union (EU), as well as from countries such as Japan, Korea and the US, that was already underway.

China operations are also becoming increasingly isolated because staff, both foreign and Chinese, are unable to travel freely to European HQs for regular business exchanges, networking, training and experience/expertise sharing. Senior decision-makers from HQs are also being deprived of first-hand China experience, which is resulting in less understanding of—and therefore less desire to engage with—China. European HQs will only become more averse to committing to investing in a country they have a diminishing understanding of, particularly when they perceive political, economic and reputational risks to be increasing. To justify their investments, European companies therefore need China to demonstrate more transparency and predictability, as the challenge of aligning China operations with both global corporate pledges and legislation increases. Meanwhile, as the rest of the world operates largely under pre-pandemic levels of openness, a vacuum is being created for other emerging markets with more predictable and reliable business environments to step in and aggressively pursue foreign investment that may have previously been China-bound.

That is not to say that European companies no longer attach great importance to the China market. The

11 Both the US' Uyghur Forced Labor Prevention Act and the European Union's (EU's) forthcoming Corporate Sustainability Reporting Directive pose a compliance challenge for European businesses operating in China, or their partners, due to the inability to carry out independent third-party audits of supply chains in Xinjiang to prove that their goods and services are free of forced labour. *Implementation of the Uyghur Forced Labor Prevention Act*, US Department of State, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.state.gov/implementation-of-the-uyghur-forced-labor-prevention-act/>>; *New rules on corporate sustainability reporting: provisional political agreement between the Council and the European Parliament*, European Council, Council of the European Union, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.consilium.europa.eu/en/press/press-releases/2022/06/21/new-rules-on-sustainability-disclosure-provisional-agreement-between-council-and-european-parliament/>>

12 *Outline of the People's Republic of China 14<sup>th</sup> Five-Year Plan for National Economic and Social Development and Long-Range Objectives for 2035*, Center for Security and Emerging Technology, 12<sup>th</sup> May 2021, viewed 28<sup>th</sup> July 2022, <[https://cseset.georgetown.edu/wp-content/uploads/t0284\\_14th\\_Five\\_Year\\_Plan\\_EN.pdf](https://cseset.georgetown.edu/wp-content/uploads/t0284_14th_Five_Year_Plan_EN.pdf)>

13 Schuman, Michael, *China's 'Very Dangerous Trajectory'*, *The Atlantic*, 21<sup>st</sup> June 2022, viewed 21<sup>st</sup> July 2022, <<https://www.theatlantic.com/international/archive/2022/06/china-xi-jinping-power-zero-covid/661228/>>



country still has significant growth potential, and its manufacturing base and world-class industrial clusters are hard, if not impossible, to replicate elsewhere. However, the extent of European firms' engagement can no longer be taken for granted. Although statistics published by China's Ministry of Commerce show that FDI into China grew in 2020, investment from the EU dropped 11.8 per cent from the previous year, and its proportion of overall FDI fell to 3.8 per cent from a high of 11.1 per cent in 1999.<sup>14</sup> The trend of declining FDI is unlikely to reverse while European executives are heavily restricted from travelling to and from China to develop potential greenfield projects.

In fact, the growing list of challenges is pushing many to reduce, localise and silo their China operations, with an increasing number creating two separate systems—one for China and one for the rest of the world—which is an expensive and inefficient solution.<sup>15</sup> Several companies are also now looking into the options of reshoring, 'nearshoring' and 'friend-shoring',<sup>16,17&18</sup> a trend that is likely to continue as European companies look to maintain a strong presence in this important market, while ensuring that they do not become over-reliant.

As governments respond to the uncertain environment in China by reducing engagement, and businesses increasingly consider shifting planned or future investments to other markets,<sup>19</sup> the chances for miscommunication and misunderstanding increase. This issue risks being further aggravated by rising negative public opinion in many countries towards China, which in turn pushes foreign governments to take harsher stances towards the country.<sup>20</sup> At the same time, given China's self-imposed quarantine, it is not possible that opinion leaders in China understand Europe better than they did pre-COVID.

The change in European public sentiment towards China, and the increasing need to ensure fairness in its Single Market, has resulted in the European Union (EU) re-evaluating and updating its China policy. Messaging coming from China now has a much bigger impact in the EU and is taken more seriously than previously, as the population has become more sceptical towards the country. This—among other factors—has had an influence on the EU's decision to become more proactive instead of reactive to third countries, particularly through the development of new trade instruments. Although these instruments—including the investment screening mechanism, the International Procurement Instrument (IPI) and the anti-coercion instrument, among others—have not necessarily been developed specifically for China, they are aimed at protecting the EU Single Market against distortions, pushing for reciprocal treatment and increasing market access for EU companies in third countries; all issues that the EU has encountered in regard to China.

14 Wang, Orange, *Explainer: How much is China's foreign direct investment and is it still a good destination for overseas investors?*, SCMP, 10<sup>th</sup> June 2022, viewed 9<sup>th</sup> August 2022, <<https://www.scmp.com/economy/economic-indicators/article/3181037/how-much-chinas-foreign-direct-investment-and-it-still>>

15 This includes companies' staff, supply chains, information technology systems and data storage infrastructure. For more information see: *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 24<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>; Some companies are also separating their research and development (R&D) operations, with core R&D being carried out in Europe or other countries, and China R&D functions focussing more on localisation. For more information see: *China's Innovation Ecosystem: Right for many, but not for all*, European Union Chamber of Commerce in China and MERICS, 8<sup>th</sup> June 2022, viewed 28<sup>th</sup> July 2022, <[https://www.europeanchamber.com.cn/en/publications-archive/1019/China\\_s\\_Innovation\\_Ecosystem\\_Right\\_for\\_Many\\_But\\_Not\\_for\\_All](https://www.europeanchamber.com.cn/en/publications-archive/1019/China_s_Innovation_Ecosystem_Right_for_Many_But_Not_for_All)>

16 These are all terms that are related to the reshaping of supply chains to fix weaknesses and increase economic resilience. Reshoring is the act of bringing manufacturing from a remote location to the company's home country; nearshoring is the act of bringing manufacturing nearer to the point of use; friend-shoring is the act of relocating manufacturing to a country that is considered a trusted partner to the company's home country.

17 Masters, Brooke & Edgecliffe-Johnson, Andrew, *Supply chains: companies shift from 'just in time' to 'just in case'*, *Financial Times*, 20<sup>th</sup> December 2021, viewed 11<sup>th</sup> July 2022, <<https://www.ft.com/content/8a7cdc0d-99aa-4ef6-ba9a-fd1a1180dc82>>

18 Beattie, Alan, *The US 'friendshoring' experiment risks making enemies*, *Financial Times*, 2<sup>nd</sup> August 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.ft.com/content/d8a0ce5e-dc8b-4bce-8dbf-c09d08d263a5>>

19 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, p. 12, 20<sup>th</sup> June 2022, viewed 24<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

20 Kurlantzick, Joshua, *China's Collapsing Global Image*, Council on Foreign Relations, p. 2, July 2022, viewed 12<sup>th</sup> August 2022, <[https://www.cfr.org/report/chinas-collapsing-global-image?utm\\_source=substack&utm\\_medium=email](https://www.cfr.org/report/chinas-collapsing-global-image?utm_source=substack&utm_medium=email)>

Further adding to the complexity of EU-China relations and doing business in China is the position of Taiwan in global supply chains and the potential for related geopolitical issues to erupt. As a leading producer of semiconductors, Taiwan's strategic importance in global supply chains cannot be overstated.<sup>21</sup> The semiconductor shortage, which started in 2020,<sup>22</sup> illustrated both how critical semiconductors are to multiple industries and how reliant the world is on Taiwan.<sup>23&24</sup>

The EU is looking to increase investment opportunities with Taiwan in areas where "interests intersect", including attracting additional investment in the EU's semiconductor industry to reach the goals set out in its European Chips Act.<sup>25&26</sup> In May 2022, the EU and Taiwan committed to upgrading their annual trade dialogue, which China perceived to be a breach of the 'one China' policy.<sup>27</sup> EU-China relations had already become more strained over Taiwan when a representative office was opened in the Lithuanian capital of Vilnius in November 2021 under the name 'Taiwan' instead of 'Taipei', which is the name used in 20 EU Member States.<sup>28&29</sup> US-China tensions over Taiwan, which had been on the rise since former US President Donald Trump made it policy to increase engagement with the island, have added further complexity to the issue.<sup>30&31</sup> Wary of becoming victims of a political dispute, European companies are monitoring this increasingly sensitive issue and are assessing the potential risks very carefully.

Despite all these challenges, China is proficient at reacting and adapting to tectonic shifts, and turning a crisis into an opportunity. The stage is set for it to do so, too, with much of the world expected to face strong economic headwinds in the second half of 2022 and into 2023. This could provide the opportunity for China to roll out its proven toolbox from the 1990s and turn its attention back to reform and opening up to reaffirm its credentials of being a reliable, predictable and efficient market.<sup>32</sup>

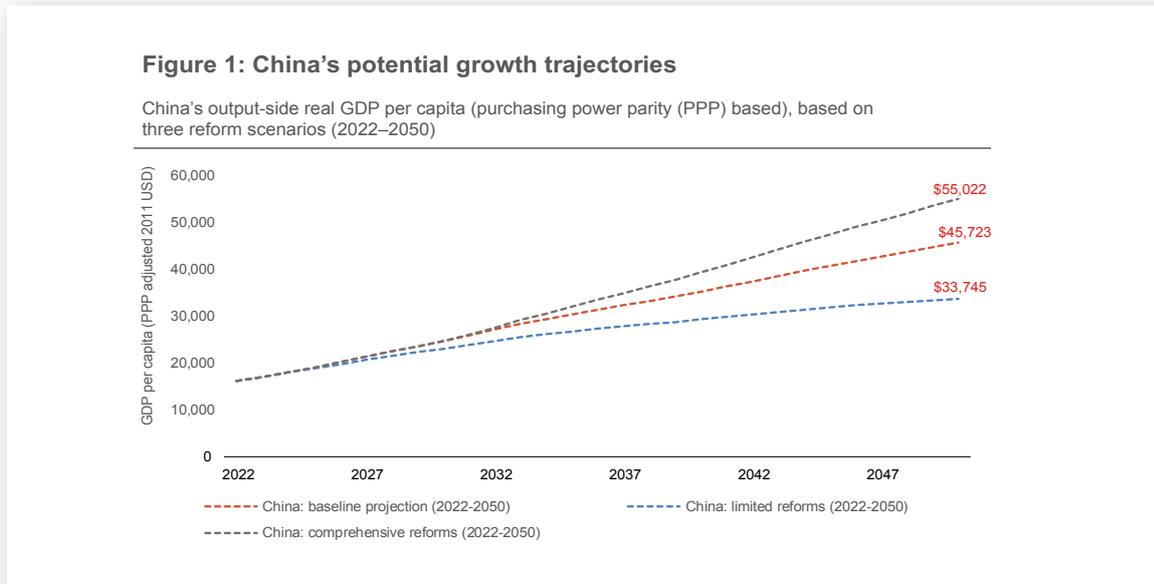
Importantly, pursuing such a strategy would see China avoid punching below its economic weight. Analysis carried out by the World Bank in 2021 illustrates that if China were to implement comprehensive market reforms, its gross domestic product (GDP) per capita would reach US dollars (USD) 55,022 by

- 21 Not only does Taiwan produce around two thirds of the world's semiconductors, it is also the world's largest producer of the most advanced. Advanced semiconductors are seen as the 'engines' that will drive the future global economy: *Taiwan/Pelosi, push to pick US or China leaves TSMC in dire straits*, *Financial Times*, 2<sup>nd</sup> August 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.ft.com/content/2a86d801-2794-4320-a182-173c17dd50b0>>; Jackson, Keith, *Semiconductors are the engine of the global economy—and America isn't making enough of them*, *Fortune*, 30<sup>th</sup> June 2020, viewed 4<sup>th</sup> August 2022, <<https://fortune.com/2020/06/30/america-tech-semiconductor-manufacturing-investment/>>
- 22 The shortage came about due to many different factors. Demand declined in many industries, particularly automotive, during the height of the COVID-19 pandemic, as safety concerns saw factories slowdown or even cease production, which forced the semiconductor industry to work at a much-reduced capacity. At the same time, demand for personal computers (PCs), laptops and gaming platforms increased due to large numbers of people being locked down and/or forced to work from home. By the time demand had started to recover in the third quarter of 2020, the entire semiconductor supply chain was empty. The supply chain was further impacted in different parts of the world by a host of other factors, including extreme winter weather conditions in Texas, power shortages, and a potential drought in Taiwan: Krysiak, Bob, *Why There Is a Global Semiconductor Shortage*, GLG, 18<sup>th</sup> May 2021, viewed 3<sup>rd</sup> August 2022, <<https://glginsights.com/articles/the-reason-why-there-is-a-global-semiconductor-shortage/>>
- 23 Young, Chris, *A China-Taiwan conflict could lead to a catastrophic semiconductor shortage in the world*, *Interesting Engineering*, 2<sup>nd</sup> August 2022, viewed 3<sup>rd</sup> August 2022, <<https://interestingengineering.com/culture/a-china-taiwan-conflict-could-lead-to-a-catastrophic-semiconductor-shortage-in-the-world>>
- 24 Lee, Yen Nee, *2 charts show how much the world depends on Taiwan for semiconductors*, *CNBC*, 15<sup>th</sup> March 2021, viewed 4<sup>th</sup> August 2022, <<https://www.cnbc.com/2021/03/16/2-charts-show-how-much-the-world-depends-on-taiwan-for-semiconductors.html>>
- 25 Bermingham, Finbarr, *EU to upgrade ties with Taiwan as China warns Brussels 'not to gamble on this issue'*, *SCMP*, 18<sup>th</sup> May 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.scmp.com/news/china/diplomacy/article/3178237/eu-upgrade-trade-ties-taiwan>>
- 26 *Digital sovereignty: Commission proposes Chips Act to confront semiconductor shortages and strengthen Europe's technological leadership*, European Commission, 8<sup>th</sup> February 2022, viewed 3<sup>rd</sup> August 2022, <[https://ec.europa.eu/commission/presscorner/detail/en/ip\\_22\\_729](https://ec.europa.eu/commission/presscorner/detail/en/ip_22_729)>
- 27 Bermingham, Finbarr, *EU to upgrade ties with Taiwan as China warns Brussels 'not to gamble on this issue'*, *SCMP*, 18<sup>th</sup> May 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.scmp.com/news/china/diplomacy/article/3178237/eu-upgrade-trade-ties-taiwan>>
- 28 This led to China blocking imports of Lithuanian products and products with Lithuanian components, with the EU subsequently launching a WTO case against China over economic coercion against Lithuania and other EU Member States: Valero, Jorge & Whitelaw, Kevin, *EU Launches WTO Case Against China Over Lithuania Blockade*, *Bloomberg*, 27<sup>th</sup> January 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.bloomberg.com/news/articles/2022-01-27/eu-set-to-launch-wto-case-against-china-over-lithuania-blockade>>
- 29 Bermingham, Finbarr, *Slovenia tries to head off row with Beijing over Taiwan office*, *SCMP*, 31<sup>st</sup> January 2022, viewed 8<sup>th</sup> August 2022, <<https://www.scmp.com/news/china/diplomacy/article/3165441/slovenia-tries-head-row-beijing-over-taiwan-office-saying-it>>
- 30 Chin, Josh, *China-Taiwan Tensions: What's Behind the Divide*, *The Wall Street Journal*, 6<sup>th</sup> April 2022, 2<sup>nd</sup> August 2022, <<https://www.wsj.com/articles/china-taiwan-tensions-explained-11646894687>>
- 31 Lee, Yimou & Wu, Sarah, *Pelosi arrives in Taiwan vowing U.S. commitment; China enraged*, *Reuters*, 3<sup>rd</sup> August 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.reuters.com/world/asia-pacific/pelosi-expected-arrive-taiwan-tuesday-sources-say-2022-08-02/>>
- 32 *OECD Economic Surveys: China 2022*, OECD, pp. 68–108, 18<sup>th</sup> March 2022, viewed 14<sup>th</sup> July 2022, <[https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-china-2022\\_b0e499cf-en](https://www.oecd-ilibrary.org/economics/oecd-economic-surveys-china-2022_b0e499cf-en)>



2050, over 63 per cent higher than if it were to follow a path of limited market reforms (Figure 1).<sup>33</sup> Is China willing to sacrifice USD 22,000 per capita GDP on the altar of self-reliance?

With the 20<sup>th</sup> National Congress of the Communist Party taking place on 16<sup>th</sup> October 2022, China finds itself at a critical juncture: the decision of whether to take action to reach its full economic potential is entirely in its own hands.



Source: World Bank

33 Based on unpublished analysis conducted by the World Bank at the request of the European Chamber.

# Section One

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## Executive Position Paper

# 1





# Executive Position Paper

## Key takeaways

### China's standing as an investment destination is being eroded

- While China once shaped globalisation, the country is now being seen as less predictable, less reliable and less efficient.
- This is leading to a loss of business confidence, opening the doors for other emerging markets to fill the vacuum that has been created and aggressively pursue foreign investment that may otherwise have been China-bound.

There are five key factors undermining the predictability, reliability and efficiency of China's market:

1. State-owned enterprise (SOE) reforms have stalled, and policymaking has become more *ad hoc*
  - While segments of China's economy continue to open and are increasingly well-regulated, strategic industries are only fully open to its favoured SOEs, to the detriment of the public sector.
  - Over-reliance on SOEs has led to lower productivity.
  - There has been a worrying trend in recent years of policies being implemented in a blanket manner, with limited transparency and little prior consultation.
2. COVID policy is inflexible and inconsistently implemented
  - China was successful in managing the initial COVID-19 outbreak in the first two years.
  - However, continuing to adhere to stringent dynamic-zero control measures in the face of new, highly transmissible variants threatens economic growth and stability.
  - Sudden mass lockdowns and strict quarantines saw China's economy slump in 2022.
  - The uncertainty that businesses now feel has led to record numbers looking at shifting current or planned investments to other markets.
  - A way to alleviate the current situation would be to refocus on fully vaccinating the population and to permit the best mix of vaccinations and boosters.
  - China may not be able to fully reopen its borders until the latter half of 2023.
3. Diversity is dwindling and opportunities for knowledge-exchange are scarce
  - People-to-people ties have been weakened due to travel restrictions, which is having a negative impact on China's image to the rest of the world.
  - Companies' foreign talent options are increasingly limited.
  - The exodus of European nationals from China has accelerated.
  - China-based staff have few, if any, opportunities to participate in information exchanges, networking, training and the sharing of expertise with colleagues and partners at European headquarters (HQs), and China operations are becoming more isolated.
  - Executives from HQs are being deprived of first-hand China experience, which means less opportunities for China to attract future investments.
  - The lack of face-to-face interactions increases the risk of misunderstandings between China and the rest of the world.

4. Business is becoming increasingly politicised
  - A long list of issues has increased political risks for businesses.
  - Rising negative public sentiment towards China is pushing foreign governments to take harsher stances towards the country.
  - Businesses are coming under pressure, both from consumers and through legislation, to demonstrate transparency in their China operations.
  - Companies need a transparent and predictable business environment to align their global corporate pledges with realities on the ground.
  - China needs to provide the conditions that allow companies to conduct trusted, third-party audits of their operations so that they can be certified as being fully compliant with global legislation.
  
5. Supply chain strategies are shifting
  - There are now many factors prompting companies to re-evaluate their production and distribution networks.
  - China's position at the centre of global supply chains looks set to be challenged.
  - There will not be full decoupling from China, but alternative supply chain strategies are increasingly being discussed in boardrooms.
  - Prior to the COVID-19 lockdowns in early 2022, some companies were looking into increasingly onshoring supply chains into China, and several were looking into creating two separate supply chains – one for China and one for the rest of the world.
  - Since the lockdowns, more and more companies have started to explore options that can provide more resilience in their supply chains.
  - Companies will continue to maintain a strong presence in this important market, while keeping viable back-up options.

## What lies ahead?

### Worst-case scenario

- China's predictability, reliability and efficiency would continue to erode.
- European companies would have to further evaluate their future investments and operations in China.
- Divergent systems would be created—one to serve China and one for the rest of the world—slowing down innovation and leading to higher costs.
- More countries would be likely to try and increase their own self-reliance, undercutting globalisation.

### The next 12 months – potential disruptions on the horizon

1. The European Union's (EU's) evolving China policy and new trade instruments
  - The EU has long sought reciprocity and transparency with all of its trading partners.
  - To protect the Single Market, and push for its companies to receive greater market access and fairer treatment in third markets, the EU has created a series of trade tools.
  - While it is crucial that the EU maintains a flexible China strategy that can evolve and adapt to any emerging challenges, it is equally important that it continues to push for deeper bilateral engagement with China.
  - There are numerous shared challenges and areas for EU-China cooperation to deepen, including World Trade Organization (WTO) reform, international standardisation and working together to



define a practical COVID-19 exit strategy.

- One area especially ripe for future cooperation is tackling climate change.

## 2. Taiwan and semiconductors

- As a leading producer of semiconductors, Taiwan has strategic importance in global supply chains.
- As its largest investor, the EU maintains strong trade and investment relations with Taiwan and is looking to deepen investment in areas where “interests intersect”.
- EU-China relations have been increasingly strained over Taiwan, with a series of incidents escalating tensions and complicating the situation further.
- Wary of becoming victims of a political dispute, European companies are monitoring this increasingly sensitive issue and are assessing the potential risks very carefully.
- It is important that the EU and China work together to de-escalate tensions over Taiwan.

### **Refocussing on reform efforts would rebuild investor confidence**

- Focussing on comprehensive reform and opening up would be the most effective way for China to quickly rebuild investor confidence.
- Doing so would put China on a much stronger growth trajectory through to the middle of the century.
- To implement necessary reforms, political space must be given to policymakers to 'make mistakes', and stakeholders to challenge policy ideas, to ensure that resulting policies are practical and implementable.

## China's standing as an investment destination is being eroded

Over the past two decades, China shaped globalisation. Its impressive manufacturing bases and advanced industrial clusters, combined with an abundance of cheap labour, transformed it into a leading global destination for investment. However, China is increasingly being seen as less predictable, less reliable and less efficient. This is leading to a loss of business confidence, presenting an opportunity for other emerging markets—many of which would previously have been overlooked—to fill the vacuum that has been created and aggressively pursue foreign investment that may otherwise have been China-bound.

1. **China's predictability** is being eroded by the frequent, erratic policy shifts that have taken place in recent months, such as the unexpected disruptions to power supplies that took place in 2021, and the sudden mass lockdowns that were imposed in an attempt to contain COVID. The surprise crackdowns on the technology and education sectors have also made it clear to business that certainty can no longer be taken for granted and have left many wondering which industry will be targeted next.<sup>1</sup>
2. **China's reliability** is increasingly being questioned. The inability to carry out independent third-party audits of China operations means the country is no longer viewed as a stable sourcing destination. External factors such as new globally-binding regulatory measures, including the United States' (US') Uyghur Forced Labor Prevention Act and the EU's forthcoming Corporate Sustainability Reporting Directive,<sup>2</sup> have added additional layers of complexity.
3. **China's efficiency** is being undermined as companies decouple parts of their China operations from global operations, both to hedge against potential global shocks and to remain compliant in both China and their home markets. At the same time, structural advantages that the country had previously capitalised on to great effect, such as its 'demographic dividend',<sup>3</sup> are rapidly fading, leading to a loss of productivity.

The loss of these three key pillars, which risks preventing China from maintaining a strong, sustainable growth pattern, is happening due to five key factors:

### 1. SOE reforms have stalled, and policymaking has become more ad hoc

#### *China's 'one economy, two systems' model strengthens*

Segments of China's economy continue to open and are increasingly well-regulated, with restrictions on foreign investment loosening in recent years.<sup>4</sup> On the other side, strategic industries remain fully open

1 He, Laura, *China is cracking down on data privacy. That's terrible news for some of its biggest tech companies*, CNN, 8<sup>th</sup> July 2021, viewed 23<sup>rd</sup> July 2022, <[https://edition.cnn.com/2021/07/07/tech/china-didi-data-tech-crackdown-intl-hnk/index.html?utm\\_term=.1658471593902aa57865d8b9e&utm\\_source=cnn\\_Meanwhile+in+China+-+07.22.2022&utm\\_medium=email&bt\\_ee=RwpYzuwwK6vi6r4IFYXFm1PHd0C0JLBODyNJTbgsSAFN%2FoTfsOpYhw026XRm3RM&bt\\_ts=1658471593909](https://edition.cnn.com/2021/07/07/tech/china-didi-data-tech-crackdown-intl-hnk/index.html?utm_term=.1658471593902aa57865d8b9e&utm_source=cnn_Meanwhile+in+China+-+07.22.2022&utm_medium=email&bt_ee=RwpYzuwwK6vi6r4IFYXFm1PHd0C0JLBODyNJTbgsSAFN%2FoTfsOpYhw026XRm3RM&bt_ts=1658471593909)>

2 These could both pose a compliance challenge for European businesses operating in China, or their partners, due to the inability to carry out independent third-party audits of supply chains in Xinjiang to prove that their goods and services are free of forced labour. *Implementation of the Uyghur Forced Labor Prevention Act*, US Department of State, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.state.gov/implementation-of-the-uyghur-forced-labor-prevention-act/>>; *New rules on corporate sustainability reporting: provisional political agreement between the Council and the European Parliament*, European Council, Council of the European Union, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.consilium.europa.eu/en/press/press-releases/2022/06/21/new-rules-on-sustainability-disclosure-provisional-agreement-between-council-and-european-parliament/>>

3 The 'demographic dividend' refers to economic development that is driven by a high proportion of working-age population. This is being lost as China's unprecedented low number of newborns is being exacerbated by its rapidly ageing population. See: Magnus, George, *Red Flags: Why Xi's China is in Jeopardy*, pp. 112–129, Yale University Press: New Haven.

4 For example, in the automotive sector, restrictions have been removed on ownership as well as on the number of joint ventures that foreign entities can enter into: *European Chamber Stance on the Liberalisation of Ownership Restrictions in the Automotive Sector*, European Union Chamber of Commerce in China, 11<sup>th</sup> January 2022, viewed 21<sup>st</sup> July 2022, <[https://www.eurochamber.com.cn/en/press-releases/3414/european\\_chamber\\_stance\\_on\\_the\\_liberalisation\\_of\\_ownership\\_restrictions\\_in\\_the\\_automotive](https://www.eurochamber.com.cn/en/press-releases/3414/european_chamber_stance_on_the_liberalisation_of_ownership_restrictions_in_the_automotive)>



only to China's SOEs, which hold the advantage in many areas of doing business—including access to financing, licences and public procurement, and the ability to influence policy—and are largely protected from competition, to the detriment of the public sector, and small and medium-sized enterprises in particular.<sup>5</sup>

Although the resurgence of SOEs is a longer-term trend, dating back to at least 2012, it accelerated in 2017 following a speech delivered by President Xi Jinping at the 19<sup>th</sup> Party Congress, in which he exhorted SOEs to become “stronger, better and bigger”.<sup>6</sup> This advancement of the public sector diverges from the spirit of reform and opening-up that put the country firmly on the path to WTO accession in 2001, an event that catalysed the liberalisation of many sectors of China's economy, promoted competition in the private sector and made the market more predictable.

This approach is also seemingly at odds with China's goal to alleviate structural problems in its economy and increase productivity. International Monetary Fund (IMF) analysis shows that China's economy is only 30 per cent as productive as leading economies such as Germany, the US and Japan, with this partly due to the fact that “reform progress on SOEs and competitive neutrality has been lagging, contributing to lower productivity and growth”.<sup>7</sup>

The need to rebalance the state-owned and private sectors has been acknowledged publicly by Chinese financial experts, including both the former and current People's Bank of China governors Zhou Xiaochuan and Yi Gang.<sup>8&9</sup> Yi Gang asserted that China should consider applying the principle of 'competitive neutrality' to SOEs as part of a solution to “solve the structural problems in the Chinese economy”.<sup>10</sup>

### *Erratic policy implementation*

While China has a strong track record of trialling policies before rolling them out, there has been a trend in recent years of policies being implemented in a blanket manner, with limited transparency and little prior consultation. The lack of policy consultation frequently ranks as a top issue facing businesses across all European Chamber chapters.<sup>11</sup>

China's 'dual control' mechanism provides a good example of the kind of economic damage that can be caused by erratic policy implementation.<sup>12</sup> In August 2021, in response to a National Development and Reform Commission warning that only 10 out of 30 regions had achieved their energy reduction goals,

5 For example, some formal restrictions have been removed in the financial sector, but only after it had become saturated by dominant domestic players. This left foreign banks to compete in only a few remaining niches, such as cross-border services. In addition, even after formal market access has been granted, many companies struggle due to indirect barriers, such as difficulties obtaining operating licences or certification: *European Business in China Position Paper 2020/2021*, European Union Chamber of Commerce in China, September 2020, viewed 24<sup>th</sup> July 2022, <[https://www.europeanchamber.com.cn/en/publications-archive/865/Executive\\_Position\\_Paper\\_2020\\_2021](https://www.europeanchamber.com.cn/en/publications-archive/865/Executive_Position_Paper_2020_2021)>

6 Xi calls for furthering SOE reform, *China Daily*, 18<sup>th</sup> October 2017, viewed 29<sup>th</sup> July 2022, <[https://www.chinadaily.com.cn/china/2017-10/18/content\\_33403609.htm](https://www.chinadaily.com.cn/china/2017-10/18/content_33403609.htm)>

7 *People's Republic of China: 2020 Article IV Consultation – Press Release; Staff Report; and Statement by the Executive Director for the People's Republic of China*, International Monetary Fund, p.5, 8<sup>th</sup> January 2021, viewed 1<sup>st</sup> August 2022, <<https://www.imf.org/en/Publications/CR/Issues/2021/01/06/Peoples-Republic-of-China-2020-Article-IV-Consultation-Press-Release-Staff-Report-and-49992>>

8 Miles, Tom, *Ex-PBOC Chief says China Must Address “Loopholes” as Part of WTO Reform*, *Reuters*, 19<sup>th</sup> September 2018, viewed 1<sup>st</sup> August 2022, <<https://www.reuters.com/article/us-china-economy-zhou-idUSKCN1LZ0XU>>

9 Antonini, Renato, *Comment: Expect More on ‘Competitive Neutrality’ in WTO Reform Talks*, *Borderlex*, 12<sup>th</sup> December 2018, viewed 1<sup>st</sup> August 2022, <<https://borderlex.net/2018/12/12/comment-expect-more-on-competitive-neutrality-in-wto-reform-talks/>>

10 Ibid.

11 As part of its annual *Business Confidence Survey*, the European Chamber's local chapters survey their membership on the top three priorities that the chapter should focus its local government advocacy on. The need for both greater policy consultation and communication frequently rank as top concerns.

12 China's 'dual control' mechanism was initially aimed at controlling energy consumption and energy intensity. It has since been announced that it will eventually be focussed on carbon emissions and carbon intensity, which is a far more effective approach to tackling climate change: Yin, Ivy, *China will establish dual control system for cutting emissions, carbon intensity*: Xi, S&P Global, 27<sup>th</sup> January 2022, viewed 10<sup>th</sup> March 2022, <<https://www.spglobal.com/commodity-insights/en/market-insights/latest-news/energy-transition/012722-china-will-establish-dual-control-system-for-cutting-emissions-carbon-intensity-xi>>. For more information on the policy and how it impacted businesses see: *Carbon Neutrality: The Role of European Business in China's Race to 2060*, European Union Chamber of Commerce in China, pp. 9–10, 25<sup>th</sup> May 2022, viewed 17<sup>th</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-carbon-neutrality-report>>

local governments took extreme measures to achieve their targets before the end of the year. Many went as far as cutting off power supplies to businesses and residential properties, with some businesses informed only a few hours in advance. This approach lacked transparency and consistency, and even legal grounds in certain cases.<sup>13</sup> Furthermore, it did not deliver the desired result, as many companies installed diesel or other highly-polluting, fossil-fuelled micro generators to enable them to continue production; and in some cases, bringing operations back online consumed more energy than if they had been left continuously running. This situation was seen by many business executives as the biggest blow to China's predictability in recent years.

In a similar vein, China's crackdowns on technology and private education firms raised alarm bells within the business community.<sup>14&15</sup> Many education businesses were forced to close shop in a matter of days, leaving investors to bear significant losses and parents out-of-pocket for what they believed were investments in their children's education. As outlined by the IMF, "the multitude, timing, seemingly uncoordinated, and the discretionary nature of these interventions [...] has led to heightened policy uncertainty."<sup>16</sup> It raises questions over which sector will next be subject to sudden state intervention in an effort to steer the economy.

## 2. COVID policy is inflexible and inconsistently implemented

China was successful in managing the initial stages of the COVID-19 pandemic in the first two years, which led to a swift economic recovery relative to the rest of the world, while protecting the health of its population. However, lacklustre vaccination rates, the reluctance to permit a better mix of vaccines and the continued adherence to stringent COVID-19 control measures in the face of new variants of the virus that are highly transmissible come at an extremely high and ever-increasing cost. Unlike the rest of the world, China is far from herd immunity.

China's goal of achieving its 2022 5.5 per cent growth target<sup>17</sup> suffered a major blow when economic growth fell to just 0.4 per cent in the second quarter. This was attributed predominantly to the impact of the lockdown measures,<sup>18</sup> and, with no exit strategy in sight, it is difficult to see how this will change in the near future.<sup>19</sup> The steep increase in unemployment rates among urban young people—which in July 2022 stood at 19.9 per cent among 16- to 24-year-olds—is attributable to long-standing issues as well as COVID.<sup>20&21</sup> This adds a complicated social dimension on top of the economic challenges.

13 Riordan, Primrose, White, Edward & Dempsey, Harry, *China's energy crisis threatens lengthy disruption to global supply chain*, *Financial Times*, 17<sup>th</sup> October 2022, viewed 19<sup>th</sup> July 2022, <<https://www.ft.com/content/5174e592-1f0b-4334-91ab-aa89ceff3821>>

14 Ponciano, Jonathan, *China Bans Didi From App Stores Just Days After Massive U.S. IPO*, *Forbes*, 4<sup>th</sup> July 2022, viewed 15<sup>th</sup> July 2022, <<https://www.forbes.com/sites/jonathanponciano/2021/07/04/china-bans-didi-from-app-stores-just-days-after-massive-us-ipo/?sh=31b54cce1202>>

15 Schuman, Michael, *China's 'Very Dangerous Trajectory'*, *The Atlantic*, 21<sup>st</sup> June 2022, viewed 21<sup>st</sup> July 2022, <<https://www.theatlantic.com/international/archive/2022/06/china-xi-jinping-power-zero-covid/661228/>>

16 *People's Republic of China: 2021 Article IV Consultation – Press Release; Staff Report; and Statement by the Executive Director for the People's Republic of China*, IMF, 28<sup>th</sup> January 2022, viewed 24<sup>th</sup> July 2022, <[https://www.elibrary.imf.org/configurable/content/journals/S002f002\\$002f022\\$002f021\\$002farticle-A001-en.xml?t:ac=journals%24002f002%24002f2022%24002f021%24002farticle-A001-en.xml](https://www.elibrary.imf.org/configurable/content/journals/S002f002$002f022$002f021$002farticle-A001-en.xml?t:ac=journals%24002f002%24002f2022%24002f021%24002farticle-A001-en.xml)>

17 *Xinhua Headlines: China sets 2022 GDP target at around 5.5 pct, giving a shot in arm to world recovery*, *Xinhua*, 5<sup>th</sup> March 2022, viewed 26<sup>th</sup> July 2022, <<https://english.news.cn/20220305/e9e1edff08344543aee8bbc9d40ff58/c.html>>

18 Dou, Eva, *China's economic growth slows to 0.4%, weakest in two years*, *The Washington Post*, 15<sup>th</sup> July 2022, viewed 26<sup>th</sup> July 2022, <<https://www.washingtonpost.com/world/2022/07/14/china-gdp-economy-covid-lockdown/>>

19 Oxford University associate George Magnus has estimated that China's growth prospects could slow to two to three per cent for the coming years, in no small part due to the knock-on effects of its COVID-19 policies. Should this happen, then China's official goal of doubling its gross domestic product (GDP) per capita between 2020 and 2035 will not be realised. Magnus, George, *The High Costs of Disengagement for China*, Project Syndicate, 28<sup>th</sup> June 2022, viewed 14<sup>th</sup> July 2022, <[https://www.project-syndicate.org/commentary/us-china-rivalry-costs-of-deglobalization-by-george-magnus-2022-06?utm\\_source=substack&utm\\_medium=email](https://www.project-syndicate.org/commentary/us-china-rivalry-costs-of-deglobalization-by-george-magnus-2022-06?utm_source=substack&utm_medium=email)>

20 Unemployment amongst 16–24-year-olds rose from 12.2 per cent in December 2019 to 19.3 per cent in 2022, and then to 19.9 per cent in July 2022: Pike, Lili, *China has an unemployment problem. Why nearly 20 percent of young job-seekers can't land a job*, GRID, 18<sup>th</sup> July 2022, viewed 26<sup>th</sup> July 2022, <<https://www.grid.news/story/global/2022/07/18/china-has-an-unemployment-problem-why-nearly-20-percent-of-young-job-seekers-cant-land-a-job/>>; and Cheng, Evelyn, *China's consumer and factory data miss expectations in July*, *CNBC*, 14<sup>th</sup> August 2022, viewed 16<sup>th</sup> August 2022, <<https://www.cnbc.com/2022/08/15/chinas-consumer-and-factory-data-miss-expectations-in-july.html>>

21 Wakabayashi, Daisuke, *China's Economy Hits a Slump as Covid Policy Takes a Toll*, *The New York Times*, 14<sup>th</sup> July 2022, viewed 2<sup>nd</sup> August 2022, <<https://www.nytimes.com/2022/07/14/business/economy/china-economy-slows.html>>



China's stringent dynamic-zero COVID-19 policy had a negative impact on overall operations for 75 per cent of respondents to a European Chamber flash survey carried out in April 2022.<sup>22</sup> Overall, the most significant challenge was the massive uncertainty that it created. At the height of the lockdowns in April 2022,<sup>23</sup> businesses were struggling to carry out the most basic tasks and did not know from one day to the next if they would have enough staff to maintain operations or if their premises would be suddenly shut down altogether.

This sense of uncertainty resulted in 23 per cent of respondents to the same flash survey considering shifting current or planned investments in China to other markets.<sup>24</sup> This is more than double the number that were considering the same just two months prior and is the highest percentage that the Chamber has recorded in the past decade.<sup>25</sup>

A significant 97 per cent of respondents to the flash survey reported that China's tightening of COVID-19 containment measures had a negative impact on business travel.<sup>26</sup> China's aviation industry almost ground to a halt in April 2022, with flight volumes sinking to a level last seen in 2003 during the severe acute respiratory syndrome (SARS) outbreak.<sup>27</sup> According to the Civil Aviation Administration of China, the total passenger volume of domestic carriers in April 2022 dropped by 84.6 per cent compared to April 2021.<sup>28</sup> Companies need certainty when they are making investments, so the inability to freely travel and conduct face-to-face meetings, even within China, has made China's business environment far less predictable and reliable, while also decreasing its efficiency.

Inconsistent implementation of COVID-19 policies has also made for a more complex business environment. For instance, as detailed in this year's *Logistics Working Group Position Paper*, China continues to impose varying COVID-19 containment measures on goods transported throughout the country. This causes severe administrative headaches for businesses, disrupts supply chains and negatively impacts the logistics industry's growth prospects.<sup>29</sup>

China's business environment will remain unpredictable as long as the threat of lockdowns exists. As outlined in a letter sent by the European Chamber to Vice Premier Hu Chunhua in early April 2022,<sup>30</sup> a way out of this would be to focus on fully vaccinating the entire population, with special attention paid to those at higher risk of disease, in particular the elderly and those with chronic conditions. It would also be advisable to permit the best mix of vaccinations and boosters to be used, including those based on messenger ribonucleic acid (mRNA) technology. However, this is not a realistic short-term solution for three main reasons.

22 *Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China*, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 29<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-archive/973>>

23 At least 45 cities were under full or partial lockdown during this period, accounting for around 370 million people and 40 per cent of China's GDP: Hancock, Tom, *Lockdown Financial Aid in China Leaves Households Behind*, Bloomberg, 13<sup>th</sup> April 2022, viewed 26<sup>th</sup> July 2022, <<https://www.bloomberg.com/news/articles/2022-04-13/lockdown-financial-aid-in-china-leaves-households-behind#xj4y7vzkg>>

24 *Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China*, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 29<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-archive/973>>

25 Since 2012, the percentages of respondents to the European Chamber's *Business Confidence Survey* considering shifting current or planned investments out of China to other markets are as follows: 2012, 22%; 2013, 10%; 2014, 11%; 2015, 16%; 2016, 11%; 2017, 12%; 2018, 11%; 2019, 15%; 2020, 11%; 2021, 9%; 2022, 11%.

26 *Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China*, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 29<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-archive/973>>

27 *Domestic flights fall to 2003 levels under a quadruple whammy! How much longer will this dip last? What about the small and medium sized airlines?*, CARNOC, 6<sup>th</sup> April 2022, viewed 9<sup>th</sup> August 2022, <<http://news.carnoc.com/list/582/582249.html>>

28 *Key Performance Indicators for Civil Aviation Industry in April 2022*, Civil Aviation Administration of China (CAAC), viewed 2<sup>nd</sup> August 2022, <<http://www.caac.gov.cn/en/HYYJ/SJ/202206/P020220606403625424209.pdf>>

29 *Logistics Working Group Position Paper 2022/2023*, European Union Chamber of Commerce in China, p. 357.

30 *Sent letter to Vice Premier Hu Chunhua of the State Council regarding the impact of current epidemic prevention measures on business*, European Union Chamber of Commerce in China, 9<sup>th</sup> April 2022, viewed 8<sup>th</sup> August 2022, <<https://www.europeanchamber.com.cn/en/lobby-actions/5673#>>

First, at the time of writing, China's vaccine delivery rate remains low: as of mid-July 2022 it was around 610,000 shots per day, far below its peak of 20 million shots per day during the summer of 2021.<sup>31&32</sup>

Second, while as of April 2022 the vaccine status of China's overall population that had received at least two shots stood at nearly 88 per cent, this only applied to around half of 80-year-olds, and more than 50 million people over the age of 60 had yet to receive two jabs.<sup>33</sup> This is significant, as two jabs of China's domestic vaccines cannot be considered as being fully vaccinated: data gathered from the large outbreak in Hong Kong in early 2022 has shown that they only become fully effective at protecting against severe diseases after three doses have been administered.<sup>34</sup>

Third, foreign mRNA vaccines have not been approved for use in Mainland China at the time of writing. While progress has been made towards a domestic mRNA vaccine, China is still playing catch-up with regard to mastering the technology,<sup>35</sup> and experts have warned that any domestic solution risks being outpaced by the emergence of new COVID-19 variants.<sup>36</sup>

The European Chamber fears that China will not be able to fully reopen to the rest of the world until at least the latter half of 2023, handing yet another advantage to other markets that can provide more openness and predictability to investors.

### 3. Diversity is dwindling and opportunities for knowledge-exchange are scarce

People-to-people ties are being weakened as foreigners now have few opportunities to experience China first-hand and Chinese officials and citizens are reluctant to travel overseas. As Figure 2 illustrates, China's banning of international flights—a policy adopted since the start of the pandemic—has resulted in a near suspension of visitors to the country, and the number of tourists and workers (international and Chinese) travelling from China overseas has plummeted. Trips out of China taken by Mainland Chinese citizens fell 79 per cent compared with 2019 data, while trips by foreign nationals fell to just 4.6 per cent of the 2019 figure.<sup>37</sup>

As documented in the European Chamber's *Human Resources Working Group Position Paper*, businesses are struggling to maintain foreign staff, as they are increasingly unwilling or unable to stay in China due to its stringent travel restrictions.<sup>38</sup> Companies are even questioning whether it is responsible for them to deploy foreign staff to China when the numerous restrictions mean they are unable to guarantee a basic duty of care for them and their families. Companies' foreign talent options are therefore increasingly restricted to staff that are either very junior and have no family, or those that are senior and whose families have grown up. This leaves an extremely shallow pool to draw from.

31 *Reuters COVID-19 TRACKER: Mainland China*, Reuters, last updated 15<sup>th</sup> July 2022, viewed 16<sup>th</sup> July 2022, <<https://graphics.reuters.com/world-coronavirus-tracker-and-maps/countries-and-territories/china/>>

32 Had it maintained the rate of 20 million shots per day in June 2021, China would have been able to fully vaccinate its entire population in three months: Mallapaty, Smriti, *China is vaccinating a staggering 20 million people a day*, *Nature*, 9<sup>th</sup> June 2021, viewed 16<sup>th</sup> July 2022, <<https://www.nature.com/articles/d41586-021-01545-3>>

33 *Why so many elderly Chinese are unvaccinated: Some are complacent, others are afraid*, *The Economist*, 2<sup>nd</sup> April 2022, viewed 29<sup>th</sup> July 2022, <<https://www.economist.com/china/2022/04/02/why-so-many-elderly-chinese-are-unvaccinated>>

34 McMenamin, Martina E., Nealon, Joshua, Lin, Yun, Wong, Jessica Y., Cheung, Justin K., Lau, Eric H.Y., Wu, Peng, Leung, Prof. Gabriel M., & Cowling, Prof. Benjamin J., *Vaccine effectiveness of one, two, and three doses of BNT162b2 and CoronaVac against COVID-19 in Hong Kong: a population-based observational study*, *The Lancet*, 15<sup>th</sup> July 2022, viewed 10<sup>th</sup> August 2022, <[https://www.thelancet.com/journals/laninf/article/PIIS1473-3099\(22\)00345-0/fulltext](https://www.thelancet.com/journals/laninf/article/PIIS1473-3099(22)00345-0/fulltext)>

35 Zhao, Jinzhao, Jiang, Moting, Chen, Pengduo, & Han, Wei, *In Depth: Why China Still Doesn't Have an mRNA Shot*, *Caixin Global*, 14<sup>th</sup> July 2022, viewed 5<sup>th</sup> August 2022, <<https://www.caixinglobal.com/2022-07-14/in-depth-why-china-still-doesnt-have-an-mrna-shot-101913146.html>>

36 Olcott, Eleanor, *New Covid variants threaten China's mRNA vaccine hopes*, *Financial Times*, 7<sup>th</sup> July 2022, viewed 8<sup>th</sup> July 2022, <<https://www.ft.com/content/1ce91ee9-5e74-40db-80ec-fc2cbe97533d>>

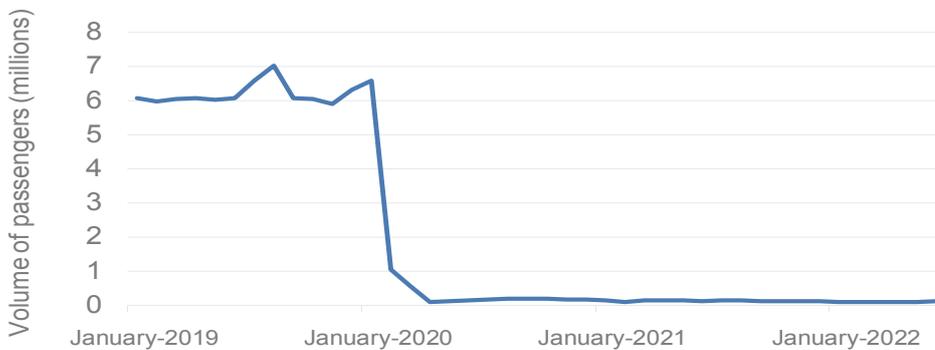
37 Wang, Huiyao, *China's zero-COVID policy has damaged its stock of global talent*, *Financial Times*, 17<sup>th</sup> July 2022, viewed 18<sup>th</sup> July 2022, <<https://www.ft.com/content/fef5a71d-8a19-4f65-804e-42bfb02af083>>

38 See: *Human Resources Working Group Position Paper 2022/2023*, p. 65.



The lack of clarity on when current measures will be relaxed weighs heavily on career choices. After having spent long periods separated from family members and facing significant barriers to return home and then come back to China, many foreign professionals have given up and either returned home for good or taken opportunities in other countries. As reported in the European Chamber's BCS 2022, the exodus of European nationals from China was already underway prior to the pandemic but accelerated as a result of it.<sup>39</sup> The results of China's seventh national census, conducted in 2020, shows that the populations of foreign nationals from the US, Japan, Korea, Germany and France had dropped by 23, 44, 51, 22 and 39 per cent respectively since 2010.<sup>40</sup> The European Chamber has estimated that the total number of Europeans now living in China has halved since the start of the pandemic.<sup>41</sup> It further estimated that the current population of Europeans would not fill Beijing's Bird's Nest—a stadium with a capacity of 80,000—and that this figure could halve again by the end of summer 2022.<sup>42</sup>

**Figure 2: Chinese international inbound and outbound passenger numbers (2019–2022; millions of persons)**



Source: Bruegel; data from the Civil Aviation Administration of China, CEIC

The strict travel restrictions have seen companies' China operations becoming increasingly isolated and challenged.<sup>43</sup> Those that do decide to risk international travel have very few flights to choose from, which has made the experience highly unpredictable and has seen the cost of tickets rise to stratospheric levels. The suspension of flights to China when positive COVID cases have been detected among passengers has further added to the unpredictability. And while travellers can now transit rather than having to fly direct from their country of origin back to China, the mandating of COVID tests at each layover has made the process very time-consuming and added even more cost.

39 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 24<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

40 *Number of foreigners on China, results of 7<sup>th</sup> national census, Expat Focus*, 11<sup>th</sup> July 2022, viewed 5<sup>th</sup> August 2022, <[https://mp.weixin.qq.com/s?\\_\\_biz=MjM5OTg2MTgzOA==&mid=2654317267&idx=1&sn=c790b7572d9186ac1fc15c3255db77d9&chksm=bcf401f28b8388e495d439dbd33c62d556744c1c65c6c100eeaea0ce63fdc5b779a72e6b20ce#rd](https://mp.weixin.qq.com/s?__biz=MjM5OTg2MTgzOA==&mid=2654317267&idx=1&sn=c790b7572d9186ac1fc15c3255db77d9&chksm=bcf401f28b8388e495d439dbd33c62d556744c1c65c6c100eeaea0ce63fdc5b779a72e6b20ce#rd)>

41 Wang, Huiyao, *China's zero-COVID policy has damaged its stock of global talent*, *Financial Times*, 17<sup>th</sup> July 2022, viewed 18<sup>th</sup> July 2022, <<https://www.ft.com/content/fe5a71d-8a19-4f65-804e-42bfb02af083>>

42 *Expats flee as Shanghai's Covid lockdown drags*, *The Standard*, 29<sup>th</sup> April 2022, viewed 5<sup>th</sup> August 2022, <<https://www.thestandard.com.hk/breaking-news/section/3/189637/Expats-flee-as-Shanghai%27s-Covid-lockdown-drags%C2%A0>>

43 In the European Chamber's BCS 2022, 81 per cent of businesses reported that a lack of business travel negatively impacted them, with the top effects being: 1) difficulties establishing/maintaining rapport with partners/clients (faced by 74 per cent); 2) difficulties with/ inability to secure new business deals or partnerships (faced by 60 per cent); and 3) delays to delivery of / inability to deliver services / project deliverables (experienced by 42 per cent). *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, pp. 18–19, 20<sup>th</sup> June 2022, viewed 24<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

One of the consequences is that China-based staff now have few, if any, opportunities to participate in information exchanges, networking, training and the sharing of expertise with colleagues and partners in Europe. This contrasts starkly with colleagues from other countries who can easily visit European HQs. Bringing in experts on short-term assignments to China to carry out maintenance or provide technical assistance, for example, is also burdensome, if not impossible. Furthermore, executives from HQs are being deprived of first-hand China experience and are opting to visit other destinations in the region instead. This is resulting in less understanding of China, which will inevitably lead to less desire to engage with the country. As expressed by a senior executive at one European multinational, “[c]ompanies’ headquarters are increasingly reluctant to contribute to or invest in China, given they have a diminishing understanding of the country.”

Although statistics published by China’s Ministry of Commerce show that foreign direct investment (FDI) into China grew in 2020, it is important to note that the place where a business is registered is counted as the source of investment rather than where the actual money comes from. This means that investments into China from Hong Kong, as well as Singapore and other tax havens such as the Cayman Islands and the British Virgin Islands, are coming not only from multinationals, but also subsidiaries of Chinese companies, a practice known as ‘round-tripping investment’.<sup>44</sup> According to official figures, 71 per cent of China’s FDI in 2021 came from Hong Kong, and according to a Fitch report, a large proportion of FDI coming from Hong Kong and Macau originated from Chinese companies, calling “into question how ‘foreign’ such direct investments are”.<sup>45</sup> Meanwhile, in 2020, investment from the EU into China dropped 11.8 per cent from the previous year, and its proportion of overall FDI fell to 3.8 per cent from a high of 11.1 per cent in 1999.<sup>46</sup> While there are still “a select group of high-profile multinational companies ready to make billion dollar splashes”,<sup>47</sup> the trend of declining FDI is unlikely to reverse while European executives are heavily restricted from travelling to and from China to develop potential greenfield projects. China’s ability to attract foreign investment has also decreased because Chinese dignitaries who could previously travel the world showcasing what the country can offer business are now mostly limited to online meetings, which lack the ‘human touch’.

The absence of people-to-people exchanges is also damaging China’s image to the outside world. Foreign nationals working in China are some of the best ‘ambassadors’ for the country – they frequently extol the positive aspects of their experiences when back in their home countries.<sup>48</sup> It is not just the business world that is missing such ‘ambassadors’ either. Foreign students are also being prevented from studying in China, while at the same time interest among Europeans to learn Chinese is fading. Many journalists previously based in China are also being forced to report from outside of the country, and tourists have simply not been coming for the past nearly three years.<sup>49</sup> As highlighted by the PEW Research Center’s *Spring 2022 Global Attitudes Survey* (Figure 3), unfavourable opinions towards China are currently at an all-time high in many countries.<sup>50</sup>

44 Wang, Orange, *Explainer: How much is China’s foreign direct investment and is it still a good destination for overseas investors?*, SCMP, 10<sup>th</sup> June 2022, viewed 9<sup>th</sup> August 2022, <<https://www.scmp.com/economy/economic-indicators/article/3181037/how-much-chinas-foreign-direct-investment-and-it-still>>

45 O’Farrell, Seth, *China’s foreign investment problem*, FDI Intelligence, 18<sup>th</sup> February 2022, viewed 9<sup>th</sup> August 2022, <<https://www.fdiintelligence.com/content/feature/chinas-foreign-investment-problem-80679>>

46 Wang, Orange, *Explainer: How much is China’s foreign direct investment and is it still a good destination for overseas investors?*, SCMP, 10<sup>th</sup> June 2022, viewed 9<sup>th</sup> August 2022, <<https://www.scmp.com/economy/economic-indicators/article/3181037/how-much-chinas-foreign-direct-investment-and-it-still>>

47 O’Farrell, Seth, *China’s foreign investment problem*, FDI Intelligence, 18<sup>th</sup> February 2022, viewed 9<sup>th</sup> August 2022, <<https://www.fdiintelligence.com/content/feature/chinas-foreign-investment-problem-80679>>

48 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, p. 21, 20<sup>th</sup> June 2022, viewed 24<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

49 Gibbs, Ker, *Expat exodus is bad for China, bad for the US and bad for the world*, SCMP, 19<sup>th</sup> November 2021, viewed 17<sup>th</sup> July 2022, <<https://www.scmp.com/comment/opinion/article/3156404/expat-exodus-bad-china-bad-us-and-bad-world>>

50 The poll found that negative attitudes towards China were at the highest level on record in 10 of the 19 countries surveyed in 2022. Results are recorded annually and date back to 2002; *Large majorities continue to hold unfavorable view of China*, Pew Research Center, 27<sup>th</sup> June 2022, viewed 12<sup>th</sup> July 2022, <[https://www.pewresearch.org/global/2022/06/29/negative-views-of-china-tied-to-critical-views-of-its-policies-on-human-rights/pg\\_2022-06-29\\_views-of-china\\_00-02/?utm\\_source=substack&utm\\_medium=email](https://www.pewresearch.org/global/2022/06/29/negative-views-of-china-tied-to-critical-views-of-its-policies-on-human-rights/pg_2022-06-29_views-of-china_00-02/?utm_source=substack&utm_medium=email)>



Figure 3: Negative attitudes towards China are at an all-time high

% who have an **unfavorable** opinion of China

	Most unfavorable										Least unfavorable									
	'02	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14	'15	'16	'17	'18	'19	'20	'21	'22	
	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	%	
U.S.	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	79	76	82	
Canada	-	27	-	37	-	36	-	-	-	45	-	48	40	40	45	67	73	73	74	
Sweden	-	-	-	40	-	-	-	-	-	-	-	-	59	49	52	70	85	80	83	
Netherlands	-	34	-	-	-	-	-	-	-	-	-	-	43	42	45	58	73	72	75	
Germany	-	37	33	54	68	63	61	59	67	64	64	60	60	53	54	56	71	71	74	
UK	-	16	14	27	36	29	35	26	35	31	38	37	44	37	35	55	74	63	69	
France	-	42	41	51	72	60	59	49	60	58	53	49	61	52	54	62	70	66	68	
Italy	-	-	-	61	-	-	-	-	64	62	70	57	61	59	60	57	62	60	64	
Spain	-	21	38	43	56	41	38	39	46	47	55	50	56	43	48	53	63	57	63	
Belgium	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	71	67	61	
Poland	-	34	-	42	54	41	41	32	41	43	52	44	42	29	37	34	-	-	55	
Hungary	-	-	-	-	-	-	-	-	-	-	-	-	44	45	47	37	-	-	52	
Greece	-	-	-	-	-	-	-	-	38	37	46	-	37	40	48	32	-	-	50	
Israel	-	-	-	45	-	37	-	46	-	60	50	42	-	43	42	25	-	-	46	
Japan	42	-	71	67	84	69	69	61	84	93	91	89	86	83	78	85	86	88	87	
Australia	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	87	85	86	
South Korea	31	-	-	42	49	54	56	-	-	50	42	37	-	61	60	63	75	77	80	
Malaysia	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	39	
Singapore	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	34	34	

Source: PEW Research Center

#### 4. Business is becoming increasingly politicised

In recent years, the EU-China relationship has yielded an astonishing number of issues that have raised concerns and heightened political risks for business. The list includes allegations of human rights abuses in Xinjiang;<sup>51</sup> the politicisation of the COVID-19 pandemic; the EU’s labelling of China as a ‘systemic rival’;<sup>52</sup> the removal of Lithuania from Chinese customs lists following its opening of a Taiwan Representative Office;<sup>53</sup> perceptions of China’s implementation of the National Security Law in Hong Kong;<sup>54</sup> and the Chinese Communist Party’s plan to insinuate itself deeper into every aspect of civil society and business.<sup>55</sup> In the European Chamber’s BCS 2022, 50 per cent of respondents reported that China’s business environment became more politicised in 2021, a nine per cent year-on-year increase. More BCS 2022 respondents also foresee that political pressure will increase rather than decrease over the coming year.<sup>56</sup>

Rising negative public sentiment towards China is pushing foreign governments to take harsher stances towards the country, further straining relations between China and its international partners. The evolving United Kingdom (UK)-China relationship illustrates this dynamic. Just seven years ago, the UK viewed China as a strong potential partner, and was the first Western country to embrace the founding of the

51 Emmott, Robin, *EU extends human rights sanctions, including on Chinese officials*, Reuters, 24<sup>th</sup> November 2021, viewed 13<sup>th</sup> July 2022, <<https://www.reuters.com/world/eu-extends-human-rights-sanctions-including-chinese-officials-2021-11-24/>>

52 Von der Burchard, Hans, *EU slams China as ‘systemic rival’ as trade tension rises*, Politico, 12<sup>th</sup> March 2019, viewed 17<sup>th</sup> July 2022, <<https://www.politico.eu/article/eu-slams-china-as-systemic-rival-as-trade-tension-rises/>>

53 Sytas, Andrius, *Lithuania says Chinese customs is blocking its exports*, Reuters, 3<sup>rd</sup> December 2021, viewed 17<sup>th</sup> July 2022, <<https://www.reuters.com/article/china-lithuania-trade-idUSKBN2I0Y7>>

54 Kurlantzick, Joshua, *China’s Collapsing Global Image*, Council on Foreign Relations, July 2022, viewed 2<sup>nd</sup> August 2022, <[https://www.cfr.org/report/chinas-collapsing-global-image?utm\\_source=substack&utm\\_medium=email](https://www.cfr.org/report/chinas-collapsing-global-image?utm_source=substack&utm_medium=email)>

55 Russo, Federica, *Politics in the Boardroom: The Role of Chinese Communist Party Committees*, The Diplomat, 24<sup>th</sup> December 2019, viewed 20<sup>th</sup> July 2022, <<https://thediplomat.com/2019/12/politics-in-the-boardroom-the-role-of-chinese-communist-party-committees/>>

56 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 8<sup>th</sup> August 2022, <[https://www.eurochamber.com.cn/en/publications-archiv/1020/Business\\_Confidence\\_Survey\\_2022](https://www.eurochamber.com.cn/en/publications-archiv/1020/Business_Confidence_Survey_2022)>

Beijing-backed Asian Infrastructure Investment Bank.<sup>57</sup> Former UK Prime Minister David Cameron even went as far as to declare that UK-China relations were on the cusp of entering a “golden era”.<sup>58</sup> Attitudes have shifted considerably in the intervening years.<sup>59</sup> The final two candidates in the UK's 2022 Conservative Party leadership battle both sought to gain an advantage by each attempting to portray themselves as the bigger ‘China hawk’.<sup>60</sup>

Businesses with China operations are now having to walk a political tightrope that is becoming more and more unstable. They are coming under pressure, both through legislation and from consumers, to demonstrate transparency in their China operations. For example, businesses exporting from China to the US are now bound by the Uyghur Forced Labor Prevention Act to prove that they are not involved in forced labour practices.<sup>61</sup> The EU is also planning to introduce similar legislation—the Corporate Sustainability Reporting Directive (CSRD)—which will introduce strict reporting requirements, obliging large public-interest companies to report on sustainability issues such as environmental, social and governance (ESG) and human rights. Under the CSRD, companies' sustainability reports will have to be certified by independent, third-party auditors and will also need to be published in a dedicated section of company management reports.<sup>62</sup>

For companies to align their global corporate pledges with realities on the ground, they need a business environment that is transparent and predictable. Crucially, they need China to provide the conditions that allow them to conduct trusted, third-party audits of their operations so that they can be certified as being fully compliant with global legislation. They also need Chinese partners that are willing to demonstrate a similar commitment to corporate sustainability. Until this is possible, businesses will face mounting pressure to relocate operations away from sensitive regions.

At the same time, companies fear being perceived as acting against China's interests on politically controversial topics, as doing so risks a backlash, with the threat of consumer boycotts ever-present. As highlighted by a recent study by the Swedish National China Centre,<sup>63</sup> there were no fewer than 90 consumer boycotts of foreign companies from 2008 to 2021, with the majority of these occurring after 2016 (Figure 4). The study also found that foreign companies have been made scapegoats for geopolitical or human-rights-related decisions taken by the governments in their home countries.

57 Osborn, Andrew, *Britain says in 'national interest' to join China-backed bank*, Reuters, 13<sup>th</sup> March 2015, viewed 29<sup>th</sup> July 2022, <<https://www.reuters.com/article/us-britain-asia-bank-cameron-idUKKBN0M91DV20150313>>

58 Shirbon, Estelle & Jones, Gareth, *China, Britain to benefit from 'golden era' in ties - Cameron*, Reuters, 18<sup>th</sup> October 2015, viewed 29<sup>th</sup> July 2022, <<https://www.reuters.com/article/us-china-britain-idUSKCN0SB10M20151017>>

59 In July 2022, then incumbent UK Prime Minister Boris Johnson resigned, sparking a battle for leadership of the UK Conservative Party. At the time of writing, a new leader had not been elected.

60 Courea, Eleni & Lau, Stewart, *In the race to succeed Boris Johnson, only China hawks need apply*, Politico, 27<sup>th</sup> July 2022, viewed 30<sup>th</sup> July 2022, <<https://www.politico.eu/article/boris-johnson-china-liz-truss-rishi-sunak-tory-leadership/>>

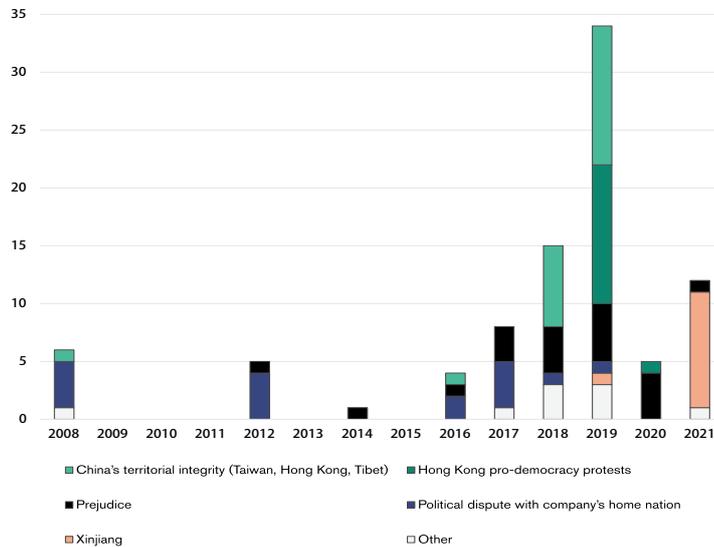
61 *Implementation of the Uyghur Forced Labor Prevention Act*, US Department of State, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.state.gov/implementation-of-the-uyghur-forced-labor-prevention-act/>>

62 A provisional agreement has already been reached between the European Council and the European Parliament on the CSRD with approval pending at the time of writing: *New rules on corporate sustainability reporting: provisional political agreement between the Council and the European Parliament*, European Council, Council of the European Union, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.consilium.europa.eu/en/press/press-releases/2022/06/21/new-rules-on-sustainability-disclosure-provisional-agreement-between-council-and-european-parliament/>>

63 Bohman, Viking & Pärup, Hillevi, *Purchasing with the Party: Chinese consumer boycotts of foreign companies, 2008–2021*, Swedish National China Centre, 11<sup>th</sup> July 2022, viewed 11<sup>th</sup> August 2022, <<https://kinacentrum.se/en/publications/chinese-consumer-boycotts-of-foreign-companies/>>



Figure 4: Number of consumer boycotts of foreign companies in China 2008–2021



Source: Swedish National China Centre

Russia’s invasion of Ukraine, which saw over 1,000 companies publicly announce they would be voluntarily curtailing their Russia operations,<sup>64</sup> has acted as a further wake-up call for businesses, and pushed them to evaluate how susceptible their China operations would be to a similar disruption.<sup>65</sup> In a flash survey conducted by the European Chamber in April 2022, a third of respondents reported that the war in Ukraine made China a less attractive investment destination.<sup>66</sup> This indicates that, regardless of whether there is actually a serious dispute between Mainland China and Taiwan, just the threat of wars or blockades is enough to increase the sense of unpredictability.

### 5. Supply chain strategies are shifting

Over the past two years, the fragility of global supply chains has been exposed and risk management has become a priority. While there are many reasons for this, COVID-19, Russia’s invasion of Ukraine, inadequate logistics infrastructure, a lack of truck drivers in many markets, as well as freak occurrences such as the container ship that ran aground and blocked the Suez Canal,<sup>67</sup> are some of the main factors now prompting companies to re-evaluate their production and distribution networks. Legislation is an additional driver of change as new or forthcoming laws—including the aforementioned US’ Uyghur Forced Labor Prevention Act and the EU’s CSRD—will compel companies to carry out thorough due diligence,

64 Over 1,000 Companies Have Curtailed Operations in Russia – But Some Remain, Yale School of Management, 25<sup>th</sup> July 2022, viewed 26<sup>th</sup> July 2022, <<https://som.yale.edu/story/2022/over-1000-companies-have-curtailed-operations-russia-some-remain>>

65 Sevastopulo, Demetri & Edgecliffe-Johnson, Andrew, Executives seek briefings on Taiwan war risk, Financial Times, 12<sup>th</sup> July 2022, viewed 16<sup>th</sup> July 2022, <[https://www.ft.com/content/8c753573-b2d7-42a9-810f-25ab37eb0099?utm\\_source=substack&utm\\_medium=email](https://www.ft.com/content/8c753573-b2d7-42a9-810f-25ab37eb0099?utm_source=substack&utm_medium=email)>

66 Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed July 26<sup>th</sup> 2022, <[https://www.europeanchamber.com.cn/en/publications-archive/973/Flash\\_Survey\\_COVID\\_19\\_and\\_the\\_War\\_in\\_Ukraine\\_The\\_Impact\\_on\\_European\\_Business\\_in\\_China](https://www.europeanchamber.com.cn/en/publications-archive/973/Flash_Survey_COVID_19_and_the_War_in_Ukraine_The_Impact_on_European_Business_in_China)>

67 Egypt’s Suez Canal blocked by huge container ship, BBC, 24<sup>th</sup> March 2021, viewed 8<sup>th</sup> August 2022, <<https://www.bbc.com/news/world-middle-east-56505413>>

both up- and downstream.<sup>68&69</sup> As a result, China's position at the centre of global supply chains looks set to be challenged. There will not be full decoupling with companies leaving China altogether as the size and potential of the market are still too great to ignore. Instead, more nuanced strategies will emerge.

Prior to the Omicron outbreaks that led to full or partial lockdowns in at least 45 cities, several European companies were further onshoring supply chains into China to better service the domestic market and isolate themselves from potential global shocks. However, this strategy is not without significant drawbacks: initial costs are steep, and communication and data flows between HQs and China operations will be impeded for those that pursue this option. Furthermore, 31 per cent of European manufacturers import critical components into China for which they cannot source alternatives, meaning that full onshoring for them is not possible.<sup>70</sup>

Several companies had begun, or were exploring the possibility of, creating separate supply chains – one to serve China and one for the rest of the world. Indeed, some customers in China are already asking for 'US-free' products, and some customers in the US are asking for 'China-free' products, due to demands from both the state and private sectors.<sup>71</sup> Producing two separate products, one for each market, can allow companies to avoid import and export restrictions. However, it also carries considerable risk. Operating costs will increase while efficiency and economies of scale decrease, and any changes to regulations may lead to this solution becoming redundant. Also, similar to the option of increasingly onshoring supply chains into China, it may not be possible to find multiple sources for the same components, meaning that this strategy is simply not feasible for some.

Since the lockdowns in early 2022, which paralysed supply chains in China, there has been a shift in priorities, from 'just in time' to 'just in case'.<sup>72&73</sup> Companies are no longer just exploring 'China+1'<sup>74</sup> strategies. To strengthen risk management and reduce the risk of supply chain failures, many are increasingly looking into 'China+1+2+3'. While this will not necessarily affect existing investments, future investments are increasingly likely to be placed outside China for risk reasons. It is probable that this trend will continue, as European companies look to maintain a strong presence in this important market while identifying viable back-up options.

### *Environmental legislation challenges feasibility of exporting from China*

Environmental regulations, and growing consumer awareness for low-carbon products, could make it less feasible for goods and components to be transported over longer distances.<sup>75</sup> One example of this is in the field of shipping, the mode of transportation that carries 90 per cent of global trade. The arrival of the International Maritime Organization's (IMO's) 2023 regulations—targeted at heavily reducing the carbon

68 *Implementation of the Uyghur Forced Labor Prevention Act*, US Department of State, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.state.gov/implementation-of-the-uyghur-forced-labor-prevention-act/>>

69 *New rules on corporate sustainability reporting: provisional political agreement between the Council and the European Parliament*, European Council, Council of the European Union, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.consilium.europa.eu/en/press/press-releases/2022/06/21/new-rules-on-sustainability-disclosure-provisional-agreement-between-council-and-european-parliament/>>

70 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, p. 16, 20<sup>th</sup> June 2022, viewed 24<sup>th</sup> July 2022, <<https://www.eurochamber.com.cn/en/publications-business-confidence-survey>>

71 *The Challenge of "Decoupling USA-China" – What Can the European Machinery Industry Do?*, VDMA, p. 13 & p. 20, 12<sup>th</sup> July 2022, viewed 9<sup>th</sup> August 2022, <<https://vdma.org/viewer/-/v2article/render/54169456>>

72 Masters, Brooke, and Edgecliffe-Johnson, Andrew, *Supply chains: companies shift from 'just in time' to 'just in case'*, *Financial Times*, 20<sup>th</sup> December 2021, viewed 11<sup>th</sup> July 2022, <<https://www.ft.com/content/8a7cdc0d-99aa-4ef6-ba9a-fd1a1180dc82>>

73 Beattie, Alan, *The US 'friendshoring' experiment risks making enemies*, *Financial Times*, 2<sup>nd</sup> August 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.ft.com/content/d8a0ce5e-dc8b-4bce-8dbf-c09d08d263a5>>

74 "The phrase 'China+1' captures the strategy that many large manufacturers are following to increase the diversity and resiliency of their supply chains by moving some Chinese-based sourcing to other countries.: *Is a China+1 strategy feasible?*, Resilinc, 8<sup>th</sup> December 2020, viewed 9<sup>th</sup> August 2022, <<https://www.resilinc.com/blog/is-a-china-1-strategy-feasible/>>

75 *New rules on corporate sustainability reporting: provisional political agreement between the Council and the European Parliament*, European Council, Council of the European Union, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.consilium.europa.eu/en/press/press-releases/2022/06/21/new-rules-on-sustainability-disclosure-provisional-agreement-between-council-and-european-parliament/>>



footprint of shipping—could accelerate ‘nearshoring’ and ‘reshoring’ unless the transportation industry invests in and develops green transport solutions that can reduce or eliminate its carbon emissions.<sup>76</sup> EU shipping lines are already investing in decarbonising their operations, but as the world’s largest trading nation, largest shipbuilder and host to the seven largest ports in the world, it will take collaboration with stakeholders in China to meet both regulatory requirements and the expectations of consumers.

The EU’s CSRD—which also covers corporate reporting requirements on carbon footprints—and the EU’s phased introduction of the carbon border adjustment mechanism (CBAM) from 2026 onwards will also increasingly shape decision-making among companies that want to remain globally competitive.<sup>77&78</sup>

## What lies ahead?

In a worst-case scenario, China’s predictability, reliability and efficiency would continue to erode, and European companies would have to further evaluate how many eggs to keep in their China baskets, with more exploring the idea of creating divergent systems, with one to serve China and one for the rest of the world.<sup>79</sup> The resulting loss of efficiency—such as the smaller data pools to draw from—would negatively impact the pace of innovation and lead to higher costs. This would lead to China performing well below its economic potential. Decoupling of market features, including branding, distribution, payment systems and underlying technology, would accelerate the siloing of China operations as synergies with the rest of the world become increasingly limited.<sup>80</sup>

As these dynamics continue, more countries would be likely to try and increase their own self-reliance, particularly in critical areas such as medical devices, pharmaceuticals and raw materials. If globalisation is not prevented from scaling down further into regionalisation, the likelihood of global conflict would increase as dominant countries within each regional cluster push others to ‘take sides’.

## The next 12 months – potential disruptions on the horizon

Looking towards the next 12 months, there are two potential disruptions that threaten to add complexity to both the EU-China relationship and doing business in China: the EU’s reappraisal of its relationship with China and Taiwan’s significance relative to the rest of the world.

### *The EU’s evolving China policy and new trade instruments*

While the EU has been attempting to continually engage China at the political level on numerous important issues, progress on concrete deliverables has fallen below expectations, particularly given the country’s rise to global prominence since its WTO accession and the strength of its economy today.

<sup>76</sup> The IMO’s Greenhouse Gas Strategy aims to reduce the carbon intensity of international shipping by 40 per cent by 2030, and by 70 per cent by 2050, compared with a 2008 baseline level. Under its 2023 measures, all ships of 400 gross tonnage and above will be required to have their Energy Efficiency Existing Ship Index (EEXI) calculated, with specific requirements for improvements in energy efficiency depending on the size and type of ships. For gas carriers, ships of 10,000 deadweight tonnage and above will be required to improve their technical energy efficiency by 30 per cent compared to a 2013 baseline. Failure to meet the required standard will exclude the vessels from being used for international trade: Kim, Charles & He, Yanyu, *Potential impact of IMO 2023 on global LPG shipping*, IHS Markit, 2<sup>nd</sup> September 2021, viewed 14<sup>th</sup> July 2022, <<https://ihsmarkit.com/research-analysis/IMO-2023-impact-on-lpg-shipping.html>>

<sup>77</sup> *New rules on corporate sustainability reporting: provisional political agreement between the Council and the European Parliament*, European Council, Council of the European Union, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.consilium.europa.eu/en/press/press-releases/2022/06/21/new-rules-on-sustainability-disclosure-provisional-agreement-between-council-and-european-parliament/>>

<sup>78</sup> “The Carbon Border Adjustment Mechanism (CBAM) is a climate measure that should prevent the risk of carbon leakage and support the EU’s increased ambition on climate mitigation, while ensuring WTO compatibility.”: *Carbon Border Adjustment Mechanism: Questions and Answers*, European Commission, 14<sup>th</sup> July 2021, viewed 3<sup>rd</sup> August 2022, <[https://ec.europa.eu/commission/presscorner/detail/en/qanda\\_21\\_3661](https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3661)>

<sup>79</sup> *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 24<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

<sup>80</sup> *Decoupling: Severed Ties and Patchwork Globalisation*, European Union Chamber of Commerce in China and MERICS, 14<sup>th</sup> January 2021, viewed 15<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-innovation-report>>

The increasing frustration that the EU has felt with regard to the lack of deliverables was encapsulated by High Representative of the EU for Foreign Affairs and Security Policy Josep Borrell's remarks, when he described the April 2022 EU-China Summit—the two sides' flagship meeting—as a “dialogue of the deaf.”<sup>81</sup>

The shift in how the EU views its relations with China, and other third countries, is far from sudden. The EU has long sought reciprocity and transparency with all its trading partners, and the European Chamber has been advocating for greater market access and a level playing field for European business in China for more than two decades. Back in 2017, European businesses began suffering from an accumulation of “promise fatigue” after having received countless assurances from China about market-opening and regulatory reform that never quite materialised.<sup>82&83</sup> In that same year, the European Commission proposed a new framework for investment screening. In his 2017 State of the Union address, then president of the European Commission Jean-Claude Juncker said that the European trade agenda needed to be strengthened, and that, “[While] Europe is open for business [...] there must be reciprocity. We have to get what we give.” In the same speech, when he announced the EU's intention to introduce an investment screening mechanism, he explained that “we are not naïve free traders”.<sup>84</sup> The EU framework for screening FDI, which became fully operational on 11<sup>th</sup> October 2020, is now in place to ensure that the EU's Single Market can remain fully open but not be taken advantage of or compromised.

The EU will also soon adopt the International Procurement Instrument (IPI), a mechanism that was first discussed in 2012, aimed at ensuring reciprocity with regard to public procurement in third countries. The EU has an open public procurement market in the interests of ensuring transparency and competition, and eliminating corruption. With the introduction of this mechanism, the EU will be able to push for reciprocity by rejecting companies' bids on public procurement tenders in the EU if they come from a country that discriminates against EU companies in their own public procurement market. The IPI was adopted by the European Parliament on 9<sup>th</sup> June 2022,<sup>85</sup> and then by the European Council on 17<sup>th</sup> June 2022,<sup>86</sup> and the regulation will come into force 60 days after its publication in the *Official Journal of the European Union*.

In December 2021, the European Commission published a proposal for the adoption of an anti-coercion mechanism in “response to the EU and its Member States becoming the target of economic coercion in recent years”, with ‘economic coercion’ defined as actions taken “by one country against another through restrictions on trade or investment in order to interfere with their sovereign choices”. While the mechanism is aimed at deterring third countries from taking coercive action against any EU Member State, it would also allow for retaliation with countermeasures that could include restrictions on trade, investment and funding.<sup>87</sup>

The EU has several additional tools in the legislative process, variously aimed at guaranteeing fairness for EU companies, protecting the EU Single Market and ensuring transparency, in the interest of securing

81 Bermingham, Finbarr, *EU-China summit was a 'dialogue of the deaf', says top Brussels diplomat*, SCMP, 6<sup>th</sup> April 2022, viewed 26<sup>th</sup> July 2022, <<https://www.scmp.com/news/china/article/3173188/eu-china-summit-was-dialogue-deaf-says-top-brussels-diplomat>>

82 *European Business in China Position Paper 2017/2018*, European Union Chamber of Commerce in China, p.9, 19<sup>th</sup> September 2017, viewed 10<sup>th</sup> August 2022, <<https://www.europeanchamber.com.cn/en/publications-archiv?page=5&f%5Bcategory%5D%5B3%5D=1&f%5Bdate%5D%5B2017%5D=1>>

83 *When it Comes to China, Foreign Investors are Getting "Promise Fatigue"*, Reuters, 19<sup>th</sup> September 2017, viewed 8<sup>th</sup> August 2022, <<https://fortune.com/2017/09/18/china-politburo-reforms-foreign-investment/>>

84 *President Jean-Claude Juncker's State of the Union Address 2017*, European Commission, 13<sup>th</sup> September 2017, viewed 1<sup>st</sup> August 2022, <[https://ec.europa.eu/commission/presscorner/detail/en/SPEECH\\_17\\_3165](https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_17_3165)>

85 *International public procurement instrument: securing fairness for EU firms*, European Parliament, 9<sup>th</sup> June 2022, viewed 5<sup>th</sup> August 2022, <[https://www.europarl.europa.eu/pdfs/news/expert/2022/6/press\\_release/20220603IPR32143/20220603IPR32143\\_en.pdf](https://www.europarl.europa.eu/pdfs/news/expert/2022/6/press_release/20220603IPR32143/20220603IPR32143_en.pdf)>

86 *International Procurement Instrument: Council gives green light to new rules promoting reciprocity*, European Council, 17<sup>th</sup> June 2022, viewed 5<sup>th</sup> August 2022, <<https://www.consilium.europa.eu/en/press/press-releases/2022/06/17/international-procurement-instrument-council-gives-final-go-ahead-to-new-rules-boosting-reciprocity/>>

87 The file on economic coercion has been given to the Committee on International Trade within the European Commission, with the committee due to vote on the proposal in autumn 2022: *Proposed anti-coercion instrument*, European Parliament, 16<sup>th</sup> June 2022, viewed 1<sup>st</sup> August 2022, <[https://www.europarl.europa.eu/thinktank/en/document/EPRS\\_BRI\(2022\)729299](https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2022)729299)>



fair market competition based on the principles of corporate sustainability. They include the regulation on foreign subsidies distorting the internal market;<sup>88</sup> the CSRD (see p. 21),<sup>89</sup> a new trade instrument to ban products made by forced labour,<sup>90</sup> the CBAM<sup>91</sup> and an amendment to the blocking statute.<sup>92</sup>

The creation of these trade tools is the result of the EU recognising that it needs to become more strategic in its approach to protecting its own sovereignty, and pushing for its companies to receive greater market access and fairer treatment in third markets. They are also not necessarily aimed specifically at China, nor would they even come into use against any country that provides reciprocal market access, does not practice coercion and does not adopt measures that may distort the EU Single Market.

In addition to strengthening its toolbox, the EU is deepening cooperation with likeminded partners, for example through the EU-US Trade and Technology Council, described as “a transatlantic forum fostering cooperation on trade- and technology-related issues, based on shared democratic values”.<sup>93</sup> The five key areas for cooperation that were agreed upon at the inaugural meeting on 29<sup>th</sup> September 2021 are all areas where the EU and the US is either competing, or experiencing challenges, with China. They include export controls, FDI screening, secure supply chains (focussed on semiconductors in particular), technology standards (including cooperation on artificial intelligence) and global trade challenges.<sup>94</sup>

The EU is also stepping up its engagement in the Indo-Pacific region, with a view to contributing to “the region’s stability, security, prosperity and sustainable development, in line with the principles of democracy, rule of law, human rights and international law.”<sup>95</sup> Part of this strategy includes engaging with China to cooperate “on issues of common interest and encouraging China to play its part in a peaceful and thriving Indo-Pacific region”.<sup>96</sup>

While it is crucial that the EU maintains a flexible China strategy that can evolve and adapt to any emerging challenges, it is equally important that it continues to push for deeper bilateral engagement. Although the 2022 EU-China Summit was largely perceived to be a failure in terms of concrete deliverables, one reassuring outcome was the agreement to continue with the EU-China High-level Economic and Trade Dialogue (HED), which took place on 19<sup>th</sup> July 2022.<sup>97</sup> While the HED did not come close to solving the major long-standing points of friction, such as market access and regulatory reform,

88 This regulation will scrutinise the activities of third-country actors benefitting from subsidies within the Single Market—from mergers and acquisitions to bids—with a view to prevent distortions and unfair competition: *Foreign subsidies distorting the internal market: provisional political agreement between the Council and the European Parliament*, European Council, 30<sup>th</sup> June 2022, viewed 8<sup>th</sup> August 2022, <<https://www.consilium.europa.eu/en/press/press-releases/2022/06/30/foreign-subsidies-regulation-political-agreement/>>

89 A provisional agreement has already been reached between the European Council and the European Parliament on the CSRD with approval pending at the time of writing: *New rules on corporate sustainability reporting: provisional political agreement between the Council and the European Parliament*, European Council, Council of the European Union, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.consilium.europa.eu/en/press/press-releases/2022/06/21/new-rules-on-sustainability-disclosure-provisional-agreement-between-council-and-european-parliament/>>

90 *European Parliament asks to ban forced labour products*, European Coalition for Corporate Justice, 9<sup>th</sup> June 2022, viewed 5<sup>th</sup> August 2022, <<https://corporatejustice.org/news/european-parliament-asks-to-ban-forced-labour-products/>>

91 “The Carbon Border Adjustment Mechanism (CBAM) is a climate measure that should prevent the risk of carbon leakage and support the EU’s increased ambition on climate mitigation, while ensuring WTO compatibility”: *Carbon Border Adjustment Mechanism: Questions and Answers*, European Commission, 14<sup>th</sup> July 2021, viewed 3<sup>rd</sup> August 2022, <[https://ec.europa.eu/commission/presscorner/detail/en/qanda\\_21\\_3661](https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3661)>

92 “The blocking statute is an important achievement of unified EU action to protect EU operators, whether individuals or companies, from the extra-territorial application of third country laws.”: *Blocking statute: Protecting EU operators, reinforcing European strategic autonomy*, European Commission, viewed 5<sup>th</sup> August 2022, <[https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/restrictive-measures-sanctions/blocking-statute\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/international-relations/restrictive-measures-sanctions/blocking-statute_en)>

93 *Shaping Europe’s digital future—Digital in the EU-US Trade and Technology Council*, European Commission, viewed 5<sup>th</sup> August 2022, <<https://digital-strategy.ec.europa.eu/en/policies/trade-and-technology-council>>

94 *EU-US Trade and Technology Council*, European Commission, viewed 5<sup>th</sup> August 2022, <[https://ec.europa.eu/info/strategy/priorities-2019-2024/stronger-europe-world/eu-us-trade-and-technology-council\\_en#areas-of-cooperation](https://ec.europa.eu/info/strategy/priorities-2019-2024/stronger-europe-world/eu-us-trade-and-technology-council_en#areas-of-cooperation)>

95 *EU Strategy for Cooperation in the Indo-Pacific*, European Union External Action Service, February 2022, viewed 5<sup>th</sup> August 2022, <[https://www.eeas.europa.eu/sites/default/files/eu-indo-pacific\\_factsheet\\_2022-02\\_0.pdf](https://www.eeas.europa.eu/sites/default/files/eu-indo-pacific_factsheet_2022-02_0.pdf)>

96 *Questions and Answers: EU Strategy for Cooperation in the Indo-Pacific*, 16<sup>th</sup> September 2021, viewed 5<sup>th</sup> August 2022, <[https://ec.europa.eu/commission/presscorner/detail/en/QANDA\\_21\\_4709](https://ec.europa.eu/commission/presscorner/detail/en/QANDA_21_4709)>

97 *EU-China: A stable global economy is a shared responsibility*, European Commission, 19<sup>th</sup> July 2022, viewed 11<sup>th</sup> August 2022, <[https://ec.europa.eu/commission/presscorner/detail/en/IP\\_22\\_4547](https://ec.europa.eu/commission/presscorner/detail/en/IP_22_4547)>

or more recent issues, such as China's economic coercion against Lithuania or the 'circuit breaker' policy imposed on European airlines,<sup>98</sup> the dialogue at least clarified areas where there is or is not room for cooperation.

The most positive aspect was that the HED resulted in several concrete outcomes that will be beneficial to European industry. The more noteworthy are some of those linked to financial services,<sup>99</sup> as they address pressing issues that European companies have raised through the European Chamber to European and Chinese regulators.

Continuing to hold these kinds of dialogues is critical for ensuring meaningful engagement at the political level, which can help to provide more predictability at the business level. Engagements such as the Symposium for the 70<sup>th</sup> anniversary of the China Council for the Promotion of International Trade (CCPIT) are also important for keeping the channels of communication open. During that event, European Chamber President Jörg Wuttke spoke directly with Premier Li Keqiang about the challenges being faced by European companies in China.<sup>100</sup> Continued EU-China engagement is vital because there are still numerous shared challenges and many areas on which bilateral cooperation can deepen, including WTO reform, international standardisation and working together to define a practical COVID-19 exit strategy. In particular, there is enormous scope for the EU and China to cooperate on tackling climate change.<sup>101</sup>

### *Taiwan and semiconductors*

Further adding to the complexity of EU-China relations and doing business in China is the position of Taiwan in global supply chains and the potential for related geopolitical issues to erupt.

As a leading producer of semiconductors, Taiwan's strategic importance in global supply chains cannot be overstated. The semiconductor shortage, which started in 2020,<sup>102</sup> illustrated both how critical semiconductors are to multiple industries and how reliant the world is on Taiwan.<sup>103</sup> Not only does it produce around two thirds of the world's semiconductors, it also produces some of the most advanced.<sup>104</sup> This increases the territory's importance to the EU, the US and China, all of which are trying to not only increase their respective domestic semiconductor production capacity but also secure access to the most sophisticated chips. Advanced semiconductors are the 'engines' that will drive the future global economy

98 The 'circuit breaker' policy refers to the suspension of flights into China whose number of confirmed COVID cases reaches four per cent or above of the total number of passengers. The period of suspension was one week as of August 2022: *Circuit Breaker Measures for Scheduled International Passenger Flights Adjusted*, CAAC, 8<sup>th</sup> August 2022, viewed 16<sup>th</sup> August 2022, <[http://www.caac.gov.cn/en/XWZX/202208/t20220808\\_214894.html](http://www.caac.gov.cn/en/XWZX/202208/t20220808_214894.html)>

99 Other positive outcomes included the commitment to conclude a bilateral agreement on regionalisation for certain animal diseases, under which export restrictions of animal products in cases of outbreaks will be limited to certain areas within a country rather than the whole territory, although no concrete timeline was agreed; the discussions on the implementation of the Geographical Indications Agreement, with a view to potentially add new products, could also be beneficial for European businesses; and both sides committed to establishing a communication mechanism on critical raw materials which, if implemented, could help to address supply chain shortages: See: *EU-China: A stable global economy is a shared responsibility*, European Commission, 19<sup>th</sup> July 2022, viewed 11<sup>th</sup> August 2022, <[https://ec.europa.eu/commission/presscorner/detail/en/IP\\_22\\_4547](https://ec.europa.eu/commission/presscorner/detail/en/IP_22_4547)>

100 *President Wuttke Attended the Symposium with Premier Li Keqiang on the 70<sup>th</sup> Anniversary of CCPIT*, European Union Chamber of Commerce in China, 19<sup>th</sup> May 2022, viewed 8<sup>th</sup> August 2022, <[https://www.europeanchamber.com.cn/en/lobby-actions/5695/President\\_Wuttke\\_Attended\\_the\\_Symposium\\_with\\_Premier\\_Li\\_Keqiang\\_on\\_the\\_70th\\_Anniversary\\_of\\_CCPIT\\_](https://www.europeanchamber.com.cn/en/lobby-actions/5695/President_Wuttke_Attended_the_Symposium_with_Premier_Li_Keqiang_on_the_70th_Anniversary_of_CCPIT_)>

101 *Carbon Neutrality: The Role of European Business in China's Race to 2060*, European Union Chamber of Commerce in China, 25<sup>th</sup> May 2022, viewed 17<sup>th</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-carbon-neutrality-report>>

102 The shortage came about due to many different factors. Demand declined in many industries, particularly automotive, during the height of the COVID-19 pandemic, as safety concerns saw factories slow down or even cease production, which forced the semiconductor industry to work at a much-reduced capacity. At the same time, demand for personal computers, laptops and gaming platforms increased due to increasing numbers of people being locked down and forced to work from home. By the time demand had started to recover in the third quarter of 2020, the entire semiconductor supply chain was empty. The semiconductor supply chain was further impacted in different parts of the world by a host of other factors, including extreme winter weather conditions in Texas, power shortages, and a potential drought in Taiwan: Krysiak, Bob, *Why There Is a Global Semiconductor Shortage*, GLG, 18<sup>th</sup> May 2021, viewed 3<sup>rd</sup> August 2022, <<https://glginsights.com/articles/the-reason-why-there-is-a-global-semiconductor-shortage/>>

103 Young, Chris, *A China-Taiwan conflict could lead to a catastrophic semiconductor shortage in the world*, Interesting Engineering, 2<sup>nd</sup> August 2022, viewed 3<sup>rd</sup> August 2022, <<https://interestingengineering.com/culture/a-china-taiwan-conflict-could-lead-to-a-catastrophic-semiconductor-shortage-in-the-world>>

104 *Taiwan/Pelosi, push to pick US or China leaves TSMC in dire straits*, *Financial Times*, 2<sup>nd</sup> August 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.ft.com/content/2a86d801-2794-4320-a182-173c17dd50b0>>



through the ability “to deploy new game-changing technologies, such as 5G, artificial intelligence, and quantum computing.”<sup>105</sup> The fact that they are also key components in advanced military equipment means gaining access to them is viewed as a national security issue.<sup>106</sup>

As its largest investor,<sup>107</sup> the EU maintains strong trade and investment relations with Taiwan and is looking to deepen investment in areas where “interests intersect”. This includes attracting additional investment in the EU’s semiconductor industry to fulfil the goals set out in its European Chips Act,<sup>108</sup> which are “to ensure the EU’s security of supply, resilience and technological leadership in semiconductor technologies and applications”.<sup>109</sup> In the interests of increasing their level of cooperation in this and other areas, in May 2022, the EU and Taiwan committed to upgrading their annual trade dialogue. This provoked a stiff rebuke from the Chinese mission to the EU, which told Brussels “not to gamble” on what it perceived to be a breach of the ‘one China’ policy.<sup>110</sup>

EU-China relations had already become more strained over Taiwan when a representative office was opened in the Lithuanian capital of Vilnius in November 2021, under the name ‘Taiwan’ instead of ‘Taipei’, which is the name used in 20 EU Member States.<sup>111</sup> Viewing this as a challenge to the ‘one China’ policy, in December 2021 Beijing began blocking imports of Lithuanian products as well as European goods that contained Lithuanian components. This led to the EU taking China to the WTO over economic coercion against Lithuania and other EU Member States.<sup>112</sup> US-China tensions over Taiwan had already been on the rise since former US President Donald Trump made it policy to increase engagement with the island. Several additional incidents have since taken place that have escalated tensions,<sup>113&114</sup> complicating the situation further.

Wary of becoming victims of a political dispute, European companies are monitoring this increasingly sensitive issue and are assessing the potential risks very carefully. For example, when Russia invaded Ukraine, speculation rose that China may take similar actions against Taiwan, which prompted scenario-planning to take place in European companies’ HQs. This includes calculating the impact on global operations in the event they have to withdraw from the China market in the same way that many did from Russia.<sup>115</sup>

## Refocussing on reform efforts would rebuild investor confidence

Since the founding of the People’s Republic, China has demonstrated the ability to reinvent itself. With

105 Jackson, Keith, *Semiconductors are the engines of the global economy—and America isn’t making enough of them*, *Fortune*, 30<sup>th</sup> June 2020, 3<sup>rd</sup> August 2022, <<https://fortune.com/2020/06/30/america-tech-semiconductor-manufacturing-investment/>>

106 Smith, Elliot, *‘Downright scary and untenable’: Commerce secretary warns U.S. needs to secure a future for its chip industry*, *CNBC*, 25<sup>th</sup> May 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.cnn.com/2022/05/25/gina-raimondo-warns-us-needs-to-secure-future-for-chip-industry.html>>

107 “2021 EU-Taiwan Relations” Published, European Economic and Trade Office in Taiwan, 27<sup>th</sup> September 2021, viewed 3<sup>rd</sup> August 2022, <[https://www.eeas.europa.eu/delegations/taiwan/2021-eu-taiwan-relations-published\\_en?s=242](https://www.eeas.europa.eu/delegations/taiwan/2021-eu-taiwan-relations-published_en?s=242)>

108 Birmingham, Finbarr, *EU to upgrade ties with Taiwan as China warns Brussels ‘not to gamble on this issue’*, *SCMP*, 18<sup>th</sup> May 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.scmp.com/news/china/diplomacy/article/3178237/eu-upgrade-trade-ties-taiwan>>

109 *Digital sovereignty: Commission proposes Chips Act to confront semiconductor shortages and strengthen Europe’s technological leadership*, European Commission, 8<sup>th</sup> February 2022, viewed 3<sup>rd</sup> August 2022, <[https://ec.europa.eu/commission/presscorner/detail/en/ip\\_22\\_729](https://ec.europa.eu/commission/presscorner/detail/en/ip_22_729)>

110 Birmingham, Finbarr, *EU to upgrade ties with Taiwan as China warns Brussels ‘not to gamble on this issue’*, *SCMP*, 18<sup>th</sup> May 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.scmp.com/news/china/diplomacy/article/3178237/eu-upgrade-trade-ties-taiwan>>

111 Birmingham, Finbarr, *Slovenia tries to head off row with Beijing over Taiwan office*, *SCMP*, 31<sup>st</sup> January 2022, viewed 8<sup>th</sup> August 2022, <<https://www.scmp.com/news/china/diplomacy/article/3165441/slovenia-tries-head-row-beijing-over-taiwan-office-saying-it>>

112 Valero, Jorge & Whitelaw, Kevin, *EU Launches WTO Case Against China Over Lithuania Blockade*, *Bloomberg*, 27<sup>th</sup> January 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.bloomberg.com/news/articles/2022-01-27/eu-set-to-launch-wto-case-against-china-over-lithuania-blockade>>

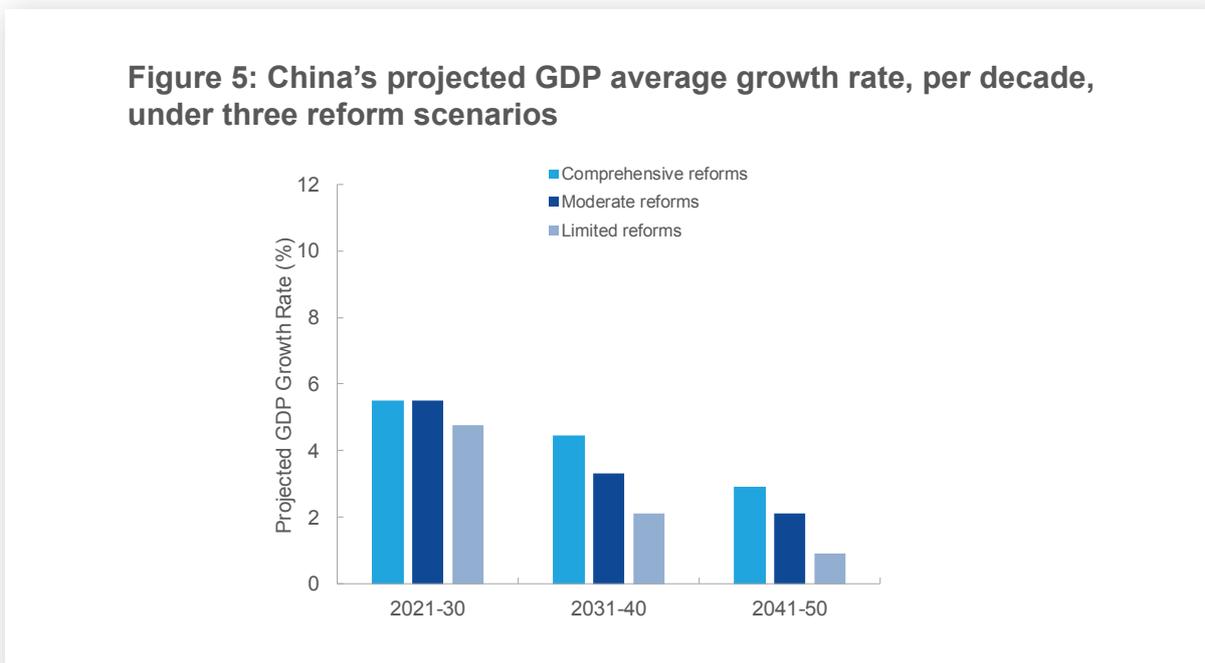
113 Chin, Josh, *China-Taiwan Tensions: What’s Behind the Divide*, *The Wall Street Journal*, 6<sup>th</sup> April 2022, 2<sup>nd</sup> August 2022, <<https://www.wsj.com/articles/china-taiwan-tensions-explained-11646894687>>

114 Lee, Yimou & Wu, Sarah, *Pelosi arrives in Taiwan vowing U.S. commitment; China enraged*, *Reuters*, 3<sup>rd</sup> August 2022, viewed 3<sup>rd</sup> August 2022, <<https://www.reuters.com/world/asia-pacific/pelosi-expected-arrive-taiwan-tuesday-sources-say-2022-08-02/>>

115 Hille, Kathrin, *Corporate jitters over Taiwan and China on the rise*, *Financial Times*, 20<sup>th</sup> July 2022, viewed 2<sup>nd</sup> August 2022, <<https://www.ft.com/content/bfa317e0-743b-4994-a4f5-7c0b25ed9cec>>

the country now facing economic headwinds, focussing on comprehensive reforms, accelerating market opening and avoiding decoupling would be the most effective way for it to do so again and quickly rebuild investor confidence.

As highlighted by the World Bank, for China “to achieve high-quality growth, policymakers should not lose sight of critical structural reforms, despite the current challenging environment. Decisive action to encourage a shift toward consumption, tackle social inequality, and rekindle innovation and productivity growth—including in technologies vital for China’s dual carbon goals—would help achieve a more balanced, inclusive, and sustainable growth trajectory.”<sup>116</sup> Figure 5 illustrates how adopting a path of more comprehensive reforms would put China on a much stronger growth trajectory through to the middle of the century.



Source: World Bank

For China to undertake necessary reforms, it will be important for political space to be given to policymakers to 'make mistakes', discuss ideas and ultimately change course, something that was previously a characteristic of policymaking in the country. As outlined by a prominent European think tank focussed on China, technocrats, experts from various ministries and even think tanks now have less scope to challenge policies—an important correction mechanism—with Chinese policymakers coming under increased pressure to toe the party line, regardless of whether or not it makes sense in practice.<sup>117</sup> The harsh repercussions faced by local Party officials that record COVID-19 cases in their jurisdictions provide an example of how the ability to develop pragmatic policy has been eroded. By March 2022, over 1,000 local officials had been sacked or reprimanded for not strictly following China’s zero-COVID policy. This has put them under pressure to adopt an often excessive ‘one size fits all’ approach, even at the

<sup>116</sup> *China Economic Update – June 2022*, World Bank, p. 6, June 2022, viewed 26<sup>th</sup> July 2022, <<https://documents1.worldbank.org/curated/en/099640106102210762/pdf/P17579708f26d5018098840f1ad978bb54b.pdf>>

<sup>117</sup> Grunberg, Nis & Drinhausen, Katja, *The Party Leads on Everything*, MERICS, 24<sup>th</sup> September 2019, viewed 1<sup>st</sup> August 2022, <<https://merics.org/en/report/party-leads-everything>>



expense of economic growth.<sup>118&119</sup>

With the 20<sup>th</sup> National Congress of the Communist Party taking place on 16<sup>th</sup> October 2022, China has the platform to signal the direction in which the country is headed. The European Chamber believes that by keeping the channels of communication open with business and adopting the 967 recommendations outlined in this *European Business in China Position Paper 2022/2023*, China will be able to re-establish a predictable, reliable and efficient market, and set itself on a course towards achieving its full economic potential.

## Recommendations

### Recommendations for China

- Refocus on reform and opening up to address market access and regulatory issues, and to increase the predictability, reliability and efficiency of the business environment.
- Remain committed to globalisation and contribute to the strengthening of multilateral institutions.
- Refrain from erratic policy shifts, and seek consultation with business, allowing reasonable transition times before implementing any changes to policies or regulations.
- Allow flexibility and accept feedback from key stakeholders from government, think tanks and industry so that new policies can be developed, and existing ones adapted, to tackle emerging challenges in a way that does not sacrifice other key priorities such as sustainable economic growth.
- Continue with reforms that bring SOEs more in line with market forces through the adoption of modern governance structures to make them more efficient, and eventually implement competitive neutrality.
- Refocus on fully vaccinating the population against COVID-19, particularly the elderly and others that are most vulnerable, and permit the best mix of vaccines and boosters, including those based on mRNA technology.
- Continue to increase international flights to China and rescind the 'circuit breaker' policy imposed on airlines.
- Address barriers that prevent businesses from attracting and retaining foreign talent.
- Provide the conditions that allow companies to conduct independent, third-party audits of their operations so that they can be certified as being fully compliant with global legislation.
- Continue to work with the EU and other key interlocutors to de-escalate tensions over Taiwan.
- Engage in dialogue with other governments and key stakeholders to depoliticise the business environment, and refrain from punishing companies for the actions of their home governments.
- Increase China's integration with the global economy and steer away from excessive 'self-sufficiency'.
- Develop nuanced strategies for strengthening supply chains that do not err towards trade protectionism.
- Develop sound institutions that can provide a truly level playing field between foreign and Chinese investors, and make administrative processes transparent, consistent and predictable.
- Deepen EU-China cooperation in areas where interests overlap, such as in relation to combating climate change, international standard-setting, sustainable development, WTO reform and working together to define a practical COVID-19 exit strategy.
- Ensure that European businesses can fully contribute their expertise and technology to help China achieve its carbon neutrality goals.

118 Huang Zhenze, *China's 'Fragmented Authoritarianism' During the COVID-19 Pandemic*, *The Diplomat*, 25<sup>th</sup> June 2022, viewed 2<sup>nd</sup> August 2022, <<https://thediplomat.com/2022/06/chinas-fragmented-authoritarianism-during-the-covid-19-pandemic/>>

119 Zheng, William, *Dozens of Chinese officials punished over latest wave of COVID-19 cases*, *SCMP*, 21<sup>st</sup> March 2022, viewed 2<sup>nd</sup> August 2022, <<https://sg.news.yahoo.com/dozens-chinese-officals-punished-over-143444783.html>>

## Recommendations for the European Union

- Continue to proactively engage with China, and reject calls for disengagement.
- Remain deeply integrated with the global economy and steer away from excessive ‘self-sufficiency’.
- Enhance the overall coordination between member states and EU institutional stakeholders in order to foster a united European approach towards China.
- Avoid provoking China unnecessarily, while defending European core interests.
- Ensure that responses are measured and proportionate when EU-China disagreements arise.
- Continue to work with China and other key interlocutors to de-escalate tensions over Taiwan.
- Deepen EU-China cooperation in areas where interests overlap, such as in relation to combating climate change, international standard-setting, sustainable development, WTO reform and working together to define a practical COVID-19 exit strategy.
- Re-calibrate the EU’s China strategy in such a way that reflects both existing and emerging priorities and challenges, and strikes the right balance between collaboration and competition.
- Continue to work towards reciprocity with third countries, including in relation to public procurement.
- Continue to engage with chambers of commerce, China-focussed think tanks, industry organisations and standard-setting bodies when formulating China policy, to ensure that it reflects on-the-ground realities.
- Strengthen the competitive capabilities of European players by developing bottom-up industrial policy that promotes market competition and innovation in strategic industries, without prescribing technological pathways.

## Recommendations for European Companies

- Maintain strong communication between company HQs and China operations, to ensure that HQs receive accurate, on-the-ground information in order to make informed investment and operational decisions.
- Continue to integrate foreign staff into China operations—as well as Chinese staff into global operations—in order to maintain diverse teams and avoid talent silos.
- Establish ‘decoupling teams’ to evaluate the costs associated with both localisation in China and disconnection from certain global systems.
- Develop a cost/benefit analysis of adopting either a ‘flexible architecture’ model that can be localised for different markets or a ‘dual system’ model that completely separates China production from production for the rest of the world.
- Continue to monitor areas of potential political risk or backlash.
- Develop strategies that can allow for quick adaptation to changes in markets, public opinion and governments that could have an impact on China operations.
- Adhere to new, and prepare for emerging, global regulations on supply chains to demonstrate transparency to the greatest extent possible, and to determine levels of exposure to current and potential sanctions.
- Invest and participate more in government advocacy efforts through chambers of commerce, industry associations and standard-setting bodies.



European Chamber  
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# 2

## Section Two

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### Horizontal Issues



## Horizontal Issues

The position papers in this section address the main horizontal issues that affect European businesses in China, covered by the following 10 working groups and one sub-working group:

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

At the beginning of 2022, there was a drastic deterioration in China's business environment. The international travel restrictions that had been in place for more than two years were compounded by domestic travel restrictions introduced in an attempt to contain the Omicron variant of COVID-19. These restrictions have had an extremely negative impact on European businesses in China, both in terms of human resources (HR) attraction and retention, and communication with headquarters.

While the easing of some travel restrictions in mid-2022—such as the removal of the requirement for PU invitation letters,<sup>1</sup> transit being permitted through third countries and the shortening of centralised quarantine periods from 14 to seven days—were welcome developments, they were too little, too late for many. The changes were announced at a time when many foreign national employees had already decided to leave China after almost three years of travel restrictions, with no indication of improvement. Months-long lockdowns in many cities in early 2022, along with the threat of further ad hoc restrictions, fuelled the exodus of foreign nationals from China as they found opportunities in other parts of the world that are now open again for business and travel. According to the European Chamber's *Business Confidence Survey 2022* (BCS 2022), almost 40 per cent of respondents reported a decrease of foreign employees over the last five years, with 33 per cent indicating COVID-related restrictions as the main reason.<sup>2</sup> Immigration and other HR-specific issues and recommendations are addressed in the *Human Resources Working Group Position Paper*.<sup>3</sup>

On 31<sup>st</sup> December 2021, the Ministry of Finance (MOF) and the State Taxation Administration (STA) jointly announced that non-taxable allowances for foreign national employees—which include

1 Since November 2020, foreign nationals applying for Chinese work visas, as well as their relatives, have been required to obtain a special invitation letter, referred to as a 'PU letter', from the Chinese foreign affairs authorities. The process for obtaining the PU letter was lengthy and created additional uncertainty as some local authorities would not issue them due to various reasons, including quotas.

2 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, p. 22, 20<sup>th</sup> June 2022, viewed 12<sup>th</sup> August 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

3 See: *Human Resources Working Group Position Paper 2022/2023*, p. 65.



among other allowances for housing, education and language training—would be extended for two more years.<sup>4</sup> The Finance and Taxation Working Group, which had advocated for the last three years for an extension of this exemption of allowances, welcomed this step, hoping that it would temporarily stem the outflow of foreign talent from China.<sup>5</sup> However, the ongoing stringent COVID containment measures meant the 'expat exodus' continued unabated.

European companies reported ambiguous rules and regulations, the unpredictable legislative environment, and discretionary enforcement of rules and regulations as the top three regulatory challenges they faced in China in 2021.<sup>6</sup> Ambiguous legal requirements and inadequate law/policy implementation, as well as a lack of guidance on inter-market conflicts, are all issues addressed in the *Legal and Competition Working Group Position Paper*.<sup>7</sup> The working group continues to advocate for the advancement of the rule of law in China, as well as the creation of a fair and unified market as outlined in the *Opinion on Accelerating the Establishment of a Unified Domestic Market (Opinion)*.<sup>8</sup> Although not legislation, the *Opinion* explicitly calls for the eradication of all policies that compromise fair competition between companies. Creating a level playing field between foreign-invested and domestic companies had been expected following the promulgation of the Foreign Investment Law (FIL) in 2020.<sup>9</sup> Yet, more than two years later, foreign and Chinese companies are still being treated differently, as the legal regime set up by the FIL does not fundamentally abolish the distinction between foreign and domestic investment, and implementation of the law remains fragmented and inconsistent.

In addition, intellectual property rights (IPR) protection remains a significant concern for European companies. Although European companies report a steady improvement in IPR enforcement, 46 per cent of respondents to the BCS 2022 still see it as inadequate, a poor result by any objective assessment. Furthermore, 14 per cent reported still being compelled to transfer technology to maintain market access,<sup>10</sup> despite Article 22 of the FIL stating that, "No administrative department or its staff member shall force any transfer of technology by administrative means."<sup>11</sup>

The Environment Working Group continues to raise important concerns around green development and carbon neutrality, and to advocate for more engagement between China and Europe in these fields. European companies in China are well positioned to leverage their advanced technologies and management systems developed over decades in Europe to provide green solutions that can help China achieve its 2030 and 2060 goals.<sup>12</sup> The Environment Working Group will continue to engage with national and local government stakeholders to promote knowledge exchanges in the development of a low-carbon and circular economy, and to advocate for increased transparency and predictability of enforcement of environmental protection rules and regulations.

4 *Announcement on the Continuation of Implementation of Individual Income Tax Preferential Policies Such as for Foreign Nationals' Benefits*, MOF and STA, 31<sup>st</sup> December 2021, viewed 11<sup>th</sup> July 2022, <[http://szs.mof.gov.cn/zhengcefabu/202112/t20211231\\_3780374.htm](http://szs.mof.gov.cn/zhengcefabu/202112/t20211231_3780374.htm)>

5 See: *Finance and Taxation Working Group Position Paper 2022/2023*, p. 54.

6 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, p. 22, 20<sup>th</sup> June 2022, viewed 12<sup>th</sup> August 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

7 See: *Legal and Competition Working Group Position Paper 2022/2023*, p. 103.

8 *Opinion on Accelerating the Establishment of a Unified Domestic Market*, State Council, 21<sup>st</sup> April 2022, viewed 21<sup>st</sup> July 2022, <[http://www.gov.cn/xinwen/2022-04/10/content\\_5684388.htm](http://www.gov.cn/xinwen/2022-04/10/content_5684388.htm)>

9 Foreign Investment Law of the People's Republic of China, National People's Congress (NPC), 15<sup>th</sup> March 2019, viewed 21<sup>st</sup> July 2022, <<http://www.npc.gov.cn/englishnpc/c23934/202012/5b80fe5055504efa93b6744f9272b3c2.shtml>>

10 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, pp. 34–36, 20<sup>th</sup> June 2022, viewed 26<sup>th</sup> July 2022, <[https://www.europeanchamber.com.cn/en/publications-archive/1020/Business\\_Confidence\\_Survey\\_2022](https://www.europeanchamber.com.cn/en/publications-archive/1020/Business_Confidence_Survey_2022)>

11 Foreign Investment Law of the People's Republic of China, NPC, 15<sup>th</sup> March 2019, viewed 21<sup>st</sup> July 2022, <<http://www.npc.gov.cn/englishnpc/c23934/202012/5b80fe5055504efa93b6744f9272b3c2.shtml>>

12 *Carbon Neutrality: The Role of European Companies in China's Race to 2060*, European Union Chamber of Commerce in China, 25<sup>th</sup> May 2022, viewed 1<sup>st</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-carbon-neutrality-report>>



## Compliance and Business Ethics Working Group

### Key Recommendations

#### 1. Duly Consider the Adequacy and Effectiveness of a Corporate's Compliance Programme in the Principle of Enforcement 2

- Modify related legislations and implementation guidelines to allow recognition of the implementation of a robust compliance system as a valid defence in bribery cases.
- Issue guidance on the key elements of an adequate and effective compliance programme.
- Enhance experience exchanges among the government and business community on best practices in combatting corruption and bribery.

#### 2. Encourage Systematic Compliance Talent Cultivation and Establish a Holistic Compliance Professional Qualification and Management System to Ensure State-of-the-art Compliance Capabilities 2

- Cultivate compliance professionals by creating a standardised curriculum in universities and training programmes in law firms.
- Establish a compliance professional qualification certification at various levels and incentivise companies to build internal compliance management systems.
- Establish continuous education programmes at local or national level that will allow compliance professionals to update and broaden their expertise and techniques.

#### 3. Incentivise Business Entities to Allocate Sufficient Resources for Developing Compliance Expertise 2

- Draft and issue guidelines, local standards or industry standards to educate business entities and society on compliance matters.
- Learn best practices from other law jurisdictions such as the United States or the European Union on government-enterprise cooperation on compliance topics.
- Leverage experiences from multinationals to further enhance and improve state-owned and private companies' compliance practice through *jour fixe* meetings.

#### 4. Create and Enhance an Expertise-Sharing and Communication Platform among Business Entities, Policy-makers and Law Enforcement Authorities to Leverage Jour Fixe Efforts and Upgrade Compliance Professionals' Skills to the Next Level

- Create common platforms enabling business entities, policy-makers and law enforcement authorities to share expertise, and discuss and align best compliance practices.
- Initiate and implement collaboration systems among stakeholders with well-defined deliverables.
- Create a continued compliance education system to educate relevant China compliance professionals and help them to upgrade their skills to the next level.





## Introduction to the Working Group

Created in 2015, the Compliance and Business Ethics Working Group aims to create a trusted environment for European Chamber members to discuss their compliance and business ethics experiences. The purpose is to foster learning and development in this area, and thereby enhance the quality of compliance among European Chamber member companies. The Compliance and Business Ethics Working Group also advocates to the Chinese Government on a range of compliance-related issues that regularly affect European Chamber members. This working group is only open to in-house counsels, compliance officers and internal auditors from industry players.

## Recent Developments

Over the past few years, compliance in China has evolved from the traditional areas of anti-corruption and anti-bribery to new and broader areas—in line with the government’s strengthening of a rule of law society—which include data security and privacy protection, intellectual property protection, export control and competition law compliance, among others.<sup>1</sup> In President Xi Jinping’s speech on 14<sup>th</sup> October 2020 to mark the 40<sup>th</sup> anniversary of the Shenzhen Economic Zone, he mentioned the rule of law seven times, and expressly stated that China needs to “make rule of law the consensus and basic norm of society, and develop a market-orientated, law-based and internationalised business environment”.<sup>2</sup> The promotion of internationalising legal standards for business environment development in China is welcomed by both domestic and international businesses, as it presents good opportunities and challenges for the compliance community and governmental enforcement agencies. The announcement on 9<sup>th</sup> March 2021 by the Ministry of Human Resources and Social Security (MOHRSS) that ‘corporate compliance officer’ is now officially recognised as a new profession in China is a good example of such internationalisation efforts.<sup>3</sup>

1 *Outline for Implementing the Building of a Rule of Law Society*, State Council, 7<sup>th</sup> December 2020, viewed 6<sup>th</sup> May 2022, <[http://www.gov.cn/zhengce/2020-12/07/content\\_5567791.htm](http://www.gov.cn/zhengce/2020-12/07/content_5567791.htm)>

2 *Xi Jinping: Speech at the 40<sup>th</sup> Anniversary Celebration of Shenzhen Special Economic Zone*, Xinhua, 14<sup>th</sup> October 2020, viewed 6<sup>th</sup> May 2022, <[www.xinhuanet.com/politics/leaders/2020-10/14/c\\_1126611290.htm](http://www.xinhuanet.com/politics/leaders/2020-10/14/c_1126611290.htm)>

3 *The Ministry of Human Resources and Social Security, the State Administration for Market Supervision and Administration, and the National Bureau of Statistics jointly release 18 new occupations including integrated circuit engineering and technical personnel*, MOHRSS, 18<sup>th</sup> March 2021, viewed 6<sup>th</sup> May 2022, <[www.mohrss.gov.cn/SYrtzyhshzbz/dongtaixinwen/buneyiaowen/rsxw/202103/t20210318\\_411376.html](http://www.mohrss.gov.cn/SYrtzyhshzbz/dongtaixinwen/buneyiaowen/rsxw/202103/t20210318_411376.html)>

The national and local governments have actively enacted laws, regulations, and guidelines in recent years to help build a rule of law society and compliance management systems in China. For instance, the *Civil Code of China*—consisting of seven sections with a total of 1,260 articles, it well deserves its nickname as an ‘Encyclopedia of Social Life’—took effect from 1<sup>st</sup> January 2021, and provides basic guidance for civil activities, transaction activities and civil disputes.<sup>4</sup> Several regulations and judicial interpretations related to the *Anti-monopoly Law* (AML) or the *Anti-unfair Competition Law* (AUCL) were published over the past two years. Although China already has numerous stand-alone civil laws and regulations in place, these were introduced at different times, sometimes overlap and occasionally even contradict each other. The unified *Civil Code* provides an overarching law that lawyers and judges can refer to when resolving civil cases in order to minimise contradicting verdicts.

The following are highlights of other recent compliance-related legislation developments:

### Anti-monopoly Law and Regulations

During the State Administration for Market Regulation’s (SAMR’s) public consultation on the AML in January 2020, the working group raised concerns about the law’s lack of clear definitions on the implementation process, and the need for measures to prevent the abuse of power, as the proposed revisions will give enforcement agencies great discretion over the awarding of penalties.<sup>5</sup>

The Anti-monopoly Commission of the State Council issued the *Anti-monopoly Guidelines*, effective from 7<sup>th</sup> February 2021, which aim to prevent monopolistic activities in the field of online platform economies.<sup>6&7</sup> The *Shanghai Anti-unfair Competition Regulations*, promulgated by the Shanghai Municipal Government and effective from 1<sup>st</sup> January 2021, require all businesses in Shanghai to strengthen their internal

4 *Civil Code*, National People’s Congress, 2<sup>nd</sup> June 2020, viewed 6<sup>th</sup> May 2022, <[www.npc.gov.cn/npc/c30834/202006/75ba6483b8344591abd07917e1d25cc8.shtml](http://www.npc.gov.cn/npc/c30834/202006/75ba6483b8344591abd07917e1d25cc8.shtml)>

5 *Announcement of the State Administration for Market Regulation on the Public Consultation on the Anti-monopoly Law Amendment Draft (Draft for Public Consultation)*, SAMR, 2<sup>nd</sup> January 2020, viewed 6<sup>th</sup> May 2022, <[http://www.samr.gov.cn/hdlzjdc/202001/t20200102\\_310120.html](http://www.samr.gov.cn/hdlzjdc/202001/t20200102_310120.html)>

6 *The Anti-monopoly Guidelines of the Anti-monopoly Commission of the State Council on the Platform Economy*, SAMR, 7<sup>th</sup> February 2021, viewed 6<sup>th</sup> May 2022, <[http://gkml.samr.gov.cn/nsjg/fljdj/202102/t20210207\\_325967.html](http://gkml.samr.gov.cn/nsjg/fljdj/202102/t20210207_325967.html)>

7 The platform economy is economic and social activity facilitated by platforms, typically online sales or technology frameworks. By far the most common type are ‘transaction platforms’, also known as ‘digital matchmakers’. Examples of transaction platforms include Amazon, Airbnb, Uber and Baidu.





control and compliance management.<sup>8</sup> *Interpretations on Several Issues related to Application of the Anti-unfair Competition Law* issued by the Supreme People's Court, aimed at providing judicial interpretation of the AUCL, took effect on 20<sup>th</sup> March 2022.<sup>9</sup> The working group welcomes these guidelines and believes that they will boost the development of corporate compliance programmes while increasing efficiency and consistency in compliance enforcement.

### Social Credit System (SCS)

The Chinese Government is committed to establishing a national Corporate SCS that will be an embedded mechanism, based on existing laws and regulations, to sanction or reward enterprises' bad and good behaviour. In 2014, the State Council published the *Plan for Establishing a Social Credit System (2014–2020)*, which was implemented by 2020, and a unified social credit code system established at the national level.<sup>10</sup> On 10<sup>th</sup> February 2021, the SAMR published draft amendments to the *Administrative Measures for the List of Enterprises with Seriously Illegal and Dishonest Acts* for public consultation.<sup>11</sup> On 13<sup>th</sup> January 2022, the SAMR published the *Opinions on Promoting the Category-based Management of Corporate Credit Risks to Further Improve Regulatory Efficiency*, which provide comprehensive implementation of enterprise credit risk classification management, effective enterprise credit risk monitoring and early warning, and a proposal for automatic classification of enterprises based on their credit risk status over the preceding three years.<sup>12</sup> While improvements on previous measures have been introduced in these draft amendments and implementation rules, many clauses still need to be clarified. In addition, more directives or guidelines on

credit repair are expected to be released in the near future.<sup>13</sup>

These measures and their associated risks and rewards have motivated companies to look more closely at their own internal compliance procedures, and have facilitated the acceptance of compliance protocols by third parties. The Compliance and Business Ethics Working Group welcomes these developments as a positive step in China's reform process. However, uncertainty and inconsistency remain factors in law enforcement and reform efforts. Regarding compliance regulations, such ambiguity increases the risk of unintentional infractions and can incentivise non-compliance in businesses.

## Key Recommendations

### 1. Duly Consider the Adequacy and Effectiveness of a Corporate's Compliance Programme in the Principle of Enforcement



#### Concern

The robustness of a company's compliance system is not fully taken into consideration when prosecution and punishment reduction measures are rendered in China.

#### Assessment

Currently, there are no implementation measures on lenient treatment for companies with a robust compliance system when a bribery or corruption issue arises. Although the AUCL was amended in 2017 to distinguish bribery behaviour committed by a single employee and that committed by the business operator, there are no official interpretations or real-life case studies of the types of evidence companies can use to make such distinguishments.<sup>14</sup> On 3<sup>rd</sup> June 2021, the Supreme People's Procuratorate

<sup>8</sup> *Regulations of Shanghai Municipality on Anti-unfair Competition*, Shanghai Municipal People's Congress, 28<sup>th</sup> October 2020, viewed 6<sup>th</sup> May 2022, <<http://www.spccsc.sh.cn/n8347/n8467/u1ai222523.html>>

<sup>9</sup> *Interpretations on Several Issues related to Application of the Anti-unfair Competition Law*, Supreme People's Court, 17<sup>th</sup> March 2022, viewed 22<sup>nd</sup> June 2022, <<https://www.court.gov.cn/fabu-xiangqing-351291.html>>

<sup>10</sup> *Plan for Establishing a Social Credit System (2014–2020)*, State Council, 27<sup>th</sup> June 2014, viewed 6<sup>th</sup> May 2022, <[http://www.gov.cn/zhengce/content/2014-06/27/content\\_8913.htm](http://www.gov.cn/zhengce/content/2014-06/27/content_8913.htm)>

<sup>11</sup> *Administrative Measures for the List of Enterprises with Seriously Illegal and Dishonest Acts (Draft for Comments)*, SAMR, 10<sup>th</sup> February 2021, viewed 22<sup>nd</sup> June 2022, <[https://www.samr.gov.cn/hd/zjdc/202102/t20210210\\_326053.html](https://www.samr.gov.cn/hd/zjdc/202102/t20210210_326053.html)>

<sup>12</sup> *Opinions on Promoting the Category-based Management of Corporate Credit Risks to Further Improve Regulatory Efficiency*, SAMR, 13<sup>th</sup> January 2022, viewed 22<sup>nd</sup> June 2022, <[https://gkml.samr.gov.cn/nsjg/xjygs/202201/t20220113\\_339100.html](https://gkml.samr.gov.cn/nsjg/xjygs/202201/t20220113_339100.html)>

<sup>13</sup> On May 12<sup>th</sup> 2021, the National Development and Reform Commission (NDRC) issued a review of the *Administrative Measures for Credit Repair (Trial) (Draft for Comment)*, which provides detailed regulations on credit repair. The public consultation ran from 12<sup>th</sup> May 2021 to 12<sup>th</sup> June 2021. However, it is hard to predict when this *Measures* will be finalised and take effect. *Administrative Measures for Credit Repair (Trial) (Draft for Comment)*, NDRC, 12<sup>th</sup> May 2021, viewed 6<sup>th</sup> May 2022, <[https://hd.ndrc.gov.cn/yjzx/yjzx\\_add.jsp?SiteId=359](https://hd.ndrc.gov.cn/yjzx/yjzx_add.jsp?SiteId=359)>

<sup>14</sup> Article 7 of the AUCL states that: "Bribery committed by a staff member of a business operator shall be deemed as bribery committed by the business operator, except where the business operator has evidence to prove that the conduct of the said staff member has nothing to do with seeking transaction opportunities or competitive advantage for the business operator." *Anti-unfair Competition Law of the People's Republic of China*, National People's Committee Standing Committee, 4<sup>th</sup> November 2017, viewed 6<sup>th</sup> May 2022, <[http://www.gov.cn/xinwen/2017-11/05/content\\_5237325.htm](http://www.gov.cn/xinwen/2017-11/05/content_5237325.htm)>





issued the *Guidance on the Establishment of a Third-party Supervision and Evaluation Mechanism for the Compliance of Enterprises Involved in the Case (Trial Implementation)*.<sup>15</sup> In September, the Supreme People's Procuratorate, the China Federation of Industry and Commerce and nine other departments jointly established the management committee of the third-party supervision and evaluation mechanism. In November of the same year, the nine departments jointly issued two supporting provisions: the *Administrative Measures for the Selection and Appointment of Professionals of the Compliance Third-party Supervision and Evaluation Mechanism of Enterprises Involved in the Case (Trial Implementation)* and the *Implementation Rules of the Guiding Opinions on the Establishment of the Compliance Third-party Supervision and Evaluation Mechanism of Enterprises Involved in the Case (Trial Implementation)*. Although the authorities have implemented two rounds of pilot programmes,<sup>16</sup> the standards for compliance inspection and evaluation need to be further refined. So far, there has been no official interpretations or real-life case studies of how a company with a robust compliance system may use its good compliance policy or history of good compliance, for example, as a point of plea for lenient treatment.

In other countries, such as Germany and Spain, adequate compliance measures and policies adopted by the prosecuted company are recognised as a valid defence. For example, on 9<sup>th</sup> May 2017, the German Federal Court of Justice ruled that a compliance management system can lead to a reduction of a fine against a company.<sup>17</sup> According to the ruling, two issues were to be taken in consideration during the determination of fines: first, whether an effective and risk-adequate compliance management system was in place before the misconduct took place; second, and most importantly, whether the management reacted

promptly, identified the gaps in the system and bridged those gaps to prevent similar misconduct in the future.

This means that if companies can show they took meaningful actions to prevent bribery by employees, they may be 'rewarded' with a partial or full defence. Other factors are also taken into account, such as willingness to cooperate with the authorities. The applicability of the defence of adequate procedures depends on the circumstances of the offence, including the scale and complexity of the organisation and any risks the potential act of bribery exposed the company to. Anti-bribery procedures are expected to be proportionate to the risk.

Prerequisites for using a compliance system as a defence include the following principles:

- Proportionate processes which are clear, practical, accessible, effectively implemented and enforced to maintain an anti-bribery stance and create a corporate culture that supports it.
- A strong tone from the top of the organisation to foster a culture of integrity, where management should be involved in key decisions regarding, as well as in the communication of, anti-bribery policies to ensure meaningful impact.
- External communication to reassure third parties of the company's principles.
- Comprehensive training, well-rounded risk assessment, effective due diligence and monitoring of the effectiveness of their anti-bribery policies and procedures.

Allowing the compliance system defence will in addition promote greater transparency and compliance, as companies are encouraged to improve their internal compliance systems. This statutory defence may also allow other companies to assess what constitutes best practices and implement their own strong compliance systems. Consequently, it leads to continuous improvement by authorities, companies, their shareholders and society, contributing to a reduction in bribery risks.

#### Recommendations

- Modify related legislations and implementation guidelines to allow recognition of the implementation of a robust compliance system as a valid defence in bribery cases.

<sup>15</sup> *Guidance on the Establishment of a Third-party Supervision and Evaluation Mechanism for the Compliance of Enterprises Involved in the Case (Trial Implementation)*, Supreme People's Procuratorate, 3<sup>rd</sup> June 2021, viewed 22<sup>nd</sup> June 2022, <[https://www.spp.gov.cn/spp/xwfbh/wsfbh/202106/t20210603\\_520224.shtml](https://www.spp.gov.cn/spp/xwfbh/wsfbh/202106/t20210603_520224.shtml)>

<sup>16</sup> A total of 10 provinces have participated in the two rounds of corporate compliance trial programmes; procuratorates of the trial provinces handled 766 corporate compliance cases, including 503 cases applicable to third-party supervision and evaluation mechanism. *Comprehensively Accelerating Corporate Compliance Reform Trials! What are the Important Signals From This Meeting?*, Supreme People's Procuratorate, 2<sup>nd</sup> April 2022, viewed 22<sup>nd</sup> June, <[https://www.spp.gov.cn/zd gz/202204/t20220402\\_553256.shtml](https://www.spp.gov.cn/zd gz/202204/t20220402_553256.shtml)>

<sup>17</sup> *Judgment of the 1<sup>st</sup> Criminal Senate of 9<sup>th</sup> May 2017*, Bundesgerichtshof Im Namen des Volkes, 9<sup>th</sup> May 2019, viewed 6<sup>th</sup> May 2022, <<https://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&nr=78723&pos=0&anz=1>>



- Issue guidance on the key elements of an adequate and effective compliance programme.
- Enhance experience exchanges among the government and business community on best practices in combatting corruption and bribery.

## 2. Encourage Systematic Compliance Talent Cultivation and Establish a Holistic Compliance Professional Qualification and Management System to Ensure State-of-the-art Compliance Capabilities 2

### Concern

China lacks an overall framework for supporting the development of compliance officers/professionals qualified to respond to the ever-expanding scope of compliance challenges.

### Assessment

In recent years, several central government departments, including the SAMR and the Ministry of Commerce, have issued regulations and guidelines on compliance management. As a result, Chinese enterprises and institutions are paying more attention to compliance management systems. The working group finds it very encouraging that, in March 2021, the MOHRSS added 'corporate compliance officer' to the list of official professions, with the key responsibilities of setting up a company's compliance management strategy, identifying and assessing relevant risks, implementing compliance management systems and conducting compliance training and investigations.<sup>18</sup>

Although external monitoring pressure by both domestic and overseas regulatory bodies (such as the United States' (US) Department of Justice (DOJ)) and internal development needs continue to grow, the corresponding increase in demand for qualified compliance professionals in China is not being met. In addition, China currently has few systematic university-level curriculum for compliance; most compliance professionals come from legal, risk management or finance backgrounds, and many government agencies and large state-owned or private enterprises lack

compliance professionals with sufficient training.

With the recent official recognition of corporate compliance officer as a profession, China should step up its efforts to develop compliance talent by improving compliance curriculum in universities and occupational schools, and establishing compliance professional qualification systems and continuous education programmes for compliance professionals. Guidelines or policies should be developed at national or local government levels to promote a culture of compliance in society, as well as encouraging the establishment of a compliance organisation or a dedicated compliance team and management system in enterprises. These could then contribute to developing compliance talent and creating a robust and sustainable compliance culture and 'ecosystem' in China.

### Recommendations

- Cultivate compliance professionals by creating a standardised curriculum in universities and training programmes in law firms.
- Establish a compliance professional qualification certification at various levels and incentivise companies to build internal compliance management systems.
- Establish continuous education programmes at local or national level that will allow compliance professionals to update and broaden their expertise and techniques.

## 3. Incentivise Business Entities to Allocate Sufficient Resources for Developing Compliance Expertise 2

### Concern

Compliance professionals lack sufficient investment and resources to develop new expertise, and therefore may not be able to cope with increased requirements from various jurisdictions and as a result of geopolitical tensions.

### Assessment

Due to increasing geopolitical tensions and repeated outbreaks of COVID-19, jurisdictions are increasingly ring-fencing their regulatory framework to protect their national security interests and critical assets. As a result, legal professionals today not only need to manage traditional compliance challenges, such as anti-bribery and anti-corruption, but also must tackle

<sup>18</sup> The Ministry of Human Resources and Social Security, the State Administration for Market Supervision and Administration, and the National Bureau of Statistics jointly released 18 new occupations including integrated circuit engineering and technical personnel, MOHRSS, 18<sup>th</sup> March 2021, viewed 6<sup>th</sup> May 2022. <[http://www.mohrss.gov.cn/SYrtzyshshzbz/dongtaixinwen/buneyaowen/rsxw/202103/t20210318\\_411376.html](http://www.mohrss.gov.cn/SYrtzyshshzbz/dongtaixinwen/buneyaowen/rsxw/202103/t20210318_411376.html)>



newly emerging challenges, such as requirements relating to sanctions and export control, personal data protection, cybersecurity, environment, health and safety (EHS) customs and tax compliance. Some of those newly emerging topics—for example, personal data protection or EHS—need special expertise, thus necessitating investment in training. Despite this, neither business entities nor the government are willing to allocate sufficient resources to developing compliance professionals. Given this conservative approach to investment in compliance amid the current volatile, uncertain, confusing and ambiguous (VUCA) general conditions,<sup>19</sup> working group members have reported high levels of burnout and overstretching among compliance professionals.

Compliance should not be left to business alone to manage and invest in; it also requires input from all stakeholders in society, including the government, industry associations, and corporate citizens. Only when all these stakeholders allocate sufficient resources to promoting a strong compliance culture, sharpening professional expertise and advocating compliance best practice, can a robust compliance scheme gain a solid foothold in society – which may further develop into an open and diverse bedrock compliance ecosystem.

An option to engage all stakeholders is to create a communication platform where multinationals can communicate openly with their peers at state-owned and private enterprises, for example, via *jour fixe* meetings.<sup>20</sup> This will result in a platform inclusive of all kinds of commercial companies, which would ultimately build up the compliance community and ecosystem in China.

One way to mitigate burnout among compliance officers is to learn best practices from other jurisdictions. For example, the US DOJ and Securities and Exchange Commission (SEC) have jointly issued a 100-page

guide to the US Foreign Corrupt Practices Act (FCPA).<sup>21</sup> The guide provides companies, practitioners and the public with detailed information about the statutory requirements of the FCPA while also providing insight into DOJ and SEC enforcement practices through examples, summaries of applicable case law and DOJ opinion releases. It also summarises applicable new policies announced in recent years.

Similar practices are implemented by the European Commission with respect to anti-trust compliance. As an example, the European Commission and the national competition authorities in all European Union (EU) Member States created the European Competition Network (ECN), under which members engage in cooperation and exchange of best practices on merger control by setting up an EU Merger Working Group.<sup>22</sup> The Compliance and Business Ethics Working Group hopes that the Chinese Government, as part of continuing efforts to provide increased transparency, could adopt *mutatis mutandis* best practices from other jurisdictions to help businesses operating in China combat the ever-changing compliance challenges. The working group noticed with pleasure that certain Chinese government regulatory authorities have already taken substantial steps in this direction—for example, the SAMR and its provincial counterparts (local SAMRs) have promulgated guidelines for anti-trust compliance practices—and hopes such practices will be adopted by other regulatory authorities.

### Recommendations

- Draft and issue guidelines, local standards or industry standards to educate business entities and society on compliance matters.
- Learn best practices from other law jurisdictions such as the US or the EU on government-enterprise cooperation on compliance topics.
- Leverage experiences from multinationals to further enhance and improve state-owned and private companies' compliance practice through *jour fixe* meetings.

19 *Mastering 2020: How to get prepared for the VUCA world with Light Footprint management*, Roland Berger, February 2014, viewed 6<sup>th</sup> May 2022, <[http://contentworks.ro/wp-content/uploads/2019/05/Roland\\_Berger\\_TAB\\_Mastering\\_2020\\_20140228-2.pdf](http://contentworks.ro/wp-content/uploads/2019/05/Roland_Berger_TAB_Mastering_2020_20140228-2.pdf)>

20 *Jour fixe* meeting refers to regular structured meetings between a group of people to maintain and develop the standard process. From a business and/or political perspective, *jour fixe* meetings serve as a platform to “ensure the current process and future process changes are understood and agreed by all key stakeholders and coded in the organisation’s formal process documentation”. Kuna, Hans, *The Process Jour Fixe*, 30<sup>th</sup> August 2020, viewed 27<sup>th</sup> June 2022, <<https://hanskuna.com/2020/08/30/the-process-jour-fixe/>>

21 *A Resource Guide to the US Foreign Corrupt Practices Act*, DOJ, 25<sup>th</sup> November 2020, viewed 6<sup>th</sup> May 2022, <<https://www.justice.gov/criminal-fraud/fcpa-resource-guide>>

22 *European Competition Network (ECN)*, 2021, European Commission, viewed 6<sup>th</sup> May 2022, <<https://ec.europa.eu/competition/ecn/mergers.html>>

#### 4. Create and Enhance an Expertise-sharing and Communication Platform among Business Entities, Policy-makers and Law Enforcement Authorities to Leverage *Jour Fixe* Efforts and Upgrade Compliance Professionals' Skills to the Next Level

##### Concern

Although the Chinese Government is increasingly emphasising compliance, it lacks well-defined compliance knowledge databases—in particular for specific fields—technical expertise on legislation-making and enforcement, and best practice sharing among stakeholders.

##### Assessment

In essence, compliance is a special field of professional practice. Therefore, professionalism needs to be embedded and advocated throughout compliance exercise, i.e., from identifying compliance risks to legislature and policy formulation, to implementation and through to review and improvement.

To create an expertise-sharing and communication platform among business entities, it is of increasing importance for China's policy-makers and law enforcement authorities to leverage *jour fixe* efforts to help compliance professionals upgrade their skills. Through such joint exercises and efforts, stakeholders will gain insight into each other's perspectives, positions and concerns, which will ultimately provide the entire ecosystem with better acumen for well-informed decision-making.

In other jurisdictions, continued legal education is quite customary. Similarly, continued compliance education via Chinese Government advocacy can help to ensure state-of-the-art expertise within China's compliance ecosystem and community.

##### Recommendations

- Create common platforms enabling business entities, policy-makers and law enforcement authorities to share expertise, and discuss and align best compliance practices.
- Initiate and implement collaboration systems among stakeholders with well-defined deliverables.

- Create a continued compliance education system to educate relevant China compliance professionals and help them to upgrade their skills to the next level.

#### Abbreviations

AML	Anti-monopoly Law
AUCL	Anti-unfair Competition Law
DOJ	Department of Justice
ECN	European Competition Network
EHS	Environment, Health and Safety
EU	European Union
FCPA	Foreign Corrupt Practices Act
MOHRSS	Ministry of Human Resources and Social Security
NDRC	National Development and Reform Commission
SAMR	State Administration for Market Regulation
SCS	Social Credit System
SEC	Securities and Exchange Commission
US	United States
VOUCA	Volatility, Uncertainty, Confusion and Ambiguity



# Environment Working Group

## Key Recommendations

### 1. Increase the Transparency and Predictability of Environmental Protection Enforcement



- Enforce the Environmental Protection Law and related regulations in a transparent fashion.
- Communicate environmental enforcement plans and incentive schemes well in advance of implementation, and discuss with relevant industries how best to mitigate any potential negative impact on them.
- Provide full online access to official environmental information, including policies and standards that are applied locally and nationally.
- Install direct communication channels for companies to notify central government authorities of any issues/irregularities related to 'one-size-fits-all' approaches or other unreasonable environmental enforcement.
- Improve the effectiveness of mediation as a dispute resolution tool by establishing an expert group of environmental mediators to conduct high-level mediation for major environmental disputes and facilitate the training of government officials, judges and private sector actors.

### 2. Establish a Holistic Resource Management System to Address the Plastic Pollution Crisis with Measures Along the Whole Value Circle

- Define an overall strategy for plastic pollution control based on circular economy and holistic resource management concepts, with a mid- and long-term legislation framework that includes quantitative targets, roadmaps and waste management hierarchy.
- Accelerate the policymaking process for packaging and packaging waste, with the extended producers' responsibility mechanism as the foundation.
- Introduce a defined roadmap to consolidate and formalise the long-existing informal scrap collecting and recycling system to ensure post-consumption recyclable material can be recycled at the highest possible quality for closed-loop or high-end applications.
- Improve market conditions for recycled materials in China to attract more social investment in upgrading the sector by clarifying policies for recycled plastic for food-contact materials and further developing industrial standards on recycled materials and processes.

### 3. Reinforce the Role Played by Environmental Facilities in China's National Emergency Response System

- Enhance construction of environmental facilities to ensure their effectiveness in national emergency responses.
- Recognise the key role played by environmental facilities in ensuring the effectiveness of the Chinese public health emergency response system, and extend to them the support they need.

### 4. Contribute to Decarbonisation by Pushing Green, Low Carbon and Circular Economy Development

- Prioritise the implementation of a strategy to transition to a circular economy with a mid- and long-





term legislative framework, as well as pilot projects that include the joint involvement of Chinese and European companies.

- Enhance industrial players' involvement in, and promote frequent and in-depth exchanges and dialogues on the joint Memorandum of Understanding on Circular Economy Cooperation.
- Encourage technology developments that can facilitate better recycling of not only high-value and easy-to-recycle materials, such as cardboard and polyethylene terephthalate, but also materials such as polypropylene, polyethylene, polystyrene, glass, waste polyester, non-ferrous metals and critical mineral resources.

## 5. Develop the Recycling and Reuse Industry under the Dual Control of Energy Consumption Policy

- Clarify that the recycling and reuse industry is considered a 'green industry' that meets the requirements of Article 43 of the *Guidance Catalogue for Industrial Structure Adjustment (2019)*, while ensuring industries listed in the *Guidance Catalogue for Green Industries (2019 version)* are not classified as high energy consumption projects by local governments.
- Strengthen policy research on the recycling and reuse industry to enhance coordination between industrial development and dual control energy consumption policies.
- Clarify high energy consumption project standards, ensuring that energy usage of raw materials, energy efficiency levels and environmental benefits are taken into consideration.
- Prioritise access to green energy supply for industry players in order to support overall decarbonisation targets and improve the efficiency of resources.
- Implement financial subsidies and tax incentives, including green finance, that encourage the recycling and reuse industry and the reduction of carbon emissions.

## Introduction to the Working Group

Established in 2006, the Environment Working Group currently consists of more than 180 member companies involved in engineering, manufacturing, construction, consulting and certification services. Members come from a variety of industry sectors, such as waste, water, smart grids, chemicals, pharmaceuticals, petroleum, biochemistry and logistics. Environmental technology service providers, environmental consultants and lawyers are also active members of the working group.

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

Resources,<sup>2</sup> along with local bureaux. The working group also provides regular feedback to the Chinese authorities on environmental regulations, standards and technologies in China, and serves as a platform for companies to share best practices, experiences, solutions and recommendations on how to best protect the environment.

## Recent Developments

On 1<sup>st</sup> September 2020, the revised Prevention and Control of Environmental Pollution from Solid Waste Law (Solid Waste Law) took effect, incorporating industrial solid waste into the sewage permit management system and shifting the responsibility for properly treating waste to the original producer. Another key development was a five-year joint action plan between the NDRC and the MEE, aimed at controlling white

<sup>1</sup> Previously known as the Ministry of Environmental Protection. It became the MEE at the end of March 2018 following wider government restructuring.

<sup>2</sup> Previously known as the Ministry of Land and Resources. It became the Ministry of Natural Resources at the end of March 2018 following wider government restructuring.





plastic pollution during the 14<sup>th</sup> Five-year Plan (14FYP) period (2021–2025).<sup>3</sup>

In January 2021, the MEE released pilot rules for the national carbon emission trading system (ETS) after having piloted local ETSs in seven provinces and cities since 2011.<sup>4</sup> Effective from 1<sup>st</sup> February 2021, the national ETS allows companies emitting more than 26,000 tonnes of carbon dioxide (CO<sub>2</sub>) per year to sell surplus emission allowances to those that expect to exceed their pollution quotas, thereby shifting the responsibility of emissions reduction to companies.<sup>5</sup>

At the United Nation's (UN's) Leaders Summit on Climate on 22<sup>nd</sup> April 2021, aimed at promoting multilateral climate change mitigation, President Xi Jinping stated that “to protect the environment is to protect productivity”.<sup>6</sup> He also emphasised China's commitment to green development and ecological conservation by reducing carbon emissions, recalling his announcement in 2020 at the UN's 75<sup>th</sup> General Assembly that China will peak carbon emissions before 2030 and reach carbon neutrality in 2060 (30/60 Goals).<sup>7</sup>

For China to achieve its 30/60 Goals, companies need access to sufficient funding to support their green transitions. As part of China's latest efforts to mobilise the necessary funds to reach its national 30/60 Goals, the central bank launched a new green finance tool on 1<sup>st</sup> July 2021 to direct capital towards green and sustainable projects by appraising the green performance of investments through quarterly evaluations.<sup>8</sup> It is estimated that China's green investment needs to reach Chinese yuan (CNY) 2.2

trillion (approximately United States dollars (USD) 340 billion) per year in the current decade, increasing to CNY 3.9 trillion per year from 2031–2060.<sup>9</sup>

In a speech at the UN Biodiversity Conference (COP15) Leaders Summit on 12<sup>th</sup> October 2021, President Xi announced implementation plans and supporting measures for peaking carbon emissions in key sectors, including the ‘1+N’ policy framework as the roadmap to carbon neutrality.<sup>10,11&12</sup> The speech also emphasised the importance of building a green, low-carbon and circular economy in order for China to achieve its stated goals.<sup>13</sup> In November 2021, the *EU-China Common Ground Taxonomy* (CGT) was also published. The CGT is a crucial step towards developing international taxonomies, a key part of which will entail aligning definitions of terms such as ‘green’, ‘clean’ and ‘low carbon’.<sup>14</sup>

The European Union (EU) and China's shared goal of climate change mitigation was demonstrated at the 26<sup>th</sup> UN Conference of Parties on Climate Change (COP26) in November 2021, during which China “accepted two of the most important points in the Glasgow Climate Pact: a reaffirmation of limiting global warming to 1.5 degrees Celsius and the targeting of fossil fuels”, keeping the Paris Agreement alive.<sup>15</sup> Although the EU and China have different frameworks and timelines for achieving carbon neutrality, with the EU aiming to become the world's first climate-neutral continent by 2050 and cut greenhouse gas (GHG) emissions by

3 The aim is to reduce the use and production of plastics and the amount of plastic waste in landfill sites, particularly with single-use plastics in key sectors such as e-commerce and delivery services. See: *China Unveils 5-Year Plan To Control Plastic Pollution*, *China Daily*, 23<sup>rd</sup> September 2021, viewed 9<sup>th</sup> April 2022, <[https://english.mee.gov.cn/News\\_service/media\\_news/202109/t20210923\\_952587.shtml](https://english.mee.gov.cn/News_service/media_news/202109/t20210923_952587.shtml)>

4 *China Issues Pilot Rules for National Carbon Emission Trading*, CGTN, 6<sup>th</sup> January 2021, viewed 10<sup>th</sup> April 2022, <[http://english.www.gov.cn/statecouncil/ministries/202101/06/content\\_WS5ff5600fc6d0f72576943580.html](http://english.www.gov.cn/statecouncil/ministries/202101/06/content_WS5ff5600fc6d0f72576943580.html)>

5 See the *Carbon Market Sub-Working Group Position Paper 2022–2023* for further details.

6 *Full Text: Remarks by Chinese President Xi Jinping at Leaders Summit on Climate*, *Xinhua*, 22<sup>nd</sup> April 2021, viewed 11<sup>th</sup> April 2022, <[http://www.xinhuanet.com/english/2021-04/22/c\\_139899289.htm](http://www.xinhuanet.com/english/2021-04/22/c_139899289.htm)>

7 *Annual Installed Capacity Significantly Increases*, Energy Storage World Forum, viewed 7<sup>th</sup> April 2022, <<https://energystorageforum.com/news/energy-storage/annual-installed-capacity-significantly-increases>>

8 *PBOC Introduces New Green Finance Evaluation Tool for Country's Lenders*, Climate Cooperation, 12<sup>th</sup> June 2021, viewed 11<sup>th</sup> April 2022, <<https://climatecooperation.cn/climate/pbo-introduces-new-green-finance-evaluation-tool-for-countrys-lenders/>>

9 *China Boosts Green Finance in Pursuit of Carbon Neutrality*, *Xinhua*, 3<sup>rd</sup> July 2021, viewed 11<sup>th</sup> April 2022, <[http://www.china.org.cn/business/2021-07/03/content\\_77603598.htm](http://www.china.org.cn/business/2021-07/03/content_77603598.htm)>

10 ‘1+N’ framework, where the ‘1’ refers to the guiding opinions that set out the overarching principles of policies related to carbon peaking and carbon neutrality, while the ‘N’ refers to specific action plans that will be rolled at the local and industry level.

11 *Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of the New Development Philosophy*, NDRC, 24<sup>th</sup> October 2021, viewed 9<sup>th</sup> April 2022, <[https://en.ndrc.gov.cn/policies/202110/t20211024\\_1300725.html](https://en.ndrc.gov.cn/policies/202110/t20211024_1300725.html)>

12 De Boer, Dimitri, and Fan, Danting, *How is progress in China's 1+N policy framework?*, China Council for International and Cooperation on Environment and Development, 11<sup>th</sup> March 2022, viewed 13<sup>th</sup> April 2022, <<https://cciced.eco/climate-governance/how-is-progress-in-chinas-1n-policy-framework/>>

13 *Full text: Xi Jinping's Speech At The COP15 Leaders' Summit*, *China Daily*, 12<sup>th</sup> October 2021, viewed 8<sup>th</sup> April 2022, <<https://www.chinadaily.com.cn/a/202110/12/WS61653286a310cdd39bc6e685.html>>

14 Lund Larsen, Matthias, *EU-China Opinion Pool: Rethinking EU-China climate cooperation*, Mercator Institute for China Studies, 18<sup>th</sup> November 2021, viewed 14<sup>th</sup> June 2022, <<https://merics.org/en/opinion/eu-china-opinion-pool-rethinking-eu-china-climate-cooperation>>

15 Jiang, Yifan, *China At COP26: Coal, 1.5C And Short-term Actions*, China Dialogue, 16<sup>th</sup> November 2021, viewed 29<sup>th</sup> May 2022, <<https://chinadialogue.net/en/climate/coal-1-5c-and-short-term-actions-china-at-cop26/>>





at least 55 per cent by 2030,<sup>16</sup> it is clear that the two sides are aligned on tackling climate change through ambitious policies at home and close cooperation with international partners. Europe has a wealth of experience in green development through legislation, technology and capitalisation. As outlined in the European Chamber's publication, *Carbon Neutrality: The Role of European Companies in China's Race to 2060*, 67 per cent of respondents to a survey conducted in conjunction with the report are already pursuing carbon neutrality, and 40 per cent have established decarbonisation teams in China, many of which report directly to the board. Driven by stringent environmental regulations and consumer demand, and guided by their global corporate carbon neutrality pledges, European companies in China now are well positioned to leverage their advanced technologies and management systems to provide green solutions that can help China achieve its 30/60 Goals.<sup>17</sup>

## Key Recommendations

### 1. Increase the Transparency and Predictability of Environmental Protection Enforcement



#### Concern

In order to meet their goals, local governments often implement environmental protection measures with a 'one-size-fits-all' approach, which results in unfair enforcement that can both negatively impact compliant companies and devalue environmental protection measures.

#### Assessment

Local government agencies are being encouraged to implement rigorous environmental protection initiatives on top of existing strict rules, regulations and standards, in order to meet their targets. This has resulted in stricter environmental standards for wastewater discharge and air emissions, among others. It also has led to environmental enforcement sometimes unexpectedly impacting companies that already comply with relevant regulations because of a one-size-fits-

all approach.<sup>18</sup> It is therefore positive that some recent progress has been made in this area, with the release of the MEE's *Guiding Opinions on Strengthening the Positive List Management of Ecological Environment Supervision and Law Enforcement*,<sup>19</sup> on 7<sup>th</sup> April 2021.

Control of fine particulate matter (PM2.5) and ozone pollution improved in 2021 with recent reports showing that, nationwide, air quality was good or excellent for 87.5 per cent of the days in the year, while the average concentration of PM2.5 dropped by 9.1 per cent.<sup>20</sup> However, there were still instances of severe air pollution in certain parts of the country,<sup>21</sup> leading to local governments imposing special measures to control emissions. These were applied to all companies in specific areas with little notice, regardless of their pollution control measures, resulting in all of them having to reduce or cease operations until the air pollution index had improved. The lack of due warning on such special measures made it hard for many to take the necessary technical measures to reduce emissions; and the setting of production limits puts these companies under enormous pressure, with some unable to complete client orders they had already committed to. It is also notable that there is no long-term incentive for companies to proactively reduce emissions if the same special measures are applied to all companies, regardless of their level of compliance. While the *Regulations on Management of Pollutant Discharge Permits*, which came into effect on 1<sup>st</sup> March 2021,<sup>22</sup> order manufacturers to closely monitor their own emission levels, the government's one-size-fits-all approach is unfair to compliant companies. The working group recommends that more clarity be provided regarding compliance management and performance improvement. By clarifying how companies can be

<sup>16</sup> *European Green Deal*, European Commission, viewed 1<sup>st</sup> June 2022, <[https://ec.europa.eu/clima/eu-action/european-green-deal\\_en](https://ec.europa.eu/clima/eu-action/european-green-deal_en)>

<sup>17</sup> *Carbon Neutrality: The Role of European Companies in China's Race to 2060*, European Union Chamber of Commerce in China, 25<sup>th</sup> May 2022, viewed 1<sup>st</sup> June 2022, <<https://www.eurochamber.com.cn/en/publications-carbon-neutrality-report>>

<sup>18</sup> *The Masses Can't Stand It, Cadres Also Complain: Why The "One Size Fits All" Governance Continues Despite Repeated Prohibitions*, Xinhuanet, 31<sup>st</sup> July 2019, viewed 13<sup>th</sup> April 2022, <[http://www.xinhuanet.com/politics/2019-07/31/c\\_1124820494.htm](http://www.xinhuanet.com/politics/2019-07/31/c_1124820494.htm)>

<sup>19</sup> *Guiding Opinions on Strengthening the Positive List Management of Ecological Environment Supervision and Law Enforcement and Promoting Differentiated Law Enforcement and Supervision*, MEE, 7<sup>th</sup> April 2021, viewed 29<sup>th</sup> April 2022, <[http://www.mee.gov.cn/xxgk/2018/xxgk/xxgk05/202104/t20210423\\_830095.html](http://www.mee.gov.cn/xxgk/2018/xxgk/xxgk05/202104/t20210423_830095.html)>

<sup>20</sup> *National Ecological Environment Quality Continued to Improve in 2021, And Eight Binding Indicators Were Successfully Completed*, People's Daily, 23<sup>rd</sup> February 2022, viewed 13<sup>th</sup> April 2022, <<http://finance.people.com.cn/n1/2022/0223/c1004-32358089.html>>

<sup>21</sup> *During the 14<sup>th</sup> Five-Year-Plan Period, The Number of Days With Excellent Air Quality in China Will Increase to 87.5%*, CCTV News, 27<sup>th</sup> February 2021, viewed 13<sup>th</sup> April 2022, <<https://news.cctv.com/2021/02/27/ARTIsi9LDPpuT9RnDgIcrCUK210227.shtml>>

<sup>22</sup> *Regulations on the Administration of Discharge Permits*, State Council, 29<sup>th</sup> January 2021, viewed 29<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2021-01/29/content\\_5583525.htm](http://www.gov.cn/zhengce/content/2021-01/29/content_5583525.htm)>





exempted from temporary production restriction measures, it will enable them to become frontrunners in green manufacturing, thereby attracting green financing and contributing to the 30/60 Goals.

In 2022, China is expected to introduce new incentives to reduce pollution and carbon emissions,<sup>23</sup> but it is not clear what they will include. Many European companies report that they encounter unexpected requirements to reduce their environmental impact through the procurement of energy from renewable energy sources, occasionally beyond what is realistically possible. For companies that are already operating in authorised locations, such as designated industrial parks, and that adhere to the highest standards in order to comply with applicable regulations, such unexpected requirements and ‘one-size-fits-all’ policies bring exactly the kind of business uncertainty that they try to avoid when choosing where to invest and manufacture.

The Environment Working Group realises that the Chinese Government faces the difficult task of balancing the needs of a healthy population, and developing a fair business environment and sustainable economy while guaranteeing long-term energy security. However, the recent decisions to prioritise energy supply and economic recovery while introducing ‘flexibility’ in areas such as energy intensity reductions has raised concerns about China’s ability to realise all the environmental targets laid out in the 14FYP.<sup>24</sup> Involving affected industries in the development of industry-level action plans would help to bring about environmental improvements in the shortest possible time. Improvements could be accelerated further by focussing discussions on how to finance industrial upgrades that would be of benefit to both society and industry.

There is also room for improvement in dispute settlement mechanisms. Increasing sophistication in monitoring and enforcement should be matched by enhancing alternative dispute resolution (ADR) processes, in particular mediation. Currently there are three ADR options available: people’s mediation, administrative

mediation and judicial mediation,<sup>25,26&27</sup> together with the *xinfang* or a ‘letters and visits’ system,<sup>28</sup> which handles the vast majority of China’s environmental disputes. While these processes channel and settle certain types of environmental complaints in an economical way, they are inadequate for handling the more complex, higher-stakes disputes that commonly arise.

For complex cases, it would be more efficient to establish a specialist and national environmental mediation body along the lines of the Environmental Dispute Adjustment Committee in South Korea and the Environmental Dispute Coordination Commission in Japan.<sup>29&30</sup> While there is no similar EU-level mediation body, several member states have similar bodies.<sup>31</sup> These bodies consist of a panel of neutral mediation experts with solid experience in environmental matters and the ability to quickly facilitate the resolution of environmental disputes. Such an expert body would also be expected to conduct training programmes for government officials, non-government organisations and the private sector, so that mediation can be more widely used in environmental dispute resolution throughout China.

### Recommendations

- Enforce the Environmental Protection Law and related regulations in a transparent fashion.
- Communicate environmental enforcement plans and incentive schemes well in advance of implementation, and discuss with relevant industries how best to mitigate any potential negative impact on them.
- Provide full online access to official environmental information, including policies and standards that are applied locally and nationally.

25 People’s mediation: a mechanism provided under People’s Mediation Law, which is conducted through People’s Mediation Committees that are established by rural village committees, resident committees, enterprises, institutions or administrative organisations.

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

27 Judicial mediation: a mechanism integrated into litigation procedures that is conducted under the guidance of a People’s Court with the mediation settlement agreement having the same legal effect as a judgment.

28 *Xinfang* or ‘letters and visits’ system: a mechanism through which citizens, legal persons or other organisations lodge complaints with government at any level and through written correspondence, e-mail, fax, phone, visits, and so on, with such complaints being dealt with by the relevant administrative departments.

29 *Environment Disputes Resolution System: Seoul Resolute Disputes*, Seoul Solution, 20<sup>th</sup> June 2015, viewed 13<sup>th</sup> April 2022, <<https://seoulsolution.kr/en/content/environment-disputes-resolution-system-seoul-resolute-disputes>>

30 *Environmental Dispute Coordination Commission*, Japanese Ministry of Internal Affairs and Communications, viewed 13<sup>th</sup> April 2022, <<https://www.soumu.go.jp/kouchou/english/>>

31 *Alternative dispute resolution for consumers*, European Commission, viewed 19<sup>th</sup> August 2022, <[https://ec.europa.eu/info/live-work-travel-eu/consumer-rights-and-complaints/resolve-your-consumer-complaint/alternative-dispute-resolution-consumers\\_en](https://ec.europa.eu/info/live-work-travel-eu/consumer-rights-and-complaints/resolve-your-consumer-complaint/alternative-dispute-resolution-consumers_en)>

23 *The Key Points of Ecological and Environmental Protection Will be Defined in an Orderly Manner in 2022, and Green and Low-Carbon Development Will Take the Lead*, *Xinhuanet*, 10<sup>th</sup> January 2022, viewed 13<sup>th</sup> April 2022, <[http://www.news.cn/2022-01/10/c\\_1128247497.htm](http://www.news.cn/2022-01/10/c_1128247497.htm)>

24 *Overall Carbon Reduction and Energy Security Based on National Conditions*, National Energy Administration, 18<sup>th</sup> February 2022, viewed 13<sup>th</sup> April 2022, <[http://www.nea.gov.cn/2022-02/18/c\\_1310478264.htm](http://www.nea.gov.cn/2022-02/18/c_1310478264.htm)>





- Install direct communication channels for companies to notify central government authorities of any issues/irregularities related to 'one-size-fits-all' approaches or other unreasonable environmental enforcement.
- Improve the effectiveness of mediation as a dispute resolution tool by establishing an expert group of environmental mediators to conduct high-level mediation for major environmental disputes and facilitate the training of government officials, judges and private sector actors.

## 2. Establish a Holistic Resource Management System to Address the Plastic Pollution Crisis with Measures Along the Whole Value Circle

### Concern

Although China has a large capacity for plastic waste recycling and has shown ambition to fight plastic pollution, institutional arrangements are weak and there is no holistic strategy or management system, which hinders implementation of waste classification policies.

### Assessment

In recent years, the mass production of durable and lightweight plastic for commercial use has become relatively inexpensive thanks to technological advancements, but plastic usage has also led to dire consequences: plastic pollution is now one of the world's most pressing issues related to environmental protection and climate change mitigation. On 2<sup>nd</sup> March 2022, during the fifth session of the UN's Environment Assembly (UNEA 5.2) in Nairobi, 175 member states, including China, agreed to work on a legally binding global treaty to end the plastic pollution crisis.<sup>32</sup> As China is the world's second largest economy, and the largest producer and consumer of plastic,<sup>33</sup> the global battle against plastic pollution will not be won without meaningful contribution from China.

The NDRC and MEE jointly issued the *Opinions on Further Strengthening Plastic Waste Management (Opinions)* on 16<sup>th</sup> January 2020,<sup>34</sup> with a five-year

action plan to cut usage of non-degradable single-use plastics items, such as plastic bags, straws and utensils. This long-overdue reform has been welcomed by many environmental activists in China, and includes stricter measures that have banned several types of single-use plastic in major cities since the end of 2020, with a nationwide ban scheduled by 2025.

However, there are concerns that this may simply lead to suppliers and manufactures switching from single-use plastics to other types of single-use materials, such as paper plastic composite materials or controversial 'bio-degradable' materials. In 2020 alone, 36 companies planned or constructed new bio-degradable plastic manufacturing facilities in China.<sup>35</sup> To put this into context, the new facilities increase production capacity by more than 4.4 million tonnes, a sevenfold increase in less than 12 months.<sup>36</sup> The absence of a renewed binding national standard for bio-degradable plastic is worrying, as it causes inconsistencies in quality that may lead to some degrading into harmful microplastics. While the National Standardisation Management Committee published revised standard recommendations in 2021, which define clear bio-degradation requirements for a range of plastics, they remain non-binding.<sup>37</sup>

On 15<sup>th</sup> September 2021, the NDRC and the MEE released the *14<sup>th</sup> Five-year Plan of Action for Plastic Pollution Control (Action Plan)*,<sup>38</sup> aimed at improving the whole chain of the plastic pollution control system, with measures to cut the production and use of plastics, develop alternatives for plastics, and substantially reduce the amount of plastic waste in landfills and environmental leakage during the 14FYP period (2021–2025). Unfortunately, while consolidation of plastic recycling capacities is mentioned and "closed-loop recycling" or high-end recycling encouraged, no quantitative target has been set. It should be noted that in the same policy a clear target has been set for the further development of the waste incineration

32 *Nations Sign Up to End Global Scourge of Plastic Pollution*, UN News, 2<sup>nd</sup> March 2022, viewed 13<sup>th</sup> April 2022, <<https://news.un.org/en/story/2022/03/1113142>>

33 Heng, Cheryl, *China's Plastic Waste Mountain the Biggest in the World: Study*, *South China Morning Post*, 23<sup>rd</sup> May 2021, viewed 13<sup>th</sup> April 2022, <<https://www.scmp.com/news/china/science/article/3134480/chinas-plastic-waste-mountain-biggest-world-study>>

34 *Opinions on Enhancing Plastics Waste Management*, NDRC, 16<sup>th</sup> January 2022, viewed 13<sup>th</sup> April 2022, <[https://www.ndrc.gov.cn/xxgk/zcfb/tz/202001/120200119\\_1219275.html?code=&state=123](https://www.ndrc.gov.cn/xxgk/zcfb/tz/202001/120200119_1219275.html?code=&state=123)>

35 *Biodegradables Will Not Solve China's Plastics Crisis*, Greenpeace International, 17<sup>th</sup> December 2021, viewed 10<sup>th</sup> June 2022, <<https://www.greenpeace.org/international/press-release/46066/biodegradables-will-not-solve-chinas-plastics-crisis/>>

36 Ibid.

37 *Degradability and Identification Requirements of Biodegradable Plastics and Products*, National Standardization Management Committee, 26<sup>th</sup> November 2021, viewed 10<sup>th</sup> June 2022, <<http://www.gb688.cn/bzgk/gb/newGbInfo?hcno=8986C280DFE938665FDFD654C5513472>>

38 *China Unveils 5-year Plan to Control Plastic Pollution*, State Council, 15<sup>th</sup> September 2021, viewed 13<sup>th</sup> April 2022, <[http://english.www.gov.cn/statecouncil/ministries/202109/15/content\\_WS6141f622c6d0df57f98e03a1.html](http://english.www.gov.cn/statecouncil/ministries/202109/15/content_WS6141f622c6d0df57f98e03a1.html)>





capacity of 800 kilotonnes per day, which indicates that burning plastic waste as a means of energy recovery is still encouraged over recycling.

Improperly managed plastic waste leads to environmental leakage, and brings about risks to the environment, biodiversity and health. While these issues are commonly acknowledged, there are two other aspects that are often overlooked.

First, most of the current plastic available is produced from fossil-fuel resources, thereby classifying plastic as a ‘high carbon-intensity’ material. The burning or incineration of plastic releases embedded carbon as CO<sub>2</sub> – about 2.7 tonnes for every tonne of plastic burned.<sup>39</sup> If the burning of plastics is not avoided, or at least tightly controlled, China will struggle to reach its commitments under the Paris Agreement as well as the 30/60 Goals.

Second, China's plastic production is heavily dependent on imports. China spends trillions importing crude oil to feed its fuel, plastic and chemicals production;<sup>40</sup> and imports more than 40 million tonnes of high-end polymers and plastic products.<sup>41</sup> While this material technically has the potential to be recycled, it is incinerated after only being used once, resulting in a huge loss of valuable natural resources. It is also worth pointing out that incineration can only recover a certain amount of energy and not the entire material value, which excludes it from the circular economy.<sup>42</sup>

China has a functioning plastic bottle recycling industry. However, it is not well regulated and, in many cases, leads to secondary pollution and unavoidable down-cycling. For example, high-value and high-quality food-grade plastic beverage bottles get recycled to lower value short fibre only. Part of the reason for this is that China still prohibits recycled polyethylene terephthalate (rPET) plastic from being used again for food-contact

purposes, despite other developed economies such as the EU and US having done so for many years without incident.<sup>43</sup> Recycling plastic beverage bottles significantly decreases their carbon footprint; for example, manufacturing a rPET bottle emits 70 per cent less CO<sub>2</sub> than manufacturing a virgin PET plastic bottle.<sup>44</sup> It would therefore be an extremely positive development if China can accelerate its policy research and investigation, and eventually allow “closed-loop” recycling for plastic bottles, as explicitly mentioned in the *Action Plan*.<sup>45</sup>

From a true circular economy perspective, since the quality of the input determines the quality of the output for down-stream processing plants, the most crucial phases are the collection and sorting of post-consumption plastics, which require both formalisation and centralisation. For single-use plastic bottles, a deposit and return system (DRS)—especially for beverage containers—is a proven mechanism for delivering the highest possible collection rate and highest quality material recovery. In addition, DRS provides accurate data to all stakeholders along the value circle, thereby creating a stable demand-supply relationship as well as transparency that can help the government improve its policymaking. Moreover, the DRS mechanism creates new and green job opportunities, and can provide unofficial or part-time waste collectors with improved working conditions and wages.<sup>46</sup>

Creating a circular economy for plastic is not only focussed on recycling; implementing better design is also key to the concept of ‘reduce, reuse and recycle’. Therefore, incentives should be provided to support the development of more eco-friendly designs. Requirements for producers to make products with longer durability and that are easier to repair, reuse or recycle should be outlined and enforced. In 2015, the EU introduced the Extended Producer Responsibility

39 *The Circular Economy – A Powerful Force for Climate Mitigation (Executive Summary)*, Material Economics, viewed 13<sup>th</sup> April 2022, <<https://materialeconomics.com/publications/the-circular-economy>>

40 *China May Spend \$100 Billion More On Crude Oil Impacts In 2022 Amid Surging Global Oil Prices: Experts*, *Global Times*, 13<sup>th</sup> April 2022, viewed 14<sup>th</sup> April 2022, <<https://www.globaltimes.cn/page/202204/1259198.shtml>>

41 Brooks, Amy L.; Wang, Shunli; Jambeck, Jenna R., *The Chinese Import Ban And Its Impact On Global Plastic Waste Trade*, *Science Advances*, 2018, vol.4, viewed 29<sup>th</sup> April 2022, <<https://www.ncbi.nlm.nih.gov/pmc/articles/PMC6010324/>>

42 Lovett, Gina, *Why Are We Still Addicted to Burning Waste?*, *The Guardian*, 3<sup>rd</sup> August 2015, viewed 13<sup>th</sup> April 2022, <<https://www.theguardian.com/sustainable-business/2015/aug/03/why-are-we-still-addicted-to-burning-waste>>

43 *Thematic Report 04 China Waste Plastic Recycling Industry*, China-Italy Chamber of Commerce, 4<sup>th</sup> May 2020, viewed 13<sup>th</sup> April 2022, <<https://www.sicab.net/wp-content/uploads/2020/05/04.-China-Waste-Plastic-Recycling-Industry-Report.pdf>>

44 *Bottle to Bottle, From the Source to the End User*, Veolia, 2022, viewed 14<sup>th</sup> June 2022, <<https://www.veolia.com/en/our-customers/achievements/industries/circular-economy/germany-rostock-0>>

45 *China to Ramp Up Recycling, Incineration in New Plastic Pollution Push*, *Reuters*, 15<sup>th</sup> September 2021, viewed 21<sup>st</sup> April 2022, <<https://www.reuters.com/world/china/china-ramp-up-recycling-incineration-new-plastic-pollution-push-2021-09-15/>>

46 *Deposit-Refund System (DRS): Facts and Myths*, Deloitte, April 2019, viewed 13<sup>th</sup> April 2022, <[https://www2.deloitte.com/content/dam/Deloitte/pl/Documents/Brochures/pl\\_DRS\\_Brochure\\_Deloitte.pdf](https://www2.deloitte.com/content/dam/Deloitte/pl/Documents/Brochures/pl_DRS_Brochure_Deloitte.pdf)>





(EPR) policy,<sup>47</sup> under which producers pay different financial contributions to the scheme based on the end-of-life-costs of their products. A similar scheme in China would help create economic incentives for the design of products that can be more easily recycled or reused. Currently, circular economy models for some 'high value' and 'easy-to-recycle' materials such as cardboard, metal and PET plastic are better established, due to the maturity of the collection and recycling value chain. However, there are many other waste materials—such as polyolefins, glass and textiles—which are not only high in volume, but also high in material value. Policies to encourage technological innovation as well as business model innovation should be encouraged to also turn these waste products into valuable resources. After China initially aimed to increase the recycling rate in 46 municipalities to 35 per cent by 2020,<sup>48</sup> it now strives to reuse 60 per cent of urban household waste by 2025.<sup>49</sup> Recycling rates are much higher in many EU Member States, like Germany for instance, where the municipal waste recycling rate has already reached 68 per cent, which highlights that European companies have expertise that can support China's waste reduction effort.<sup>50</sup> Furthermore, it takes European municipalities on average only two to three years to implement a zero-waste plan, illustrating how much experience both policymakers and companies have gained, which can also contribute to develop China's circular economy.<sup>51</sup>

### Recommendations

- Define an overall strategy for plastic pollution control based on circular economy and holistic resource management concepts, with a mid- and long-term legislation framework that includes clear quantitative targets, roadmaps and waste management hierarchy.
- Accelerate the policymaking process for packaging and packaging waste, with the EPR mechanism as the foundation.

- Introduce a defined roadmap to consolidate and formalise the long-existing informal scrap collecting and recycling system to ensure post-consumption recyclable material can be recycled at the highest possible quality for closed-loop or high-end applications.
- Improve market conditions for recycled materials in China to attract more social investment in upgrading the sector by clarifying policies for recycled plastic for FCMs and further developing industrial standards on recycled materials and processes.

## 3. Reinforce the Role of Environmental Facilities in China's National Emergency Response System 2

### Concern

Although environmental facilities can play a key role in tackling public emergencies, such as national health crises, they have been largely neglected in China, which hinders the recovery process and even poses potential risks to public safety.

### Assessment

Environmental facilities providing quality services in sanitation, wastewater treatment, municipal waste treatment, as well as hazardous and medical waste treatment not only contribute to promoting and safeguarding environmental standards, but also play an important role in dealing with public emergencies. This includes but is not limited to public health crises, chemical plant explosions and oil spills in waters.<sup>52&53</sup> However, their role is usually downplayed in China.<sup>54</sup>

For example, there have been global discoveries of the existence of the COVID-19 virus in urban sewage and river water.<sup>55</sup> Through investing in extra disinfection measures in China, environmental facilities have made a cohesive effort to prevent the COVID-19 virus from

47 *Extended Producer Responsibility*, Organisation for Economic Co-operation and Development, n.d., viewed 21<sup>st</sup> April 2022, <<https://www.oecd.org/env/tools-evaluation/extendedproducerresponsibility.htm>>

48 *Urban and Rural Municipal Solid Waste in China and the Circular Economy*, World Bank Group, April 2019, p. 18, viewed 27<sup>th</sup> June 2022, <<https://openknowledge.worldbank.org/bitstream/handle/10986/33838/Urban-and-Rural-Municipal-Solid-Waste-in-China-and-the-Circular-Economy-A-Brief-Overview-and-Opportunities-Going-Forward.pdf?sequence=1&isAllowed=y>>

49 *China Aims To Re-use 60% Of Its Trash By 2025*, Reuters, 13<sup>th</sup> May 2021, viewed 5<sup>th</sup> July 2022, <<https://www.reuters.com/business/environment/china-aims-re-use-60-its-trash-by-2025-2021-05-13/>>

50 *Waste Recycling in Europe*, European Environment Agency, 18<sup>th</sup> November 2021, viewed 14<sup>th</sup> June 2022, <<https://www.eea.europa.eu/ims/waste-recycling-in-europe>>

51 *Numbers and Statistics*, Zero Waste Europe, 2021, viewed 14<sup>th</sup> June 2022, <<https://zerowasteurope.eu/impact/numbers-and-statistics/>>

52 Take the Yancheng chemical plant explosion in March 2019, with a death toll of 78, as a key example. In April 2019, in the immediate aftermath, Jiangsu Province released the *Plan for Regulating and Improving the Chemical Industry of Jiangsu Province (Consultation Paper)*.

53 Xu, Yuanhao, *Jiangsu Chemical Park Explosion: Rectify or Shutdown?*, CWR, 18<sup>th</sup> June 2019, viewed 12<sup>th</sup> April 2022, <<https://www.chinawaterrisk.org/resources/analysis-reviews/jiangsu-chemical-park-explosion-rectify-or-shutdown/>>

54 *Interpretation II of the Guiding Opinions on Accelerating the Construction of Urban Environmental Infrastructure and Facilities*, NDRC, 15<sup>th</sup> February 2022, viewed 13<sup>th</sup> April 2022, <[https://www.ndrc.gov.cn/xxgk/jd/jd/202202/t20220215\\_1315548.html?code=&state=123](https://www.ndrc.gov.cn/xxgk/jd/jd/202202/t20220215_1315548.html?code=&state=123)>

55 *New Study Examines Whether COVID-19 Virus Has Entered Rivers and Streams*, Yale School of Environment, 29<sup>th</sup> June 2020, viewed 13<sup>th</sup> April 2022, <<https://environment.yale.edu/news/article/has-the-coronavirus-entered-rivers-and-streams>>





entering the environment again via the sewage network and waste system.<sup>56</sup> However, the role of environmental facilities was largely neglected during the management of the crisis. When policymakers were required to handle an increasing workload to mitigate the spread of the virus, environmental companies were not officially regarded as essential anti-COVID-19 companies.<sup>57</sup> As a result, they were not able to benefit from favourable policies or supplies of personal protective equipment made available to other companies deemed essential. This left the safety of employees, supply chains and finances of environmental companies at risk, affecting the quality and mobilisation of the environmental services critical to dealing with the crisis.

Similar issues also occurred with other environmental emergencies, which raised further concerns over public safety. According to the Ministry of Emergency Management, in 2021 alone, there were 122 accidents in the chemical industry, causing 150 deaths.<sup>58</sup> Without an efficient emergency response system that incorporates environmental facilities for impact mitigation, such accidents are likely to cause secondary environmental risks that may pose a threat to public health and safety. In many cities, environmental facilities are excluded from emergency response systems for two main reasons: either because the cities in question are short of environmental facilities, or the role of the facilities has been neglected by local governments. It is therefore paramount that further policy reforms are implemented to increase awareness of the potential consequences of environmental incidents and the role of environmental facilities.<sup>59</sup>

#### Recommendations

- Enhance construction of environmental facilities to ensure their effectiveness in national emergency responses.
- Recognise the key role played by environmental facilities in ensuring the effectiveness of the Chinese

<sup>56</sup> *How to Treat the Domestic Sewage of Isolation Hotels? Whole Process Monitoring*, China Forum of Environmental Journalists, 30<sup>th</sup> November 2021, viewed 13<sup>th</sup> April 2022, <[http://www.cfej.net/news/rdzz/202111/t20211130\\_962251.shtml](http://www.cfej.net/news/rdzz/202111/t20211130_962251.shtml)>

<sup>57</sup> *What Impact Does the Pandemic Have on Environmental Protection Enterprises?*, China Forum of Environmental Journalists, 14<sup>th</sup> February 2020, viewed 13<sup>th</sup> April 2022, <[http://www.cfej.net/jzhe/cmlw/202002/t20200214\\_763938.shtml](http://www.cfej.net/jzhe/cmlw/202002/t20200214_763938.shtml)>

<sup>58</sup> *China's Major Chemical Accidents Fell to Single Digits for the First Time in 2021*, Ministry of Emergency Management, 18<sup>th</sup> February 2022, viewed 13<sup>th</sup> April 2022, <[https://www.mem.gov.cn/xw/xwfbh/2022n2y15rxwfbh/mtbd\\_4262/202202/t20220218\\_408142.shtml](https://www.mem.gov.cn/xw/xwfbh/2022n2y15rxwfbh/mtbd_4262/202202/t20220218_408142.shtml)>

<sup>59</sup> *Suggestions on Improving China's Comprehensive Environmental Emergency Management Capacity*, Guangmingwang, 28<sup>th</sup> April 2021, viewed April 13<sup>th</sup> 2022, <[https://theory.gmw.cn/2021-04/28/content\\_34805091.htm](https://theory.gmw.cn/2021-04/28/content_34805091.htm)>

public health emergency response system, and extend to them the support they need.

#### 4. Contribute to Decarbonisation by Pushing Green, Low Carbon and Circular Economy Development

##### Concern

The transition to a circular economy should be considered a key pillar of China's green and low carbon development strategy, yet current incentives are insufficient to realise China's goals to peak carbon emissions by 2030 and achieve carbon neutrality by 2060.

##### Assessment

RE and energy efficiency development are crucial elements for tackling climate change effectively.<sup>60</sup> Yet, with existing technologies, the transition of the energy system to renewables would only address 55 per cent of GHG emissions, with the remaining 45 per cent derived from industry, agriculture and land use.<sup>61</sup> To address these emissions, it is vital to transition to a more circular economy. A circular economy refers to an industrial economy that is designed with the intent of being restorative, and one in which resources are managed in a regenerative way. While RE is part of the solution, a circular economy transition is needed to achieve a net-zero world. Through the reuse or recycling of end-of-life products and packaging, waste—and the subsequent carbon emissions associated with the production and incineration of waste materials—can be largely reduced. The successful implementation of a circular economy requires a holistic design with a concrete programme of action covering the whole cycle: from design, production, consumption, waste reuse and waste management. Transition towards a circular economy will also foster sustainable economic growth, improve ecological development and generate green jobs.

On 2<sup>nd</sup> December 2015, the European Commission adopted an ambitious circular economy package, creating a comprehensive framework to enable the transition from linear economies. The EU has since

<sup>60</sup> *What is a Circular Economy?*, Ellen MacArthur Foundation, viewed 12<sup>th</sup> April 2022, <<https://ellenmacarthurfoundation.org/topics/circular-economy-introduction/overview>>

<sup>61</sup> *Fixing the Economy to Fix Climate Change*, Ellen MacArthur Foundation, viewed 13<sup>th</sup> April 2022, <<https://climate.ellenmacarthurfoundation.org/>>





delivered on all the 54 actions outlined in the package, leading the way as a trailblazer for the rest of the world.<sup>62</sup> In addition, the EU rolled out its *Circular Economy Action Plan 2.0* on 11<sup>th</sup> March 2020, as one of the key priorities of the EU Green Deal, and which forms a critical part of 'Fit for 55'<sup>63</sup> and the ultimate goal of becoming net-zero by 2050.<sup>64</sup> Under this plan, a comprehensive legislative initiative will ensure that only sustainable products with a strict eco-design framework and proven circularity in the production process can be sold in the EU market. This legislation will obviously affect Chinese manufacturers and exporters to the EU.

On 17<sup>th</sup> July 2018, China and the EU signed a Memorandum of Understanding (MOU) on Circular Economy Cooperation, agreeing to establish a high priority dialogue on the circular economy to be led by high-level officials.<sup>65</sup> It is important to acknowledge that the EU's achievements relating to the circular economy would not have been possible without a comprehensive, cohesive action plan. By comparison, although China now has many initiatives in areas such as industrial symbiosis, urban mining, resource recycling and utilisation, and municipal waste separation, these efforts are led by different ministries without overall coordination.<sup>66</sup>

China was a pioneer in facilitating a circular economy when its Circular Economy Promotion Law (CEPL) became effective in January 2009, aimed at raising the utilisation rate of resources, protecting and improving the environment and realising sustainable development.<sup>67</sup> However, with the rapid development in circular economy practices globally in recent years, China may find itself lagging. For example, the EU increased the usage of circular material to 12.8 per

cent in 2020, up from 8.3 per cent in 2004.<sup>68</sup> In China, the circularity rate rose from 2.7 per cent to 5.8 per cent between 1995 and 2015, a great improvement but still significantly lower than the EU's 2004 rate.<sup>69</sup> The working group therefore recommends that China's central government initiate an overall strategy for circular economy development, with a clearly defined mid- and long-term legislation framework, including quantitative targets and actionable roadmaps. This will lay the foundation for more effective EU-China dialogue and cooperation.

Although the working group submitted numerous comments in 2021 regarding the amendment of the CEPL,<sup>70</sup> progress in adopting suggestions has been relatively slow and non-transparent. Further clarification should also be provided to encourage state-owned enterprises (SOEs) to take a more proactive approach to decarbonisation, a process that would benefit from accelerating environmental reform and utilising best practices from industry players that are well advanced with their decarbonisation plans.

### Recommendations

- Prioritise the implementation of a strategy to transition to a circular economy with a mid- and long-term legislative framework, as well as pilot projects that include the joint involvement of Chinese and European companies.
- Enhance industrial players' involvement in, and promote frequent and in-depth exchanges and dialogues on, the joint MOU on Circular Economy Cooperation.
- Encourage technology developments that can facilitate better recycling of not only high-value and easy-to-recycle materials, such as cardboard and PET, but also materials such as polypropylene, polyethylene, polystyrene, glass, waste polyester, non-ferrous metals and critical mineral resources.

62 *First Circular Economy Action Plan*, European Commission, n.d., viewed 13<sup>th</sup> April 2022, <[https://ec.europa.eu/environment/topics/circular-economy/first-circular-economy-action-plan\\_en](https://ec.europa.eu/environment/topics/circular-economy/first-circular-economy-action-plan_en)>

63 Refers to the EU's target of reducing net greenhouse gas emissions by at least 55 per cent by 2030.

64 *Changing How We Produce and Consume: New Circular Economy Action Plan Shows the Way to a Climate-Neutral, Competitive Economy of Empowered Consumers*, European Commission, 11<sup>th</sup> March 2020, viewed 11<sup>th</sup> April 2022, <[https://ec.europa.eu/commission/presscorner/detail/en/ip\\_20\\_420](https://ec.europa.eu/commission/presscorner/detail/en/ip_20_420)>

65 Roberts, Gethin, *China and EU Sign Memorandum of Understanding on Circular Economy, Resource*, 17<sup>th</sup> July 2018, viewed 13<sup>th</sup> April 2022, <<https://resource.co/article/china-and-eu-sign-memorandum-understanding-circular-economy-12744>>

66 *Urbanization Series Report*, National Academy of Development and Strategy, April 2014, viewed 13<sup>th</sup> April 2022, <[http://nads.ruc.edu.cn/upfile/file/20140402155143\\_62509.pdf](http://nads.ruc.edu.cn/upfile/file/20140402155143_62509.pdf)>

67 *China Circular Economy Promotion Law*, Green Policy Platform, August 2008, viewed 13<sup>th</sup> April 2022, <<https://www.greengrowthknowledge.org/national-documents/china-circular-economy-promotion-law>>

68 *EU's Circular Material Use Rate Increased in 2020*, Eurostat, 25<sup>th</sup> November 2021, viewed 14<sup>th</sup> June 2022, <<https://ec.europa.eu/eurostat/web/products-eurostat-news/-/ddn-20211125-1>>

69 Wang, Heming et al., 2020, *Measuring progress of China's circular economy, Resources, Conservation and Recycling*, vol. 163, no.105070, <<https://doi.org/10.1016/j.resconrec.2020.105070>>

70 *Call for Comments on the Revision of the Circular Economy Promotion Law of the People's Republic of China*, NDRC, 10<sup>th</sup> September 2021, viewed 13<sup>th</sup> April 2022, <[https://www.ndrc.gov.cn/hdjl/yjzq/202109/t20210910\\_1296453.html?code=&state=123](https://www.ndrc.gov.cn/hdjl/yjzq/202109/t20210910_1296453.html?code=&state=123)>





## 5. Develop the Recycling and Reuse Industry under the Dual Control Energy Consumption Policy

### Concern

The recycling and reuse industry has been restricted in some areas by the *Dual Control of Energy Consumption Policy*,<sup>71</sup> which ultimately hinders regulatory modernisation, advances in industry technology and opportunities for solution providers.

### Assessment

The recycling and reuse industry for materials such as metals, plastic and even textiles plays an important role in pollution control, carbon emissions reduction and promoting material efficiency. One overlooked but important industry development is the newly released *China Waste Textile Suggestion*, a document jointly published by the NDRC, the MIIT and the MOFCOM on 11<sup>th</sup> April 2022,<sup>72</sup> which is intended to establish a plan to recycle a quarter of China's textile waste into 2 million tonnes of new fibres each year by 2025, as part of its 2030 carbon peaking goal.

The recycling and reuse industry not only helps encourage resource conservation and closed-loop production, but is also strategically critical in increasing national resources security as well as life-cycle decarbonisation under the 30/60 Goals. A series of policies have been published to push energy conservation and develop a circular economy, while curbing projects with high energy consumption and emissions, known as 'two high' projects.<sup>73</sup> However, questionable classification standards for 'resources' and 'waste', ambiguities over legal liability and different policy interpretations have long hindered the development of the recycling and reuse industry in China.<sup>74</sup> In some cases, local governments support upstream waste collection and processing as a circular economy while criticising downstream recovery and

reuse as 'high energy consumption' projects. Due to 'one-size-fits-all' practices, recycling and reuse projects face many difficulties in obtaining administrative approvals.

For example, if a company applies for administrative approval for a project using PET polyester plastic recycled from waste beverage bottles as raw materials to produce environmentally friendly fibres, the high value-added project would boost development of new low-carbon textile materials. However, due to the 'one-size-fits-all' policy that categorises such projects under the chemical fibre industry, it would also be deemed a 'high-energy-consuming' project by the provincial government, and therefore would be suspended. As a major contributor to the circular economy, the recycling and reuse industry would be negatively impacted if its supply chain is broken.<sup>75</sup> First, this would hinder material streams and destroy the closed-loop of the circular economy, further affecting the industry's ability to scale up. Second, it may increase pollution, energy consumption and carbon emissions from the production of new materials.

### Recommendations

- Clarify that the recycling and reuse industry is considered a green industry that meets the requirements of Article 43 of the *Guidance Catalogue for Industrial Structure Adjustment (2019)*, while ensuring industries listed in the *Guidance Catalogue for Green Industries (2019 version)* are not classified as high energy consumption projects by local governments.
- Strengthen policy research on the recycling and reuse industry to enhance coordination between industrial development and dual control energy consumption policies.
- Clarify high energy consumption project standards, ensuring that energy usage of raw materials, energy efficiency levels and environmental benefits are taken into consideration.
- Prioritise access to green energy supply for industry players in order to support overall decarbonisation targets and improve the efficiency of resources.
- Implement financial subsidies and tax incentives, including green finance, that encourage the recycling and reuse industry and the reduction of carbon emissions.

71 Dong, Lara and Feng, Xiaonan, *China's "Dual-Control" Implementation: A Tight Balancing Act Amid the Energy Transition*, IHS Markit, 26<sup>th</sup> October 2021, viewed 19<sup>th</sup> April 2022, <<https://ihsmarkit.com/research-analysis/chinas-dualcontrol-implementation-a-tight-balancing-act-amid-t.html>>

72 Glover, Simon, *China Announces Textile Recycling Targets*, *Ecotextile News*, 13<sup>th</sup> April 2022, viewed 2<sup>nd</sup> May 2022, <<https://www.ecotextile.com/2022041329224/materials-production-news/china-announces-textile-recycling-targets.html>>

73 Fan, Angela, *Three Reform Strategies Behind Xi's Energy Revolution*, US-China Business Council, viewed 13<sup>th</sup> April 2022, <<https://www.uschina.org/three-reform-strategies-behind-xi%E2%80%99s-energy-revolution>>

74 Li, Jingheng, *Tightening Approval and Seeking Change in the Chemical Industry*, EEO, 12<sup>th</sup> June 2021, viewed 13<sup>th</sup> April 2022, <<http://www.eeo.com.cn/2021/0612/491462.shtml>>

75 *5 Barriers to Using Recycled Materials to Boost the Circular Economy*, World Economic Forum, 10<sup>th</sup> December 2021, viewed 13<sup>th</sup> April 2022, <<https://www.weforum.org/agenda/2021/12/5-barriers-to-using-recycled-materials-to-boost-the-circular-economy/>>





## Abbreviations

14FYP	14 <sup>th</sup> Five-year Plan
30/60 Goals	China's plan to peak carbon emissions before 2030 and achieve carbon neutrality by 2060
ADR	Alternative Dispute Resolution
CEPL	Circular Economy Promotion Law
CGT	Common Ground Taxonomy
CNY	Chinese Yuan
CO <sub>2</sub>	Carbon Dioxide
COP	Conference of Parties
DRS	Deposit and Return System
EPR	Extended Producer Responsibility
EU	European Union
GHG	Greenhouse Gas
MEE	Ministry of Ecology and Environment
MOU	Memorandum of Understanding
NDRC	National Development and Reform Commission
PBOC	People's Bank of China
PET	Polyethylene Terephthalate
PM	Particulate Matter
RE	Renewable Energy
rPET	Recycled Polyethylene Terephthalate
UN	United Nations
UNEA	United Nation's Environment Assembly
USD	United States Dollars





# Finance and Taxation Working Group

## Key Recommendations

### 1. Provide Relevant Tax Reliefs to Mitigate the Negative Impacts Posed by COVID-19 and Regain Economic Growth and Investment Momentum in China

- Implement temporary reductions in employer social security contributions, consumption tax rates for raw materials, general value-added tax (VAT) rates and a one-off tax loss carrybackward for 2022 losses to 2021, as immediate response measures.
- Maintain an individual income tax regime that benefits both employees and employers.
- Provide research and development (R&D) incentives for multiple operational models, including contractual R&D, and expand the tight five-year tax loss carryforward limitation for capital-intensive investment projects.

### 2. Further the Implementation of Value-added Tax (VAT) Reform 7

- Introduce bad debt relief treatment for VAT purposes.
- Clarify the Chinese VAT place-of-supply rules in the draft VAT Law.
- Include more detailed provisions to define how a supply would be treated as out-of-scope, VAT exempt or zero-rated.
- Expand the scope of zero-rating and provide clear guidance on the application thereof to mitigate administrative burdens.
- Integrate the interactive customs and tax systems.
- Enable non-resident taxpayers to register for VAT in China.
- Allow all taxpayers to claim the input VAT incurred on loan interest.
- Allow qualified agencies to issue special VAT invoices.
- Eliminate the double VAT taxation issue for on-balance-sheet asset-backed securitisation.
- Allow negative VAT taxable income of financial products to be carried forward to the next year.

### 3. Take Prudent Steps in Consumption Tax Reform 9

- Involve experts in discussions on standards and measurements and, where necessary, redetermine the scope of taxation.
- Publish in a timely manner the timetable and implementation rules for the various sectors enlisted in the pilot programme of the Consumption Law reform and provide a sufficient transition period for companies to adjust.
- Improve the effectiveness of the nationwide tax system and synchronise tax systems at central and local levels.
- Review the applicable tax threshold, tax rates and taxation method to facilitate the macro-development strategies of specific industries, in line with China's consumption reality and to better reflect international best practices.
- Implement unified direct exemption treatment for all refined oil products (ROPs) (including naphtha) purchased, regardless of source (domestic or import), as feedstock to produce chemical products without restrictions.
- Provide financial and tax incentives to encourage companies to invest in chemical recycling,



such as exemption from consumption tax on ROPs made from recycled waste plastic and full VAT refunds on ROPs or chemical products made from waste plastics.

#### 4. Introduce Tax and Fiscal Measures to Encourage Automation and Further Develop Digital Infrastructure

- Provide tax incentives for companies to invest in digital infrastructure such as hardware and software, as well as more advanced automation.
- Review tax filings and other financial procedures to focus efforts on the development of the digital economy.
- Accelerate the adoption of electronic invoicing.

#### 5. Enhance Administrative and Organisational Efficiency for Multinational Companies Investing in China

- Allow consolidated corporate income tax filing for Chinese holding companies with their wholly-owned subsidiaries in China.
- Allow consolidated handling of VAT invoices for companies within a company group.
- Implement further guidance on VAT treatment for transfer pricing adjustments and open a respective channel for payment approval.
- Increase flexibility for intercompany financing within China and across borders.
- Facilitate corporate restructurings and relocations within China through further guidance on preconditions and implications.

## Introduction to the Working Group

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

## Recent Developments

The working group appreciates efforts made by the Chinese authorities in promulgating new regulations and reinforcing the existing tax administration. Through these efforts, China has made it easier to pay taxes by implementing a preferential corporate income tax (CIT) rate for small enterprises, reducing the value-added tax (VAT) rate for certain industries and enhancing the electronic filing and payment system.

The working group welcomes the two-year extension of non-taxable allowances for foreign national employees jointly announced by the Ministry of Finance (MOF) and the State Taxation Administration (STA) on 31<sup>st</sup> December 2021.<sup>1</sup> The working group has advocated tirelessly from 2018 to 2021 for the extension of these non-taxable allowances, which include those for housing, education and language training among others. These items had been set to become fully taxable in 2022, which would have increased the financial burden of companies and/or individuals, resulting in a further decrease of international assignments to China with ripple effects on foreign direct investment.

When the two-year extension was announced, the working group was hopeful that this solution would temporarily stem the outflow of foreign talent from China. However, by the time this *Position Paper* was being drafted, the situation had taken a drastic turn

<sup>1</sup> *Announcement on the Continuation of the Implementation of Non-taxable Allowances of Individual Income Tax Policies for Foreign National Individuals*, MOF and STA, 31<sup>st</sup> December 2021, viewed 24<sup>th</sup> June 2022, <[http://szs.mof.gov.cn/zhengcefabu/202112/t20211231\\_3780374.htm](http://szs.mof.gov.cn/zhengcefabu/202112/t20211231_3780374.htm)>



towards deterioration from early 2022, due to China adopting increasingly stringent COVID-19 containment policies. This not only had a severe impact on China's economic growth, but also immediately led to an increasing number of foreign nationals leaving China.<sup>2</sup>

## Key Recommendations

### 1. Provide Relevant Tax Reliefs to Mitigate the Negative Impacts Posed by COVID-19 and Regain Economic Growth and Investment Momentum in China

#### Concern

China's COVID-19 containment policy has caused considerable economic loss for all companies in China, including European businesses, generating a grim outlook and huge uncertainty for the Chinese economy.

#### Assessment

In response to the numerous outbreaks of the Omicron variant in various parts of the country in early 2022, China adopted more stringent COVID-19 containment measures and imposed full or partial lockdowns in 45 cities, including Shanghai. These measures have posed major challenges for all businesses in China with regard to supply chains, daily operations, retention of foreign talent, and the ability to conduct business trips and face-to-face meetings.<sup>3</sup>

Overall, these challenges caused by China's pandemic control measures have resulted in a large amount of uncertainty for business, including the European community. As a result, nearly 60 per cent of European Chamber's members reported having decreased their 2022 revenue projections.<sup>4</sup> The measures have also had a negative impact on the future outlook for foreign investment in China, as 23 per cent of European Chamber companies have started to consider shifting current or planned investments in China to other markets,<sup>5</sup> and 77 per cent reported that China's

COVID-19 measures have made it a less attractive destination for investment.<sup>6</sup>

Under these circumstances, it will take considerable time and effort for China to revitalise its economy and rebuild foreign investors' confidence in the market. Though financial and tax support alone will not act as a silver bullet against difficulties, well-formulated relief policies for tax and other contributions would help mitigate the fallout for affected businesses, stabilise investment and hopefully bring the economy back on track in a timely manner.

In this regard, the MOF and STA jointly issued three notices to accelerate implementation of the tax credit refunds.<sup>7,8&9</sup> This policy was emphasised again in May 2022 by the State Council as part of a package of measures to relieve economic burdens on enterprises.<sup>10</sup> The working group welcomes the initiative and believes that it will help to remotivate market entities, provided that participation remains voluntary and implementation is carried out under the principles of transparency and consistency between central and local governments. However, when the criteria for the various types of tax refunds are taken into account, only certain types of European companies would be eligible to benefit from the initiative. Further measures, both as immediate response and strategic consideration, are therefore urgently needed in order for a wider range of companies to benefit, and the entire market to be revitalised.

As immediate response measures, stabilisation of employment could be supported through a temporary discount on employers' social security contributions. Price-driving trends could be curbed with temporary reductions of consumption tax for relevant raw materials (for example, oil-based products) that are required for many products along the value chain and

2 A flash survey conducted by the European Chamber in April 2022 shows that 27 per cent of companies experienced difficulty retaining staff as an immediate result of the pandemic control measures. See detail: *European Chamber Flash Survey on COVID-19 and the War in Ukraine: The Impact on European Business in China*, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 22<sup>nd</sup> May 2022, <<https://www.eurochamber.com.cn/en/publications-flash-survey-2022>>

3 Ibid, pp. 7–8.

4 Ibid.

5 This is more than double the number that were considering the same in early 2022 and is in fact the highest percentage recorded in the past decade. Source: Ibid.

6 Ibid.

7 *Public Notice [2022] No. 14: Announcement on Further Strengthening the Implementation of VAT Credit Refunds at the End of the Period*, MOF and STA, 21<sup>st</sup> March 2022, viewed 24<sup>th</sup> May 2022, <[http://szs.mof.gov.cn/zhengcefabu/202203/t20220322\\_3796788.htm](http://szs.mof.gov.cn/zhengcefabu/202203/t20220322_3796788.htm)>

8 *Public Notice [2022] No. 17: Announcement on Further Accelerating the Implementation of VAT Credit Refunds at the End of the Period*, MOF and STA, 17<sup>th</sup> April 2022, viewed 24<sup>th</sup> May 2022, <[http://szs.mof.gov.cn/zhengcefabu/202204/t20220420\\_3804066.htm](http://szs.mof.gov.cn/zhengcefabu/202204/t20220420_3804066.htm)>

9 *Public Notice [2022] No. 19: Announcement on Continuously Accelerating the Implementation of VAT Credit Refunds at the End of the Period*, MOF and STA, 17<sup>th</sup> May 2022, viewed 24<sup>th</sup> May 2022, <[http://szs.mof.gov.cn/zhengcefabu/202205/t20220518\\_3811434.htm](http://szs.mof.gov.cn/zhengcefabu/202205/t20220518_3811434.htm)>

10 *Li Keqiang Chaired the Executive Meeting of the State Council to Further Deploy a Package of Measures to Stabilize the Economy*, *Xinhua*, 1<sup>st</sup> June 2022, viewed 24<sup>th</sup> June 2022, <[http://www.gov.cn/xinwen/2022-06/01/content\\_5693460.htm](http://www.gov.cn/xinwen/2022-06/01/content_5693460.htm)>



have respective cost leverage. With regard to VAT, a temporary rate reduction could provide further stimulus. For heavily-affected businesses facing losses in 2022, a one-off tax loss carrybackward for 2022 losses into 2021 in combination with a respective CIT refund could provide immediate and administratively-efficient financial support.

As strategic response measures, in order to ensure China remains a prioritised investment location, and gain momentum for research and development (R&D) and regional headquarter activities, it will be important to further encourage the mobility of people in both directions. In terms of individual income tax, it will be more important than ever to offer a modern and fair tax regime for both employees and employers that allows both cross-border assignments as well as local employments. The incentive rates of 15 per cent for individual income tax available in areas in Guangdong, Hainan and other jurisdictions (with certain conditions) are effective in bringing in high-end talent and foreign investment, and should be considered for broader applicability. With regard to activity-based tax incentives, the working group believes that R&D activities should enjoy more comprehensive support, including contractual R&D activities, irrespective of which operational model is applied.

From a general perspective, for capital intensive investments, the current limitation of five years for tax loss carryforward is overly tight, as carryforwards expire quickly while loss-mitigating income is fully subject to tax. As such, the working group would recommend that the tax loss carryforward limitation be increased to 10 years. The working group would also recommend an immediate expansion of certain capital deductions for the 2022 and 2023 tax years to stimulate economic activity in capital deployment.

### Recommendations

- Implement temporary reductions in employer social security contributions, consumption tax rates for raw materials, general VAT rate and a one-off tax loss carrybackward for 2022 losses to 2021, as immediate response measures.
- Maintain an individual income tax regime that benefits both employees and employers.
- Provide R&D incentives for multiple operational models, including contractual R&D, and expand the

tight five-year tax loss carryforward limitation for capital-intensive investment projects.

## 2. Further the Implementation of VAT Reform



### Concern

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

### Assessment

Significant changes to the Chinese VAT system have been introduced over the past few years. China's tax system underwent a major overhaul in 2016, and the government has since clarified and updated VAT policies through circulars like *Caishui [2016] No. 36 (Circular 36)*.<sup>11</sup> In November 2019, the MOF published a draft VAT Law that aims to consolidate previous measures and further align China's VAT practices with international standards.<sup>12</sup> While a welcome development, this step alone does not ensure alignment, and measures to encourage the international competitiveness of businesses operating in the Mainland remain necessary. China would benefit from the proposed measure by reducing the burden on its tax bureaus, which are currently being faced with requests for clarification across the country. These measures are outlined below.

### Introduce Bad Debt Relief Treatment for VAT Purposes

The global economic downturn caused by the COVID-19 pandemic has led governments to introduce special tax and fiscal policies to help taxpayers survive and recover. In the spirit of continuing these efforts, the working group recommends the introduction of bad debt treatment for VAT purposes in China's future VAT Law. This would enable taxpayers to reclaim VAT paid on sales. Having a bad debt provision in the VAT Law, similar to the provisions on bad debt losses included in the CIT Law,<sup>13</sup> would align with the principle of fiscal neutrality, as taxpayers would not have to pay VAT when they do not receive payment from their customers.

<sup>11</sup> Notice on Fully Expanding the VAT Pilot Programme, *Caishui [2016] No. 36*, STA, 23<sup>rd</sup> March 2016, viewed 7<sup>th</sup> April 2022, <<http://www.chinatax.gov.cn/n810341/n810755/c2043931/content.html>>

<sup>12</sup> Call for Comments on the Value-added Tax Law of the People's Republic of China (PRC) (Draft for Comments), STA, 27<sup>th</sup> November 2019, viewed 7<sup>th</sup> April 2022, <<http://www.chinatax.gov.cn/chinatax/n810356/n810961/c5140207/content.html>>

<sup>13</sup> Corporate Income Tax Law of the PRC, State Council, 16<sup>th</sup> March 2007, viewed 20<sup>th</sup> June 2022, <[http://www.gov.cn/jfjg/2007-03/19/content\\_554243.htm](http://www.gov.cn/jfjg/2007-03/19/content_554243.htm)>





## Clarify the Chinese VAT Place-of-supply Rules in the Draft VAT Law

VAT neutrality in cross-border trade follows the 'destination' principle laid out in Organisation for Economic Cooperation and Development guidelines, which states that taxes should be collected in the country where the service is consumed. Currently, China adopts a wider definition of VAT place-of-supply rules: the place of supply of services is considered to be in China if either the service provider or the service recipient is located in China. However, the draft VAT Law states that services are deemed to take place within the territory of China if the sellers are domestic entities and the services are consumed within the territory of China. The working group therefore recommends a further clarification of the determination of 'consumption' in the draft VAT Law.

Moreover, it is recommended that the place of supply also be clarified and that more detailed provisions be included. For example, the working group suggests that the main place of supply for standard business-to-business services be defined as the place where the customer is located. Exceptions should be included for services that are deemed to be consumed in China, such as real estate-related services, transportation services and entertainment services. This would mean that standard services provided by Chinese suppliers to branches based overseas are not subject to Chinese VAT unless an exemption applies.

On business-to-customer services, the working group advises that the main place of supply be defined as the place where the supplier is established. Exceptions should be included for services that are deemed to be consumed in the country where the customer is located, such as telecommunication services, electronically-provided services, transportation services and entertainment services.

## Include More Detailed Provisions to Define How A Supply Would Be Treated as Out-of-scope, VAT Exempt or Zero-rated

There is much uncertainty surrounding the draft VAT Law, including under what conditions supplies are to be treated as out-of-scope, exempt or zero-rated. The Finance and Taxation Working Group suggests clarifying the input VAT recovery rules associated

with the making of out-of-scope supplies.<sup>14</sup> Current VAT rules, as well as the draft thereof, only imply input VAT recovery treatment, a condition that has caused disputes because tax authorities from different locations have adopted varying interpretations. Based on international VAT standards, out-of-scope supplies should not, in principle, lead to an input VAT recovery limitation, as long as they are closely linked to a taxable activity of the taxpayer.

## Expand the Scope of Zero-rating and Provide Clear Guidance on the Application Thereof to Mitigate Administrative Burdens

Currently, the rules for zero-rating for services and goods are not applicable for all supplied services and goods. For example, financial services provided overseas are not zero-rated. Furthermore, the zero per cent VAT rate for exports can only be applied by domestic taxpayers. Both the application of VAT to exported financial services and a limited VAT zero-rating concession make China's financial services sector less competitive internationally.

The working group recommends implementing a zero per cent VAT rate for all services provided overseas, except those consumed inside China (see the earlier recommendation for place-of-supply rules). Moreover, the working group recommends implementing a zero per cent VAT rate on all export supplies of goods. Additionally, it is necessary for the respective ministries (the STA, the General Administration of Customs and the MOF) to provide clear guidance on the conditions required for applying the zero per cent VAT rate to mitigate the administrative burden for taxpayers.

The Chinese export VAT refund system—of particular importance in China's efforts to better align with international taxation principles—should be revised to allow for VAT exemption on exports, as is the case in most jurisdictions worldwide. This would go hand-in-hand with changes to Chinese Accounting Standards (CAS) aimed at bringing them in line with International Financial Reporting Standards and International Accounting Standards.<sup>15</sup>

<sup>14</sup> Out-of-scope supplies refers to supplies that fall outside the scope of goods and services tax legislations, like sales in third countries or free trade zones, and private transactions.

<sup>15</sup> The standards became effective on 1<sup>st</sup> January 2021 and were applied for the first time on 21<sup>st</sup> December 2021. See: *Chinese Accounting Standards for Business Enterprises: Prepare for Changes in 2021*, China Briefing, 24<sup>th</sup> November 2020, viewed 7<sup>th</sup> April 2022, <<https://www.china-briefing.com/news/chinese-accounting-standards-business-enterprises-prepare-changes-2021/>>



### **Integrate the Interactive Customs and Tax Systems**

Applying for an export tax rebate is a complex process that entails cooperative work between customs and tax bureaux. In China, however, the customs system and the tax system operate independent of each other, which precludes seamless data synchronisation and delays the declaration of export tax refunds. In keeping with government efforts to optimise the business environment, integrating the interactive systems of customs and tax would make export tax refunds faster and more convenient.

### **Enable Non-resident Taxpayers to Register for VAT in China**

At the time of writing, certain services provided by overseas companies to private individuals in China are not subject to Chinese VAT, while the same services provided by Chinese companies are. On one hand, overseas companies are currently unable to reclaim Chinese input VAT, which creates a disadvantage for overseas companies compared to local ones. On the other hand, the current policies create a disadvantage for Chinese companies compared to overseas ones, as they must pay VAT on the services. To align the VAT position of Chinese companies with overseas companies, the working group recommends allowing non-resident taxpayers to register for VAT in China, including when they do not have a Chinese legal entity. This would enable overseas entities to claim back Chinese input VAT.

### **Allow All Taxpayers to Claim the Input VAT Incurred on Loan Interest**

The VAT reductions and preferential tax treatment implemented in April 2019 are aimed at reducing tax costs, promoting capital investment and spurring production upgrades to facilitate economic restructuring.<sup>16</sup> Companies often rely on loans for R&D, and related financing costs become a significant business expense. Further expansion of VAT deductions, therefore, should include the interest as well as other expenses related to corporate loan services. This way, while the state reduces business operating costs, enterprises will also be incentivised to increase production and R&D investment.

<sup>16</sup> *Bulletin on Policies of Further VAT Reform ([2019] No. 39)*, MOF, STA and GACC, 21<sup>st</sup> March 2019, viewed 7<sup>th</sup> April 2022, <<http://www.chinatax.gov.cn/n810341/n810755/c4160283/content.html>>

### **Allow Qualified Agencies to Issue Special VAT Invoices**

*Bulletin [2019] No. 39* stipulates that the input VAT associated with passenger transportation can be deducted.<sup>17</sup> However, both the collection and the handling of qualified transportation tickets with a passenger's identity constitute a significant administrative burden. As large companies often book business travel through service agents, claiming input VAT on passenger transportation requires travel agents and taxpayers not only to collect qualified transportation tickets jointly, but also to handle special scenarios, such as changed or cancelled itineraries. High volumes of travel transactions demand considerable resources and effort. Paper-ticket management, moreover, generates tremendous paper waste and runs counter to recent VAT cost reduction benefits such as streamlining and lowering rates. To mitigate such procedural burdens, service agents should be able to issue special VAT invoices, or e-VAT invoices, for specific passenger transportation.

### **Eliminate the Double VAT Taxation Issue for On-balance-sheet Asset-backed Securitisation (ABS)**

Based on *VAT Issues Related to Asset Management Products (Caishui [2017] No. 56)*, hereinafter *Circular 56*, starting from 1<sup>st</sup> January 2018, asset managers shall be the VAT taxpayer in relation to VAT taxable activities that occur during the operation of the asset management products. For on-balance-sheet ABS, interest collected from borrowers whose contracts are the ABS's underlying assets is still recognised as revenue on the profit and loss statement of the originator (entities that create a securitised financial asset), and is hence subject to VAT on the originator's side. Meanwhile, when the same interest amount is transferred to the trust company (asset manager), it will be also subject to VAT from the trust company's side to comply with *Circular 56*. For originators, issuing on-balance-sheet ABS is important to diversify financing methods to ensure adequate liquidity under different market conditions. The double VAT taxation has increased funding costs, which has a negative impact on the business development of originators.

### **Allow Negative VAT Taxable Income of Financial Products to be Carried Forward to the Next Year**

According to the current regulation, the difference

<sup>17</sup> *Ibid.*



between the buying and selling prices of financial products is subject to VAT. The negative amount can be carried forward to the next quarter, but not to the next year, which means that if such negative amounts are incurred in the last quarter of the year, they will be forfeited, even if VAT has been paid for the positive amount in the previous quarters of the same year. This has a detrimental impact on businesses, as it generates uncertainty and unfairness, and is less beneficial than the situation prior to the VAT reform, when taxpayers could apply for business tax refunds under the same scenario.

### Recommendations

- Introduce bad debt relief treatment for VAT purposes.
- Clarify the Chinese VAT place-of-supply rules in the draft VAT Law.
- Include more detailed provisions to define how a supply would be treated as out-of-scope, VAT exempt or zero-rated.
- Expand the scope of zero-rating and provide clear guidance on the application thereof to mitigate administrative burdens.
- Integrate the interactive customs and tax systems.
- Enable non-resident taxpayers to register for VAT in China.
- Allow all taxpayers to claim the input VAT incurred on loan interest.
- Allow qualified agencies to issue special VAT invoices.
- Eliminate the double VAT taxation issue for on-balance-sheet ABS.
- Allow negative VAT taxable income of financial products to be carried forward to the next year.

## 3. Take Prudent Steps in Consumption Tax Reform

### Concern

Because consumption tax regulations fail to adequately reflect China's current economic development and consumer habits—as evidenced by the scope, tax base and tax collection channels—tax reform should be prudently assessed and designed.

### Assessment

China first imposed consumption tax in 1994 on a selection of products, many of which were aligned with

how excise duty was imposed in other countries.<sup>18</sup> Over the last three decades, consumption tax has been reformed several times to reflect China's economic development and to guide consumer behaviour. For instance, in 2015, China introduced consumption tax on certain types of batteries and paint with a view to curb their usage, as these products could have a negative impact on the environment.<sup>19</sup> In December 2019, the draft Consumption Tax Law was released for public consultation.<sup>20</sup> While these developments are welcomed, further reforms should be implemented to adequately reflect China's economic development. Increasing efficiency and equality should be prioritised in these reforms, especially when increasing equality in this regard would support China's goal of common prosperity.

Compared to the existing provisional consumption tax rules, one significant update is the indication from the State Council that a pilot reform is to be implemented for consumption tax. The pilot reform programme is introduced in detail in document *Guo Fa [2019] No. 21*,<sup>21</sup> which stipulates that it is to be applied to a selective list of sectors to adjust the tax scope, tax rates and taxation points. The main purpose is for, under the premise of controllable collection and management, some existing consumption tax items at the production (import) stage to be gradually moved down to the wholesale or retail stages. In so doing, it is expected to elevate local revenue sources and improve local consumption. However, to date, there is no clear timetable to guide the progress of this pilot programme, nor a list of items that will be included in the pilot, although high-end watches and jewelry are mentioned as examples in the *Guo Fa [2019] No. 21*.

Previous rounds of the consumption tax reform were accompanied by little to no transition period from the old to new policy. This causes companies a great deal of uncertainty as they do not know if or when their

<sup>18</sup> *Interim Regulations on Consumption Tax of the PRC (Revised)*, State Council, 10<sup>th</sup> November 2008, viewed 27<sup>th</sup> June 2022, <[http://www.gov.cn/zwqk/2008-11/14/content\\_1149528.htm](http://www.gov.cn/zwqk/2008-11/14/content_1149528.htm)>

<sup>19</sup> *Notice on New Consumption Tax of Battery Coating*, MOF and STA, 26<sup>th</sup> January 2015, viewed 10<sup>th</sup> April 2022, <<http://www.chinatax.gov.cn/n810341/n810755/c1489741/content.html>>

<sup>20</sup> *Call for Comments on the Consumption Tax Law of the PRC (Draft for Comments)*, MOF and STA, 3<sup>rd</sup> December 2019, viewed 10<sup>th</sup> April 2022, <<http://www.chinatax.gov.cn/chinatax/n810356/n810961/c5140457/content.html>>

<sup>21</sup> *State Council Notice on the Issuance of Adjustment of Revenue Division Reform between the Central and Local Governments after the Implementation of Larger Tax Cuts and Fee Reductions*, State Council, 26<sup>th</sup> September 2019, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2019-10/09/content\\_5437544.htm](http://www.gov.cn/zhengce/content/2019-10/09/content_5437544.htm)>



products will be impacted, which makes it difficult for them to perform accurate stock management and planning. For example, for high-end consumer goods that have a longer sales cycle compared to fast-moving consumer goods, it may take years between a batch of those goods being imported and the same batch being sold. In other words, if a batch of goods is imported before the consumption tax pilot reform takes effect, consumption tax will be paid when it is processed by customs (this portion of tax revenue goes directly to the national treasury), and if the reform/pilot reform launches before the entire batch is 'consumed' at retail points, the remaining goods will have to be taxed again individually (this part of the tax revenue goes to the local tax office). In other words, the same batch of goods would be subject to double consumption taxation. The additional consumption tax would be adjusted into the retail price, thereby transferring the additional cost to consumers, which would be damaging to sales revenues and would ultimately make the Chinese market less competitive and attractive for foreign investment.

The working group therefore recommends a clear timetable, along with a reasonable transition period for the pilot programme, be provided as soon as possible to allow companies to adjust accordingly. The working group further recommends that, in amending the draft Consumption Law, underlying problems in the national and local tax systems be addressed in order to introduce a new set of clear and effective measures and systems for consumption tax collection.

For example, *Public Notice [2012] No. 47* and *Public Notice [2013] No. 50* levy consumption tax on refined oil products (ROPs),<sup>22&23</sup> which risks not only crippling the competitiveness of the petrochemical industry in China, in light of how high the tax rate is (for example, based on sales volume, the tax imposed on naphtha at the time of writing is Chinese yuan (CNY) 2.4 per tonne, including 12 per cent surcharges), but also lowering tax compliance due to rising costs. Expert involvement is necessary in clarifying the principles underpinning consumption tax on ROPs, since it is international practice that hydrocarbons used as feedstock in the

production of petrochemical products are consumption-tax exempt.

Petrochemical products can also be subject to double taxation. Under current consumption tax rules, there exists no proper sub-code to categorise chemical products; as a result, while some domestically-produced chemical products are consumption-tax exempt, the same types of products imported from overseas are not. This discrepancy in tax treatment affects numerous chemical product categories, including light white oil, heat-conducting oil and insulating oils. According to the prevailing consumption tax deduction policy, when taxpayers purchase taxed raw materials to be used in the continuous production of taxable finished goods, only the consumption tax paid on prescribed raw materials can be deducted in the consumption tax calculation for finished goods. This means that non-listed raw materials would be subject to double consumption tax.

The working group also recommends that the tax threshold on certain goods be re-assessed and re-adjusted to ensure it is in line with the economic development of the country.

Finally, regarding low-carbon and circular economy policies, the working group urges efforts to speed up the implementation of green transformation principles (for example, re-use of plastic waste as a raw material) through tax incentives.<sup>24&25</sup> This could include consumption tax exemption on ROPs made from recycled waste plastic and 100 per cent VAT refunds on ROPs or chemical products made from waste plastics.

### Recommendations

- Involve experts in discussions on standards and measurements and, where necessary, re-determine the scope of taxation.
- Publish in a timely manner the timetable and implementation rules for the various sectors enlisted in the pilot programme of the Consumption Tax Law reform and provide a sufficient transition period for companies to adjust.

24 For more details on plastic wastes recycling, see: *Environment Working Group Position Paper 2022/2023*, p. 42.

25 In the European Chamber's *Carbon Neutrality* report, 22 per cent of respondents hoped to receive tax incentives for decarbonisation initiatives: *Carbon Neutrality: The Role of European Business in China's Race to 2060*, European Union Chamber of Commerce in China, p. 8, 25<sup>th</sup> May 2022, viewed 20<sup>th</sup> June 2022, <[https://www.europeanchamber.com.cn/en/publications-archive/974/Carbon\\_Neutrality\\_The\\_Role\\_of\\_European\\_Business\\_in\\_China\\_s\\_Race\\_to\\_2060](https://www.europeanchamber.com.cn/en/publications-archive/974/Carbon_Neutrality_The_Role_of_European_Business_in_China_s_Race_to_2060)>

22 *Notice on Consumption Tax-related Policies*, STA, 6<sup>th</sup> November 2012, viewed 10<sup>th</sup> April 2022, <<http://www.chinatax.gov.cn/n810341/n810765/n812151/n812386/c1082513/content.html>>

23 *Notice on Supplementary Provisions on Issues Relating to Consumption Tax Policies ([2013] No. 56)*, STA, 9<sup>th</sup> September 2013, viewed 10<sup>th</sup> April 2022, <<http://www.chinatax.gov.cn/n810341/n810755/c1148574/content.html>>



- Improve the effectiveness of the nationwide tax system and synchronise tax systems at central and local levels.
- Review the applicable tax threshold, tax rates and taxation method to facilitate the macro-development strategies of specific industries, in line with China's consumption reality and to better reflect international best practices.
- Implement unified direct exemption treatment for all ROPs (including naphtha) purchased, regardless of source (domestic or import), as feedstock to produce chemical products without restrictions.
- Provide financial and tax incentives to encourage companies to invest in chemical recycling, such as exemption from consumption tax on ROPs made from recycled waste plastic and full VAT refunds on ROPs or chemical products made from waste plastics.

#### 4. Introduce Tax and Fiscal Measures to Encourage Automation and Further Develop Digital Infrastructure

##### Concern

Despite the deployment of numerous technologies over the past few years, the Chinese tax system remains below par in terms of digitalisation compared to other government departments in China and tax administrations around the world.

##### Assessment

The Chinese tax authorities have adopted sweeping reforms in recent years and made considerable progress in modernising the national tax system. Nevertheless, efforts to digitalise the tax system still lag behind other government departments in China, as well as other jurisdictions. Research has consistently shown a strong link between the adoption of digital technologies and improvements in the overall business environment.<sup>26</sup> In this regard, the digitalisation wave brought by COVID-19 clearly demonstrated the important role that robust digital infrastructures play in enabling operational efficiency and contactless transactions.

While the tax authorities have consistently expanded online procedures in recent years, there are still

<sup>26</sup> *Uncovering the Connection Between Digital Maturity and Financial Performance*, Deloitte, 26<sup>th</sup> May 2020, viewed 12<sup>th</sup> April 2022, <<https://www2.deloitte.com/us/en/insights/topics/digital-transformation/digital-transformation-survey.html>>

numerous processes and tasks that require in-person submission or verification. Most local tax offices in China are routinely crowded, leading to inefficiencies and paper-processing delays. Regulators are therefore advised to review the full range of taxation processes and, where possible, adopt interventions to perform current in-person tasks online. For example, hard-copy documents and signature are still often required in fiscal filings, both of which can be replaced by uploading scanned documents or electronic signatures. The working group recommends that the tax authorities set creating a fully automated system for tax administration processes as a goal, similar to other government departments in China that are already striving toward digitalisation.

China has one of the most standardised invoicing systems in the world (*fapiao*). While this standardisation can create complexities, it also provides opportunities for efficiency and data collection where automation and digitalisation are achieved. Electronic invoicing (*e-fapiao*) was introduced into the Chinese tax system in 2015, although currently both paper and e-fapiao co-exist, a hybrid system that leads to inconsistencies.<sup>27</sup> While electronic invoicing of some key industries has been piloted, the roll-out has been slow and inconsistent. As full adoption of electronic invoicing would allow China to dramatically improve the tax filing environment and create business opportunities, the working group suggests this be implemented as soon as possible.

##### Recommendations

- Provide tax incentives for companies to invest in digital infrastructure such as hardware and software, as well as more advanced automation.
- Review tax filings and other financial procedures to focus efforts on the development of the digital economy.
- Accelerate the adoption of electronic invoicing.

#### 5. Enhance Administrative and Organisational Efficiency for Multinational Companies (MNCs) Investing in China

##### Concern

Although China intends to offer a modern investment

<sup>27</sup> *China Starts to Issue Special VAT E-invoices to New Taxpayers*, STA, 4<sup>th</sup> February 2021, viewed 12<sup>th</sup> April 2022, <<http://www.chinatax.gov.cn/eng/c101269/c5161519/content.html>>



environment to foreign investors, companies still face inefficiencies in tax administration.

### Assessment

Modern China is increasingly in competition with neighbouring investment locations for manufacturing, establishment of regional headquarters and R&D. This has led China to make strong commitments to develop a modern and competitive investment environment. From a tax perspective, apart from tax incentives, this should also include increasing administrative efficiency. Multinational investors in China commonly maintain multiple legal entities spread over different domestic locations to serve the market, while carefully evaluating the administrative and real costs of doing so.

Per current CIT regulations in China, each legal entity has to file its own annual CIT return, with CIT being separately assessed and levied regardless of all legal entities belonging to the same group of companies. However, many other jurisdictions offer consolidated CIT regimes that allow companies within the same group to file a consolidated annual return and pay CIT on that basis. This helps reduce administrative efforts and eliminates complexities around transfer pricing within the company group. Such a concept may well fit into the Chinese Holding Company (CHC) regime. The working group therefore recommends allowing consolidated CIT filing for CHCs with their wholly-owned subsidiaries in China.

Per current VAT regulations, official VAT invoices (*fapiao*s) can only be issued within the jurisdiction of the tax authority in-charge. For groups of companies in China, this implies that each legal entity must maintain separate invoicing capability. This is inefficient for companies and contradicts the strategy to centralise administrative services. Given the national character of VAT, as well as the trend towards electronic invoicing, the working group recommends allowing consolidated handling of VAT invoices on a nationwide basis.

For MNCs with a multitude of legal entities and huge quantities of transactions between them, arranging reasonable intercompany prices is an administrative challenge, involving careful arrangement, regular adjustments and appropriate documentation. Where the taxable profit of legal entities deviates from the benchmarked target range, reasonable adjustments have to be applied in line with international and Chinese

tax principles. In China, additional complexity arises through the combination of tax implications as well as payment approval restrictions, in particular in the area of non-trade payments. The working group recommends implementing further guidance on how different types of transfer pricing adjustments should be treated for VAT purposes, as well as opening a respective channel for payment approval.

Given the importance of cash in business, multinational investors need flexibility to move cash according to business needs among their legal entities both within China and across borders. In China, two aspects in particular restrict efficient cash allocation within company groups: the application of VAT on interest charges (without availability of input credit); and the tightly-restricted framework of intercompany loans and cash pools, both within China and across borders. The working group recommends increasing the flexibility for intercompany financing, both within China and across borders.

Where investors maintain multiple legal entities, changes in the business environment may need to be reflected in the legal entity structure within the company group, for example, through mergers, splits, share transfers or similar activities, but also with regard to relocation from one location to the other within China. Relocations of legal entities within China typically fall between the competence of the authorities of the old and new locations. Therefore, the working group recommends the promulgation of further guidance in this regard. In cases of legal entity restructurings, even when assets remain within the group of companies, tax implications can be severe and prohibitive while preconditions for tax-deferred treatment are demanding and ambiguous. Therefore, the working group recommends publishing further guidance on unclear preconditions as well as opening further restructuring scenarios under tax-deferral treatment like upstream and side-stream transfers of shares within the group, both domestic and cross-border.

### Recommendations

- Allow consolidated CIT filing for CHCs with their wholly-owned subsidiaries in China.
- Allow consolidated handling of VAT invoices for companies within a company group.
- Implement further guidance on VAT treatment for transfer pricing adjustments and open a respective



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channel for payment approval.

- Increase flexibility for intercompany financing within China and across borders.
- Facilitate corporate restructurings and relocations within China through further guidance on preconditions and implications.

## Abbreviations

ABS	Asset-backed Securitisation
CAS	Chinese Accounting Standards
CHC	Chinese Holding Company
CIT	Corporate Income Tax
CNY	Chinese Yuan
GACC	General Administration of Customs of People's Republic of China
IP	Intellectual Property
MNC	Multinational Corporation
MOF	Ministry of Finance
R&D	Research and Development
ROP	Refined Oil Products
STA	State Taxation Administration
VAT	Value-added Tax



## Human Resources Working Group

### Key Recommendations

#### 1. Enhance Workforce Flexibility and Modernise Chinese Labour Laws



- Update the current Labour Law and related regulations in order to provide clear guidelines on work-from-home obligations and responsibilities.
- Allow employers to provide social insurance for employees hired at different locations to facilitate remote working.
- Apply the same statutory standards to all employees and ensure a uniform interpretation of the law is implemented at different locations.

#### 2. Loosen Cross-border Travel Restrictions

- Enable business trips to China by foreign passport holders without additional travel/visa restrictions.
- Further reduce quarantine periods across the country, especially in major entry ports.

#### 3. Accelerate Full Resumption of Air Transportation for People between China and the European Union (EU)

- Accelerate full resumption of air transportation and the mobility of people between China and the EU.
- Facilitate a gradual and orderly resumption of international traffic to pre-COVID levels, and publish in advance a roadmap of border opening under different circumstances that will be consistent nationwide.

#### 4. Enhance the Development of Practical Knowledge, Soft Skills and Access to Vocational Training Institutions

- Create curricula that include both state-of-the-art technical training and the soft skills necessary to thrive in the digital era, sharing best practices between Chinese and European institutes through pilot programmes.
- Invest in collaboration between education and business stakeholders, both in China and in Europe, to integrate teaching activities with practical training in accordance with China's and the United Nations' development goals.
- Set up a more transparent mechanism to allow European companies in China access to talent from local vocational institutions and to participate in vocational training programmes.

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



- Enhance the 2019 Overall Plan and support the Human Rights Action Plan by building a partnership between employers, non-governmental organisations and government to establish a job-search website where vacancies and training opportunities specifically suited to people



with disabilities can be posted.

- Allow employers to hire people with disabilities on three to six-month-long training programmes with no adverse termination costs if no employment contract is offered at the end of the programme (in exchange for a certificate of training competition), or other flexible hiring options.
- Provide incentives to employers, such as reduced taxes or access to funds to support training programmes and facility modifications, to encourage the hiring of people with disabilities.
- Adopt the Shenzhen model for Disability Fund contributions by reducing the basis from twice the average wage to 60 per cent of the average wage to reduce the financial burden on businesses.
- Adopt a more transparent approach to the collection and use of the Fund.

## Introduction to the Working Group

Through nurturing people and effectively managing labour relations, human resources (HR) departments play a critical role in engaging the workforce to increase business capacity, particularly amid major disruptions. HR departments have also come to play an increasingly important role in such areas as corporate social responsibility, sustainability and workplace ethics. At the same time, today's rapid technological innovation and socio-economic changes require greater adaptability from employees for companies to get ahead in an ever more dynamic work environment.

The Human Resources Working Group represents European companies employing hundreds of thousands of people who contribute to tax and social security funds in China. The working group aims to provide a platform for exchanging information, experiences and best practices among member companies, as well as to promote awareness of HR issues by facilitating an open dialogue with enterprises and relevant Chinese authorities. The working group tracks labour-related policies and advocates for initiatives that advance organisational development, improve the health and well-being of staff, and strengthen stakeholder collaboration, in an effort to contribute to China's development goal of creating more employment opportunities in a stronger national economy.

## Recent Developments

### International Travel Restrictions

China closed its borders to foreigners holding valid visas or residence permits on 28<sup>th</sup> March 2020 as a

COVID-19 prevention and control measure,<sup>1</sup> with entry policies updated repeatedly in accordance with evolving local measures. While international travel restrictions both enhanced public health protection and enabled an effective recovery from the initial outbreak of COVID-19 in China, they have also brought unprecedented labour mobility challenges, affecting the operations of foreign-invested enterprises (FIEs) whose employees, stranded overseas, cannot return to or join their China assignments. This has led to some foreign staff having to be stationed elsewhere by headquarters, giving up on the possibility of coming back to China altogether. Others left China because they no longer wanted to be separated from their families and loved ones indefinitely. These are unfavourable outcomes for China as well as businesses, considering that many of these foreign experts have spent years developing a strong understanding of the language and culture.<sup>2</sup>

Effective from 6<sup>th</sup> June 2022, PU invitation letters are no longer required for employees already holding a work permit or notice and their relatives. Starting from 28<sup>th</sup> June 2022, people who plan to resume work and production in China (including economy, trade, education, science, technology, sports, culture and other fields) also no longer need to provide PU invitation letters from relevant Chinese authorities when applying

<sup>1</sup> *Announcement on the Temporary Suspension of Entry by Foreign Nationals Holding Valid Chinese Visas or Residence Permits*, Ministry of Foreign Affairs (MFA), 26<sup>th</sup> March 2020, viewed 21<sup>st</sup> June 2022, <[https://english.www.gov.cn/statecouncil/ministries/202003/27/content\\_WS5e7d34cfc6d0c201c2cbf8c6.html](https://english.www.gov.cn/statecouncil/ministries/202003/27/content_WS5e7d34cfc6d0c201c2cbf8c6.html)>

<sup>2</sup> *European Chamber Stance on Further Restrictions on the Return of Legal Residents to China*, European Union Chamber of Commerce in China, 3<sup>rd</sup> November 2020, viewed 21<sup>st</sup> June 2022, <[https://www.eurochamber.com.cn/en/press-releases/3283/chamber\\_lauds\\_latest\\_change\\_in\\_foreign\\_national\\_returnee\\_policy\\_now\\_looks\\_to\\_students](https://www.eurochamber.com.cn/en/press-releases/3283/chamber_lauds_latest_change_in_foreign_national_returnee_policy_now_looks_to_students)>





for short-term business travel visas.

### COVID-19 Vaccinations

Since the authorisation of domestically-developed vaccines by the National Medical Products Administration (NMPA),<sup>3</sup> European businesses have requested greater transparency regarding the inclusion of their foreign staff in China's COVID-19 vaccination implementation programme, as well as if and how vaccinations would impact international travel.<sup>4</sup> When vaccinations were rolled out in early 2021, there was a delay before any were made available to foreign nationals. This situation was repeated when booster shots started to be dispensed in late 2021. While some cities have released notices for online registration for booster shots, this is not uniform throughout China. In addition, some locations have waiting lists of up to 30 days or more for booster shots.

In June 2022, several overseas Chinese embassies released the *Notice on Adjusting Visa Application Procedures for Foreign Nationals into China*,<sup>5</sup> announcing that travellers inoculated with Chinese vaccines or World Health Organization (WHO)-accredited vaccines can apply for a visa to China. The working group is pleased to see the inclusion of WHO-accredited vaccines and recommends that the Chinese authorities reduce the quarantine time for suitably vaccinated travellers.

In April 2021, Chinese officials announced plans to approve China's first foreign COVID-19 vaccine by July 2021, in a collaboration between German biotechnology company BioNTech and Shanghai Fosun Pharmaceutical Group Co. On 10<sup>th</sup> May 2022, BioNTech confirmed that the Phase II clinical trial of messenger ribonucleic acid (mRNA) vaccine NOVEL was completed. However, as of July 2022, the mRNA vaccination has still not been approved for use. The European Chamber recommends permitting the best mix of vaccinations and boosters to be used in China: in a survey published by the European Chamber in May

2022, 82 per cent of respondents stated they supported the usage of mRNA vaccines.<sup>6</sup>

### 14<sup>th</sup> Five-year Plan (14FYP)

Released in March 2021, the 14FYP calls for the deepening of the cooperation of industry sector and education, broadening the use of employment subsidies and expanding enrolment in vocational colleges to support the development of talent and provide equitable job opportunities.<sup>7</sup> The *Government Work Report* in 2021 and 2022 likewise called for further educational reform, particularly in developing more equitable and higher-quality education.<sup>8</sup>

### Private Data Protection

The Personal Information Protection Law took effect on 1<sup>st</sup> November 2021,<sup>9</sup> and poses considerable challenges for HR management in terms of processing employees' personal information. Companies must notify employees on how their personal information will be processed as well as their legal rights in relation to their own data, and obtain their consent for processing, with the exception of personal information necessary for the performance of employment contracts or for HR management purposes as set out in the company rules. Regarding personal information of a sensitive nature, if a company needs to provide the personal information of employees to a third party, the company may need to obtain the employees' specific consent. In addition, to export employees' personal information outside of China, a company must comply with mandatory requirements such as undergoing an administrative security assessment, getting certified as having providing adequate personal information protection, and drawing up contracts with overseas recipients on usage of the information, among others.

3 State Food and Drug Administration Conditionally Approved Beijing Kexing Zhongwei Biotechnology Co, Ltd New Coronavirus Inactivated Vaccine (Vero Cell) Registration Application, NMPA, 6<sup>th</sup> February 2021, viewed 10<sup>th</sup> April 2022, <<https://www.nmpa.gov.cn/yaowen/ypjgyw/20210206154636109.html>>

4 European Chamber Stance on COVID-19 Vaccine, European Union Chamber of Commerce in China, 10<sup>th</sup> February 2021, viewed 2<sup>nd</sup> April 2022, <[https://www.eurochamber.com.cn/en/press-releases/3325/european\\_chamber\\_stance\\_on\\_covid\\_19\\_vaccine](https://www.eurochamber.com.cn/en/press-releases/3325/european_chamber_stance_on_covid_19_vaccine)>

5 Notice on Adjusting Visa Application Procedures for Foreign Nationals into China, Chinese Embassy in Germany, 10<sup>th</sup> June 2022, viewed 16<sup>th</sup> June 2022, <[http://de.china-embassy.gov.cn/chn/sgyw/202206/t20220610\\_10701726.htm](http://de.china-embassy.gov.cn/chn/sgyw/202206/t20220610_10701726.htm)>

6 European Chamber Flash Survey, COVID-19 and The War in Ukraine: The Impact on European Business in China, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 21<sup>st</sup> June 2022, <<https://www.eurochamber.com.cn/en/publications-archive/973>>

7 Outline of the 14<sup>th</sup> Five-year Plan for National Economic and Social Development of the People's Republic of China and the Long-term Vision for 2035, State Council, 13<sup>th</sup> March 2021, viewed 21<sup>st</sup> June 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592681.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm)>

8 Government Work Report, State Council, 5<sup>th</sup> March 2021, viewed 5<sup>th</sup> July 2022, <[http://www.gov.cn/guowuyuan/2021zfgzbg.htm?ivk\\_sa=1024320u](http://www.gov.cn/guowuyuan/2021zfgzbg.htm?ivk_sa=1024320u)>; Full Text: Report on the Work of the Government, Xinhua, 12<sup>th</sup> March 2022, viewed 9<sup>th</sup> July 2022, <[https://english.www.gov.cn/premier/news/202203/12/content\\_WS622c96d7c6d09c94e48a68ff.html](https://english.www.gov.cn/premier/news/202203/12/content_WS622c96d7c6d09c94e48a68ff.html)>

9 Personal Information Protection Law, National People's Congress of the People's Republic of China (NPC), 1<sup>st</sup> November 2021, viewed 21<sup>st</sup> June 2022, <<http://www.npc.gov.cn/npc/c30834/202108/a8c4e3672c74491a80b53a172bb753fe.shtml>>





## Leave for Employees' Supporting Families

On 31<sup>st</sup> May 2021, the Chinese Government relaxed its birth control policy again, allowing each couple to now give birth to up three children. Accordingly, based on the amended Population and Family Planning Law, effective 20<sup>th</sup> August 2021,<sup>10</sup> many local governments updated their regulations to grant employees extended maternity leave, as well as parental leave and parent caring leave. Implementation of the leave is subject to local regulations and company rules.

## Key Recommendations

### 1. Enhance Workforce Flexibility and Modernise Chinese Labour Laws

#### Concern

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

#### Assessment

Home office and hybrid working modes are not sufficiently addressed in China's current labour laws and regulations. This leads to uncertainties in workplaces, especially when there are new waves of COVID-19 outbreaks. There is no clear legal basis yet that can be followed by employers that need or want to arrange for employees to work from home in a flexible way. Employees may encounter frequent instructions to work-from-home, a long-term shift to remote work, faster adoption of automation in the workplace and pressure to develop new skills to match, without any indication of their rights—or obligations—on these issues.

Further, the current Social Insurance Law only allows employers to provide social insurance for employees at the locations where the enterprise's business units are established.<sup>11</sup> Therefore, expanding business to other locations in China is difficult, because in order to hire one or two employees in a particular location, an

employer has to set up a business unit there, which will be very costly if remote working is adopted.

In addition, current regulations contain misleading wording that do not adequately reflect recent legislative developments. For example, the Labour Law (revised 2018) still refers to a forty-four-hour week in spite of forty hours now being the standard.<sup>12</sup> The Labour Law also stipulates a sixty-day deadline for filing a labour dispute, although the Labour-dispute Mediation and Arbitration Law (2008)<sup>13</sup> provides for a one-year deadline. Interpretation of the Labour Law also differs across cities in China; for example, the Shanghai Higher People's Court allows an employer to terminate employment without specifying a reason after the expiry of the second fixed-term contract, whereas the Beijing Higher People's Court expressly denies the employer this very right.

Furthermore, in light of the significant average salary increases in China over the past few years,<sup>14</sup> and to avoid unfair economic results, the Human Resources Working Group recommends that the 12-year cap on severance payments in the Labour Contract Law (revised 2013) be applied to all salary levels,<sup>15</sup> and that the calculation of severance payment upon termination of employment be unified nationwide.

#### Recommendations

- Update the current Labour Law and related regulations in order to provide clear guidelines on work-from-home obligations and responsibilities.
- Allow employers to provide social insurance for employees hired at different locations to facilitate remote working.
- Apply the same statutory standards to all employees and ensure a uniform interpretation of the law is implemented at different locations.

10 Population and Family Planning Law, NPC, amended on 20<sup>th</sup> August 2021, viewed 21<sup>st</sup> June 2022, <<http://www.npc.gov.cn/npc/c30834/202109/9ab0af08773c465aa91d95648df2a98a.shtml>>

11 Social Insurance Law, State Council, amended 29<sup>th</sup> December 2018, viewed 5<sup>th</sup> July 2022, <[http://www.gov.cn/guoqing/2021-10/29/content\\_5647616.htm](http://www.gov.cn/guoqing/2021-10/29/content_5647616.htm)>

12 Labour Law of the People's Republic of China, NPC, amended on 29<sup>th</sup> December 2018, viewed 5<sup>th</sup> July 2022, <<http://www.npc.gov.cn/npc/c30834/201901/ffad2d4ae4da4585a041abf66e74753c.shtml>>

13 Law of the People's Republic of China on Labor-dispute Mediation and Arbitration, International Labour Organization, 29<sup>th</sup> December 2007, viewed 5<sup>th</sup> July 2022, <<https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/78743/108018/F-268983075/CHN78743%20Eng.pdf>>

14 Estimated to range between six and nine per cent (2010–2020); compiled from Mercer Total Remuneration Surveys and notices released by municipal authorities.

15 Labour Contract Law, Ministry of Human Resources and Social Security, 28<sup>th</sup> December 2012, viewed 5<sup>th</sup> July 2022, <[http://www.mohrss.gov.cn/xxgk2020/fdzdgnr/zcfg/fl/202011/t20201102\\_394622.html](http://www.mohrss.gov.cn/xxgk2020/fdzdgnr/zcfg/fl/202011/t20201102_394622.html)>



## 2. Loosen Cross-border Travel Restrictions



### Concern

The international travel restrictions imposed by the Chinese Government in 2020 to prevent the spread of COVID-19 domestically are still having a significant impact on global mobility and the ability of FIEs to hire and retain international talents.

### Assessment

Even though more than two and a half years have passed since the initial COVID-19 outbreak, and despite the fact that most countries have gradually resumed cross-border travel, the Chinese Government has maintained a strict entry and exit policy. In March 2020, China temporarily suspended the entry of foreign nationals, including those with valid visas and residence permits. In September 2020, the Ministry of Foreign Affairs (MFA) and the National Immigration Administration adjusted their entry-restriction policies, allowing foreign nationals into the country without special visa and PU letter requirements provided that they hold valid residence permits for work, personal matters and reunion purposes issued after 28<sup>th</sup> March 2020.<sup>16</sup> All other foreign nationals, including relatives of foreign nationals who held valid residence permits for work, had to go through the process of obtaining a PU letter issued by the Foreign Affairs Office. The inability of employees and their dependents to return to China has brought considerable challenges to FIEs, many of which have had to suspend cross-border projects in light of China's business travel restrictions.

Since 6<sup>th</sup> June 2022, PU invitation letters are no longer required for two groups of foreign nationals: those applying for Z visa (work visa) and their accompanying foreign family members; and personnel returning to China to resume work (including foreign nationals who have already obtained work authorisation) and their foreign family members. This new policy allows those who have not yet been issued a work permit and their families to enter China. The waiver of the PU letter is welcomed, as it will support the recruitment of overseas talent by enterprises based in China, and the return of those whose work permit expired while they were stranded overseas due to China's COVID-related entry restrictions. Prior to this announcement,

the potential difficulties in implementing family reunion has been a major issue in attracting foreign talent, especially senior experienced managers, to relocate to China, and retaining foreign hires. According to the European Chamber's *Business Confidence Survey 2022*, COVID-19 exacerbates the challenge of attracting and retaining talent. Challenges attracting talent was reported by 58 per cent of respondents, a nine-percentage point increase over the previous year; challenges retaining talent was reported by 42 per cent of respondents, again a nine-percentage point year-on-year increase. In relation to the specific challenges faced when trying to attract and retain international talent, COVID-19-related factors topped the pack. Entry restrictions into China due to COVID-19 and visa/work permit restrictions—documents that have become more difficult to obtain due to additional COVID-19 prevention measures introduced—ranked as the top two issues preventing firms from attracting and retaining international talent.<sup>17</sup>

A China business/trade visa (M visa) is issued to foreigners coming for commercial and trade activities, such as attending trade fairs, visiting clients and factories, negotiating with clients, and signing contracts. Despite the recent relaxations in requirements for Z visas, M visas are still far from easy to obtain. This means business trips between overseas headquarters and China have become an unobtainable corporate luxury for many, which is detrimental to timely and efficient communications between member companies' European headquarters and their China subsidiaries. On 28<sup>th</sup> June, the Chinese embassy in France announced that PU letters are no longer required for business visa applications.<sup>18</sup> This waiver has since been adopted in relation to many European Union (EU) Member States.

On 28<sup>th</sup> June, China announced changes to its pandemic control policy that significantly reduce quarantine times for international travellers, making it easier to enter the country. According to the ninth edition of the State Council's report on COVID-19 epidemic prevention and control, centralised quarantine for incoming travellers to China will be shortened to seven days, followed by

<sup>16</sup> *Announcement on Entry by Foreign Nationals Holding Valid Chinese Residence Permits of Three Categories*, MFA, 23<sup>rd</sup> September 2020, viewed 14<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2020-09/23/content\\_5546462.htm](http://www.gov.cn/xinwen/2020-09/23/content_5546462.htm)>

<sup>17</sup> *Business Confidence Survey 2022*, European Union Chamber of Commerce, 20<sup>th</sup> June 2022, viewed 9<sup>th</sup> July 2022, <<https://www.eurochamber.com.cn/en/publications-business-confidence-survey>>

<sup>18</sup> *Notice on Further Adjustment of Visa Policy to China*, Embassy of the People's Republic of China in France, 28<sup>th</sup> June 2022, viewed 5<sup>th</sup> July 2022, <[http://fr.china-embassy.gov.cn/zgzfg/zsgs/lst/202206/t20220628\\_10711269.htm](http://fr.china-embassy.gov.cn/zgzfg/zsgs/lst/202206/t20220628_10711269.htm)>





three days of home health monitoring (7+3).<sup>19</sup>

The working group is pleased to see such positive steps being taken to reduce international travel restrictions, after having continuously advocated for this at both central and local government levels since the outbreak of the pandemic. However, at the time of writing, the Chinese Government has yet to provide a clear timeline indicating when international travel can fully resume.

#### Recommendations

- Enable business trips to China by foreign passport holders without additional travel/visa restrictions.
- Further reduce quarantine periods across the country, especially in major entry ports.

### 3. Accelerate Full Resumption of Air Passenger Transportation between China and the European Union (EU)

#### Concern

Air traffic has not been fully restored, and the remaining strict travel and quarantine policies for international travellers are obstructing the movement of essential personnel and talent between China and Europe.

#### Assessment

According to Civil Aviation Administration of China (CAAC) data, inbound and outbound international passenger air traffic rates declined by over 80 per cent in both 2020 and 2021.<sup>20</sup> Between January and May 2022, 312 flight ‘circuit breakers’<sup>21</sup> were implemented by the CAAC, reducing the number of inbound international passenger flights during that time by 768.<sup>22</sup> The cancellations were implemented following multiple passengers testing positive for COVID-19 on arrival as China attempted to contain Omicron outbreaks, and affected flights from Europe and other regions.<sup>23</sup> The ‘circuit breaker’ policy is a major hurdle for international

airlines attempting to plan the frequency and routes of flights to and from China.

China’s outbound travel is still extremely limited, and “international flight seat capacity and passenger numbers remain down by 95 percent compared to pre-COVID-19 levels. Government guidance is that all nonessential outbound travel should be avoided.”<sup>24</sup> There are signs that restrictions may be eased: as discussed in the previous Key Recommendation, some major cities have shortened the quarantine periods for inbound or returning passengers.

Internationally, an overwhelming number of countries have already reopened their airspace and borders based on a roadmap of mutual recognition of health information or other specific agreements. In Europe, for example, Iceland, Switzerland, the Netherlands, Denmark, Sweden and Norway abolished nucleic acid testing and vaccination passports in April 2022. The following month, the European Commission announced that passengers cannot be forced to show nucleic acid tests, vaccination certificates or health registration before boarding flights in EU Member States.<sup>25</sup>

Air travel is the only viable transportation option for strengthening business and people-to-people exchanges between the EU and China. Therefore, a lack of smooth flight connections causes market access barriers and high communication costs. In order to facilitate people mobility between China and EU Member States, travel restrictions—including the suspension of work permits or the imposition of visa restrictions—that hinder the resumption of airlines’ normal, scheduled routes between the EU and China, need to be urgently eased by the Chinese authorities.<sup>26</sup>

#### Recommendations

- Accelerate full resumption of air transportation and the mobility of people between China and the EU.
- Facilitate a gradual and orderly resumption of international traffic to pre-COVID levels, and publish in

19 COVID-19 Prevention and Control Protocols (Edition 9) Officially Announced, State Council, 29<sup>th</sup> June 2022, viewed 6<sup>th</sup> July 2022, <[http://www.gov.cn/xinwen/2022-06/29/content\\_5698473.htm](http://www.gov.cn/xinwen/2022-06/29/content_5698473.htm)>

20 Main Production Indicators, CAAC, December 2021, viewed 16<sup>th</sup> May 2022, <<http://www.caac.gov.cn/XXGK/XXGK/TJSJ/202202/P02022021495967458947.pdf>>

21 The ‘circuit breaker’ policy was introduced to penalise airlines that operate flights to China with COVID-19 cases onboard. See: Civil Aviation Administration of China Government Information Disclosure Guidelines, CAAC, viewed 16<sup>th</sup> May 2022, <<http://www.caac.gov.cn/XXGK/>>

22 Civil Aviation Administration: Since 2022, 312 Circuit Breakers have been Implemented, Reducing 768 Inbound Passenger Flights, National Business Daily, 23<sup>rd</sup> May 2022, viewed 17<sup>th</sup> June 2022, <<https://li.ifeng.com/c/8GFwLsg0mHo>>

23 The Civil Aviation Authority issued five circuit breaker orders, CAAC, 4<sup>th</sup> February 2022, viewed 16<sup>th</sup> May 2022, <[http://www.caac.gov.cn/XWZX/MHYW/202202/120220204\\_211455.html](http://www.caac.gov.cn/XWZX/MHYW/202202/120220204_211455.html)>

24 Chen, Guang; Phillips, Matthew; Saxon, Steve & Yu, Jackey, *China’s uneven travel recovery: Long road to international travel furthers domestic opportunities*, McKinsey & Company, 30<sup>th</sup> August 2021, viewed 16<sup>th</sup> May 2022, <<https://www.mckinsey.com/industries/travel-logistics-and-infrastructure/our-insights/chinas-uneven-travel-recovery-long-road-to-international-travel-furthers-domestic-opportunities>>

25 The European Union has announced the lifting of all travel restrictions, Netease News, 21<sup>st</sup> May 2022, viewed 30<sup>th</sup> May 2022, <<https://www.163.com/dy/article/H7RO4NTI05128I5E.html>>

26 For more information on air travel issues, please refer to Key Recommendation 1 of the Aviation and Aerospace Working Group Position Paper 2022/2023.





advance a roadmap of border opening under different circumstances that will be consistent nationwide.

#### 4. Enhance the Development of Practical Knowledge, Soft Skills and Access to Vocational Training Institutions

##### Concern

Due to the technological modernisation of production processes, transition to electric vehicles and the overall digitalisation of manufacturing processes in many industries, there is an increasing need for highly skilled workers, which the labour market currently cannot provide for.

##### Assessment

At the annual Two Sessions in 2021, President Xi Jinping stressed the need to promote educational reforms in the wake of the pandemic, and building a “balanced basic public education service system” to contribute to the country’s high-quality development.<sup>27</sup> In line with this remark, governments at all levels have put additional emphasis on vocational training institutions, in order to boost the modernisation of Chinese manufacturing, contribute to the China Manufacturing 2025 goals,<sup>28</sup> and help China become a major technological power by 2049.

The State Council issued a circular on February 2019 announcing that Chinese vocational schools would meet international advanced levels by 2022.<sup>29</sup> Despite the reform efforts outlined above, such standards have yet to be achieved. As a result, access to skilled labour remains a key challenge for foreign businesses in China, as several reports and surveys carried out by the European Chamber have shown.<sup>30</sup>

The Human Resources Working Group therefore

welcomes the measures included in the revised Vocational Education Law, adopted by the Standing Committee of the National People’s Congress (NPCSC) on 20<sup>th</sup> April 2022.<sup>31</sup> The revised law requires vocational education to adopt a teaching model that features industry-education integration and school-enterprise cooperation. As reflected in the *Human Resources Working Group Position Paper 2021/2022*, the working group agrees with the NPCSC statement that “skilled workers with technical know-how are an important foundation for China’s manufacturing industry and innovation-driven growth”, and that students should be given the opportunities to pursue “all-round physical and intellectual development”.<sup>32</sup>

Many countries encounter similar challenges to China’s in attracting and developing talent in the vocational school setting, due to factors including social stigmas, the low quality of graduates and the fact that graduates on average earn lower pay.<sup>33</sup> The working group sincerely welcome the government addressing this major issue by adopting the Vocational Education Law to enhance the status of vocational education in China.

The amended law also clarifies that “education fee surcharges, local education surcharge reductions and exemptions and other tax incentives will be implemented for enterprises integrating production and education”.<sup>34</sup> The working group sincerely welcome this provision, as it will facilitate in developing practical skills among students and recent graduates. In line with the amended law’s emphasis on “school-enterprise cooperation” in vocational education, European companies in China are willing to contribute to development of the labour market by being included in cooperation schemes and in-depth participation in vocational education programmes.<sup>35</sup> As

27 *Xi Focus: Xi demands building quality, balanced basic public education service system*, *Xinhua*, 6<sup>th</sup> March 2021, viewed 5<sup>th</sup> July 2022, <[http://www.xinhuanet.com/english/2021-03/06/c\\_139789921.htm](http://www.xinhuanet.com/english/2021-03/06/c_139789921.htm)>

28 The initiative’s goals include achieving domestic and international market-share targets in ten industries, attaining self-reliance for key components and turning the concept of ‘indigenous innovation’ into reality. For more details, see: *China Manufacturing 2025: Putting Industrial Policy Ahead of Market Forces*, European Union Chamber of Commerce in China, 7<sup>th</sup> March 2025, viewed 9<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/china-manufacturing-2025>>

29 *State Council encourages vocational education reform*, Ministry of Education, 20<sup>th</sup> February 2019, viewed 7<sup>th</sup> July 2022, <[http://en.moe.gov.cn/news/press\\_releases/201902/t20190214\\_369280.html](http://en.moe.gov.cn/news/press_releases/201902/t20190214_369280.html)>

30 *Business Confidence Survey 2022*, European Union Chamber of Commerce, 20<sup>th</sup> June 2022, viewed 5<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

31 Liang, Xiaohui & Zhang, Su, *The third review of the revised draft of the Vocational Education Law intends to encourage enterprises to hold high-quality vocational education*, Teller Report, 18<sup>th</sup> April 2022, viewed 20<sup>th</sup> April 2022, <<https://www.tellerreport.com/news/2022-04-18-the-third-review-of-the-revised-draft-of-the-vocational-education-law-intends-to-encourage-enterprises-to-hold-high-quality-vocational-education.S1-XlaPqVc.html>>

32 *Top legislator urges more legal support for vocational education development*, NPC, 15<sup>th</sup> April 2022, viewed 20<sup>th</sup> April 2022, <[http://subsites.chinadaily.com.cn/npc/2022-04/15/c\\_744057.htm](http://subsites.chinadaily.com.cn/npc/2022-04/15/c_744057.htm)>

33 *Reform of vocational education sought*, *China Daily*, 21<sup>st</sup> March 2022, viewed 20<sup>th</sup> April 2022, <[http://www.china.org.cn/china/2022-03/21/content\\_78119884.htm](http://www.china.org.cn/china/2022-03/21/content_78119884.htm)>

34 Liang, Xiaohui & Zhang, Su, *The third review of the revised draft of the Vocational Education Law intends to encourage enterprises to hold high-quality vocational education*, Teller Report, 18<sup>th</sup> April 2022, viewed 20<sup>th</sup> April 2022, <<https://www.tellerreport.com/news/2022-04-18-the-third-review-of-the-revised-draft-of-the-vocational-education-law-intends-to-encourage-enterprises-to-hold-high-quality-vocational-education.S1-XlaPqVc.html>>

35 Ibid.





part of corporate social responsibility activities and in order to contribute to China's 'common prosperity' goal, European companies in China would like to join forces with state and local enterprises to provide feedback on the types of skills required by various industries, and to set up full-time and part-time positions for vocational education graduates.

The Human Resources Working Group advises Chinese policymakers to equip future leaders with cognitive competencies and an entrepreneurial mindset to navigate the future of work and solve the complex, fast-changing challenges of today by setting up pilot programmes that combine state-of-the-art technical training with the necessary soft skills for talent to thrive in the digital era. Pilot projects could be a platform for sharing best practices between European and Chinese vocational training institutes and to facilitate job placement. In this context, Sino-European cooperative programmes, such as the Sino-German *Bildungswerk der Wirtschaft* initiative in Suzhou and the Sino-French training centre in Haining's industrial park are compelling examples of vocational hubs that blend hands-on education with industry placement, mutually benefitting students as well as enterprises.<sup>36&37</sup>

As a consequence of the increasing digitalisation of work, shortages of skilled workers is becoming a common challenge worldwide. Joining forces and further enhancing pilot projects that allow for joint programmes between Chinese and European institutions and companies, both in China and in Europe, will facilitate mutual learning from best practices in order to contribute to a shared global prosperity in line with the 2030 United Nations (UN) Sustainable Development Goals.

#### Recommendations

- Create curricula that include both state-of-the-art technical training and the soft skills necessary to thrive in the digital era, sharing best practices between Chinese and European institutes through pilot programmes.
- Invest in collaboration between education and business stakeholders, both in China and in Europe, to integrate teaching activities with practical training in

36 *BBW Suzhou*, Bildungswerk der Wirtschaft (BBW) Suzhou, viewed 25<sup>th</sup> May, 2021, <<http://www.bbw-suzhou.com/en/>>

37 *Le Projet de Haining une Opportunité Exceptionnelle pour Votre Implantation en Chine*, Energie7, 2015, viewed 25<sup>th</sup> May 2021, <<https://www.energie7.com/nosservices/le-projet-de-haining/>>

accordance with China's and the UN's development goals.

- Set up a more transparent mechanism to allow European companies in China access to talent from local vocational institutions and to participate in vocational training programmes.

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



### Concern

Companies face multiple challenges when it comes to identifying and hiring disabled people, including access to talent sources, training costs and risks associated with unsuccessful hires.

### Assessment

Companies operating in China are keen to explore new sources of talent, including hiring employees with disabilities.<sup>38</sup> However, accessing those talent pools, alongside the costs associated with training, as well as modifying equipment and buildings to improve accessibility, continue to be barriers for many enterprises.

In 2007, China adopted a mandatory, pro rata system for hiring people with disabilities, whereby companies are obliged to proportionally hire disabled individuals so that they constitute no less than 1.5 per cent of total staff. Enterprises unable to meet the quota must make contributions to the Disabled Persons' Employment Security Fund (Fund) in accordance with the law. While most cities comply with this rate, in 2018, Shenzhen decreased the rate to 0.5 per cent and also lowered the contribution base to 60 per cent of the average annual wage of employees in the previous year, as opposed to the original double the average wage requirement.<sup>39</sup>

In December 2019, the China Disabled Persons' Federation and five ministries jointly announced an 'Overall Plan' to establish a mechanism for sharing information on the employment of disabled persons. The

38 Cheng, Si, *Cost-effective employees changing China's traditional job market*, *China Daily*, 1<sup>st</sup> September 2021, viewed 21<sup>st</sup> June 2022, <[http://english.www.gov.cn/news/topnews/202109/01/content\\_WS612eea7ac6d0df57f98df79e.html](http://english.www.gov.cn/news/topnews/202109/01/content_WS612eea7ac6d0df57f98df79e.html)>

39 *Measures of Shenzhen Municipality for the Administration of Collection and Use of Employment Security Funds for Disabled Persons*, Shenzhen Government, 23<sup>rd</sup> April 2018, viewed 16<sup>th</sup> May 2022, <[http://www.sz.gov.cn/zfgb/zcjd/content/post\\_4981685.html](http://www.sz.gov.cn/zfgb/zcjd/content/post_4981685.html)>





aim is to improve the quality of occupational training for disabled employees, and to formulate policies for the integration of disabled hires into the regular workforce. However, employers still need better access to government agencies and other organisations providing training and resources to people with disabilities in order to recruit hires, as well as to provide information on skills requirements. Additionally, the Human Rights Action Plan of China (2021–2025) has pledged to:

- create 500,000 urban jobs for disabled people by 2025;
- offer occupational training for two million disabled people in rural and urban areas;
- create an employment counselling system; and
- improve accessibility and work facilities to accommodate people with disabilities.<sup>40</sup>

European Chamber member companies are eager to support this initiative and work with the Chinese Government and non-governmental organisations to ensure the goals are reached.

### Recommendations

- Enhance the 2019 Overall Plan and support the Human Rights Action Plan by building a partnership between employers, NGOs and government to establish a job-search website where vacancies and training opportunities specifically suited to people with disabilities can be posted.
- Allow employers to hire people with disabilities on three to six-month-long training programmes with no adverse termination costs if no employment contract is offered at the end of the programme (in exchange for a certificate of training completion), or other flexible hiring options.
- Provide incentives to employers, such as reduced taxes or access to funds to support training programmes and facility modifications, to encourage the hiring of people with disabilities.
- Adopt the Shenzhen model for Disability Fund contributions by reducing the basis from twice the average wage to 60 per cent of the average wage to reduce the financial burden on businesses.
- Adopt a more transparent approach to the collection and use of the Fund.

<sup>40</sup> Li, Lei, *500,000 jobs to be created for disabled*, *China Daily*, 15<sup>th</sup> September 2021, viewed 5<sup>th</sup> July 2022, <[http://english.www.gov.cn/statecouncil/ministries/202109/15/content\\_WS61412751c6d0df57f98e02c3.html](http://english.www.gov.cn/statecouncil/ministries/202109/15/content_WS61412751c6d0df57f98e02c3.html)>

## Abbreviations

CAAC	Civil Aviation Administration of China
EASA	European Aviation Safety Agency
EU	European Union
FIE	Foreign-invested Enterprises
HR	Human Resources
MFA	Ministry of Foreign Affairs
mRNA	Messenger Ribonucleic Acid
NMPA	National Medical Products Administration
NPC	National People's Congress
UN	United Nations
WHO	World Health Organisation





# Intellectual Property Rights Working Group

## Key Recommendations

### 1. Patents

#### 1.1 Exclude Chinese Patent Applications and Patent Assignments from Technology Exports and Simplify Overall Procedures 3

- Amend the *Regulations on the Administration of the Import and Export of Technology* to exclude Chinese patent applications or patent assignments from technology export by deleting “patent assignment” and “patent application assignment” from Article 2.2.
- In the China National Intellectual Property Administration’s (CNIPA’s) new *Guidelines for Patent Examination*, exclude Chinese patent applications and patent assignments from technology export.

### 2. Trademarks

#### 2.1 Consider Internet Activity and Accessibility from the Chinese Market in the Determination of Pre-emptive Registration in Bad Faith 3

- Consider internet activity and accessibility by the Chinese market when determining pre-emptive registration in bad faith.

#### 2.2 Lower the Burden of Proof Required to Show Bad Faith in Accordance with the Degree of Distinctiveness of the Trademark to be Protected 2

- Lower the burden of proof required to show bad faith in accordance with the degree of distinctiveness of the trademark to be protected.

#### 2.3 Ensure that Protection of a Trademark is Conditioned by Its Use

- Introduce in the Trademark Law a new provision establishing that, except during the first three years post-registration, protection of a trademark is conditioned by its use.
- Create a mechanism allowing the Trademark Review and Adjudication Department under the Trademark Office of the CNIPA, when assessing an application for trademark refusal review, to request that registrants of cited trademarks provide evidence of use, and to jointly adjudicate any claim from the new trademark applicant against the cited trademarks, including oppositions or requests for invalidation.

### 3. Access to Law

#### 3.1 Retain the Focus on Intellectual Property (IP) Protection and Enforcement, Regardless of Nationality of the IP Right (IPR) Holders 2

- Retain the focus on IP protection and enforcement, regardless of the nationality or provenance of the owners of such IPR.

#### 3.2 Simplify Procedures for the Provision of Formal Material from Overseas in Cases with no Credible Probity Concerns 2

- Apply in a coherent and predictable manner the existing provisions on exemptions for notarisation and legalisation for evidence produced outside of China and submitted in IPR civil litigation.
- Sign and ratify the Hague Convention on Abolishing the Requirement of Legalisation for Foreign Public Documents and abolish, or at least reduce/manage, the requirement of legalisation for foreign public documentation.





## 4. Online IP Protection

### 4.1 Encourage E-Commerce Platforms to Allow Proof of IP Other Than Chinese IP Certificates 3

- Prohibit e-commerce platform operators from rejecting IPR-related documentation produced outside of China that can be obtained through official or other public channels as sufficient proof of IPR ownership in e-commerce IPR infringement procedures.
- Allow an IPR established in one case to be immediately used across all other cases within the same e-commerce platform's dispute resolution mechanism.

## 5. Trade Secrets

### 5.1 Clarify the Standard for 'Prima Facie Evidence' in Civil Litigation under the Anti-unfair Competition Law 3

- Provide guidance to clarify the standard for 'prima facie evidence' and rules for burden of proof transfer through judicial interpretation and sample cases.

### 5.2 Allocate More Resources to the National Anti-monopoly Bureau (NAB) and Public Security Bureau (PSB) to Allow Them to Take Active Measures Against Trade Secret Infringement 3

- Launch special action projects annually within the law enforcement authorities to investigate and crack down on trade secret infringements.
- Allocate more resources to the PSB and the NAB to process trade secret infringement reports, especially in cases involving former employees.
- Strengthen the connection between administrative enforcement and judicial protection.

## Introduction to the Working Group

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

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

## Recent Developments

It is clear that IP protection is still a strong focus for the central government, with the publication of the *Work Plan for IPR Development (2021–2035)*<sup>1</sup> and the *14<sup>th</sup> Five-year Plan of National IPR Application and Production*,<sup>2</sup> published in September and October 2021 respectively. Both these documents emphasise the importance of innovation, application and protection of IPR.

Following the issuance of several significant other documents, IPR protection has been strengthened at the theoretical level. These include the formulation of the *Measures for Administrative Rulings on Major Patent Infringement Disputes*,<sup>3</sup> and the *Measures for*

1 *Work Plan for IPR Development (2021–2035)*, State Council, 22<sup>nd</sup> September 2021, viewed 20<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/2021-09/22/content\\_5638714.htm](http://www.gov.cn/zhengce/2021-09/22/content_5638714.htm)>

2 *14<sup>th</sup> Five-year Plan of National IPR Application and Production*, State Council, 28<sup>th</sup> October 2021, viewed 20<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2021-10/28/content\\_5647274.htm](http://www.gov.cn/zhengce/content/2021-10/28/content_5647274.htm)>

3 *Measures for Administrative Rulings on Major Patent Infringement Disputes*, State Council, 26<sup>th</sup> May 2021, viewed 20<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-05/29/content\\_5613827.htm](http://www.gov.cn/zhengce/zhengceku/2021-05/29/content_5613827.htm)>





*Administrative Rulings on Early Resolution Mechanisms for Drug Patent Disputes*,<sup>4</sup> which aim to establish a framework through which technical investigators undertake administrative protection of IPR.

## Key Recommendations

### 1. Patents

#### 1.1 Exclude Chinese Patent Applications or Patent Assignments from Technology Exports and Simplify Overall Procedures



##### Concern

Chinese patent applications or patents assignments are categorised as technology exports when the assignor includes a Chinese individual or entity and the assignee includes a foreign individual or entity, and thus require permission from the authorities for export, which creates a huge administrative burden for parties assigning Chinese patents.

##### Assessment

According to Article 2.1 of the *Regulation on Import and Export of Technology Administration*,<sup>5</sup> ‘technology export’ refers to the process of transferring technology from China to overseas, through trade, investment, or economic and technical cooperation. While Chinese patent applications or patents assignments are currently dealt with by the authorities as a technology export, they do not in fact meet the requirements of the technology export because a Chinese patent transferred from a Chinese company to a foreign company is still a Chinese patent, which is valid only within the territory of China and is not transferrable overseas.

The assignment of a Chinese patent does not result in a foreign patent based on the assigned patent, because the filing of application in a foreign country must comply with the confidentiality and security examination regulated for in Article 19 of the Patent Law.<sup>6</sup> It is not necessary to set barriers for the assignment of the Chinese patent in addition to this confidentiality

and security examination in order to regulate filing a foreign patent application based on the technology of a Chinese patent. Furthermore, the Chinese patent assigned from a foreign individual/entity to a Chinese individual/entity is not considered a technology import. This non-equivalence causes confusion on technology export and import.

##### Recommendations

- Amend the *Regulations on the Administration of the Import and Export of Technology* to exclude Chinese patent applications or patent assignments from technology export by deleting “patent assignment” and “patent application assignment” from Article 2.2.
- In the China National Intellectual Property Administration’s (CNIPA’s) new *Guidelines for Patent Examination*, exclude Chinese patent applications and patent assignments from technology export.

### 2. Trademarks

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

##### Concern

It is difficult to prove the ‘reputation’ or ‘fame’ of a trademark when this trait is developed overseas, as only Chinese sources are used during registration examination, even in cases related to webpage contents.

##### Assessment

Under Article 32 of the Trademark Law (TML), a trademark application should be rejected if applying for a trademark identical with or similar to other trademarks with a certain reputation.<sup>7</sup> In practice, the CNIPA only considers ‘certain reputation’ in China. During opposition or cancellation of pre-emptive trademarks, it is difficult for the right holder to convince the CNIPA that a trademark has a ‘certain reputation’ when this reputation is held overseas, but not in the Chinese market, even if Chinese consumers can access the brand online.

In many cases, proving use in China can be difficult. Taking the 2019 MUJI case as an example,<sup>8</sup> MUJI’s

<sup>4</sup> *Measures for Administrative Rulings on Early Resolution Mechanisms for Drug Patent Disputes*, China National Intellectual Property Administration (CNIPA), 5<sup>th</sup> July 2021, viewed 20<sup>th</sup> April 2022, <[https://www.cnipa.gov.cn/art/2021/7/5/art\\_74\\_160566.html](https://www.cnipa.gov.cn/art/2021/7/5/art_74_160566.html)>

<sup>5</sup> *Regulation on Import and Export of Technology Administration*, State Council, 29<sup>th</sup> November 2020, viewed 20<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/2020-12/26/content\\_5574449.htm](http://www.gov.cn/zhengce/2020-12/26/content_5574449.htm)>

<sup>6</sup> Patent Law, National People’s Congress (NPC), 19<sup>th</sup> November 2020, viewed 20<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202011/82354d98e70947c09dbc5e4eeb78bdf3.shtml>>

<sup>7</sup> *Trademark Law*, NPC, 7<sup>th</sup> May 2019, viewed 20<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/201905/dacf65eec798444e821a1e06a347f3ee.shtml>>

<sup>8</sup> In the MUJI case, the court did not protect the MUJI trademark because it ruled that when Hainan Nanhua filed a similar trademark in 2000, MUJI was not well-known in China.





lack of trademark registration and prior use in Mainland China of 无印良品—the Chinese version of ‘MUJI’—was key to the failure of their lawsuit against Hainan Nanhua. According to Article 13.2 of the Trademark Law, a trademark that is well-known in China shall also be protected (both against unfair registrations by others and from infringements) in respect to goods and kinds of goods not directly and explicitly designated in the trademark application.

If the definition of ‘certain reputation’ in Article 32 of the TML could be enlarged to include the internet as accessed by the Chinese market, many bad faith registrations could be successfully dealt with.

#### Recommendation

- Consider internet activity and accessibility by the Chinese market when determining pre-emptive registration in bad faith.

## 2.2 Lower the Burden of Proof Required to Show Bad Faith in Accordance with the Degree of Distinctiveness of the Trademark to be Protected 2

#### Concern

While bad faith is increasingly cited by the administrative and judicial authorities as grounds for refusal to grant trademarks, it remains a very difficult fact to prove.

#### Assessment

Two situations can be distinguished: 1) whether the trademark to be defended is not registered in China; and 2) whether it is already registered in China.

If it is not registered, the risk of the pre-emptive filing by a ‘trademark squatter’ is high. In such cases, it is not always possible to prove sufficient prior use in China and related ‘prior influence’, even if some internet access to the mark can be established. Then, the examiner should examine the degree of distinctiveness of the foreign trademark, i.e., how original, and how unrelated it is to the products concerned. If the trademark is highly distinctive, the act of filing the same mark, without being able to explain how this specific name or design has been chosen, can allow for presumption of bad faith on the part of the applicant. The above reasoning is increasingly used by the examiners with the Trademark Office, who cite Article 7 of the TML (principle of good faith) and the first sentence of Article 30, “a trademark

does not conform with the provisions of this law”.<sup>9</sup>

If the trademark to be defended is registered in China, trademark owners are often obliged to file oppositions or invalidation against similar trademark applications. It is necessary to prove the likelihood of confusion caused by these new applications. According to Article 12 of the *Provisions of the Supreme People’s Court (SPC) on Several Issues concerning the Trial of Administrative Cases involving Trademark Authorisation and Confirmation (SPC Provisions)*, the court shall examine the extent of similarity of the trademarks, of the goods concerned, the extent of distinctiveness of the trademark that requires protection, the degree of attention of the general public, and the “intention of the trademark applicant [...] may also be taken into consideration.”<sup>10</sup> Article 12 of the *SPC Provisions* concerns well-known trademarks (Article 13.2 TML), but is also to be applied to all situations, including those referred to in Article 30 of the TML.

Hence, if, for example, the disputed mark consists of the names of the real right holders, which are not familiar to Chinese consumers in any way, only the bad faith filer can explain how the disputed mark was created.

#### Recommendation

- Lower the burden of proof required to show bad faith in accordance with the degree of distinctiveness of the trademark to be protected.

## 2.3 Ensure that Protection of a Trademark is Conditioned by Its Use

#### Concern

Despite the revision of the TML providing for the refusal of trademarks filed in bad faith without intention to use, the number of trademark applications continues to grow, with a large percentage not used, which constitutes obstacles to legitimate applications and results in an increase of both procedure time and costs.

#### Assessment

In October 2019, the CNIPA announced that the average length of examination for trademark registration

<sup>9</sup> Trademark Law, NPC, 7<sup>th</sup> May 2019, viewed 20<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/201905/dacf65eec798444e821a1e06a347f3ee.shtml>>

<sup>10</sup> *Provisions of the Supreme People’s Court on Several Issues concerning the Trial of Administrative Cases involving Trademark Authorisation and Confirmation*, SPC, 11<sup>th</sup> January 2017, viewed 20<sup>th</sup> April 2022, <<http://www.court.gov.cn/zixun-xiangqing-34732.html>>



had been shortened to five months, compared to the original nine months provided for by Article 28 of the Trademark Law.<sup>11</sup> Speeding up this process has caused complications for companies. For example, when a company applies for a trademark, it will at the same time file for oppositions, non-use cancellations and/or invalidations against trademarks that could potentially block the registration. When the examination time for registration was nine months, there was no problem, as these actions would be dealt with around the same time as the trademark examination.

However, the shorter trademark examination is forcing companies to file a rejection appeal and possibly a lawsuit in order keep their application alive until any blocking trademark has been successfully opposed, cancelled or invalidated. This increases costs for registrants and places a heavy burden on their resources.

As the practice of ‘trademark hoarding’ is likely to continue if it is potentially profitable, the most efficient way to deter trademark hoarders is to provide that unused trademarks will not be protected after a certain period of time. It is not feasible for the CNIPA to request at the initial examination stage submission of evidence of use by registrants of prior trademarks found by internet search engine. Noting that, the working group advocates that if applicants of a refused trademark file for review before the CNIPA, the CNIPA should summon the owner(s) of the cited prior trademarks to appear in the review procedure and submit their evidence of use if requested. Meanwhile, it should be possible for the new trademark applicant to submit their own claim of opposition and invalidation against the cited trademark(s). This would serve to deal with all the connected cases at the same time.

#### Recommendations

- Introduce in the Trademark Law a new provision establishing that, except during the first three years post-registration, protection of a trademark is conditioned by its use.
- Create a mechanism allowing the Trademark Review and Adjudication Department under the Trademark Office of the CNIPA, when assessing an application for trademark refusal review, to request that registrants of cited trademarks provide evidence of

use, and to jointly adjudicate any claim from the new trademark applicant against the cited trademarks, including oppositions or requests for invalidation.

### 3. Access to Law

#### 3.1 Retain the Focus on IP Protection and Enforcement, Regardless of Nationality of the IPR Holders

##### Concern

Protection and enforcement of IPR are at risk of being de-prioritised over more immediate concerns, which may impede effective enforcement of IPR.

##### Assessment

While China dealt with the initial outbreak of COVID-19 comparatively well, its policies related to containment of the virus have had a significant impact on global trade and business activities throughout 2020 and 2021, and the first half of 2022. In addition to the impact of COVID-19, several trade disputes— including between the United States and China, and the EU and China— have had an impact on relations between the three parties. European Chamber members have over the same period voiced concerns about incidents that could be associated with rising levels of protectionism and bias by various organs essential for the effective protection of IPR in China. Examples include notaries in certain regions refusing to notarise evidence for ‘foreign’ companies, citing international trade tensions as the reason they cannot provide such services to foreign applicants.

Another worrisome development that must be seen in connection with the fair and equal access to law is the punishment of holders of standard-essential patents through so-called ‘anti-suit injunctions’ issued by Chinese courts in cases where these patent holders enforce their legitimate rights abroad.<sup>12</sup> Multinational companies holding patent rights under different jurisdictions particularly face a serious risk of being treated unequally by Chinese courts if they make use of their legitimate rights outside of China. This will likely affect mostly foreign right holders, as Chinese companies usually opt to enforce their rights within China due to various reasons, such as their familiarity with the legal, social and economic environment.

<sup>11</sup> Trademark Law, NPC, 7<sup>th</sup> May 2019, viewed 20<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/201905/dacf65eec798444e821a1e06a347f3ee.shtml>>

<sup>12</sup> European Union Permanent Mission to the World Trade Organization Request for Consultation, EU, 18<sup>th</sup> February 2022, viewed 25<sup>th</sup> April 2022, <[https://trade.ec.europa.eu/doclib/docs/2022/february/tradoc\\_160051.pdf](https://trade.ec.europa.eu/doclib/docs/2022/february/tradoc_160051.pdf)>





## Recommendation

- Retain the focus on IP protection and enforcement, regardless of the nationality or provenance of the owners of such IPR.

### 3.2 Simplify Procedures for the Provision of Formal Material from Overseas in Cases with no Credible Probity Concerns 2

#### Concern

Meeting the requirement for proving the content of formal material for the purposes of civil litigation has always been arduous for parties litigating in China, particularly for foreign entities and others that rely on evidence from abroad, a challenge that has been amplified by the pandemic.

#### Assessment

The status quo for formal material sourced overseas, after the initial notarisation has taken place (to this point there is no difference to evidence secured within China), is that the relevant evidence must go through a process that often involves having the notarisation attested by the responsible court. The court's certification must then be attested first at the foreign office, and then at the Chinese missions (embassies or consulates) in the country of origin of the evidence. While this process had constituted a substantial burden to the effective and timely enforcement of IPR for member companies of the European Chamber in the past, the difficulties have been amplified by COVID-related health and safety measures necessitated in many countries that are the origin of the evidence. As a result, despite their best efforts, and because of the necessity of complying with local 'COVID lockdown' requirements, Chinese missions abroad were not able to keep pace with formalisation demands for formal material. This led to backlogs (where Chinese courts have extended deadlines for submission of evidence), or missed deadlines (where such extensions have not, or could not be granted), which have impacted member companies adversely, as they have not been able to effectively protect, enforce or even defend their IPR in China.

Even after strict COVID control measures were relaxed in certain countries of origin of working group members, the general problem of undergoing the time-consuming and often costly notarisation and legalisation process, regardless of the nature of the document(s) involved, persists. By contrast, other countries—such

as Germany—leave recognition of public evidence produced in other countries to the discretion of the courts on a case-by-case basis.

In fact, according to Article 8.3 of *Several Provisions of the Supreme People's Court on Evidence in Civil Litigation Involving Intellectual Property Rights (Provisions)*,<sup>13</sup> “a People's Court shall not uphold the objection raised by one party that publications, patent documents, etc.” that can be obtained through official or other public channels are exempted from notarisation, authentication or other certification formalities. According to Article 8.4 of the *Provisions*, this also applies to evidence that can be authenticated by other evidence.<sup>14</sup> These provisions seem to grant People's Courts enough flexibility to assess the authenticity of evidence produced in IPR civil litigation on the specifics of each individual case. The working group recommends that People's Courts across China apply these provisions in a coherent and predictable manner.

Finally, the Hague Convention on Abolishing the Requirement of Legalisation for Foreign Public Documents,<sup>15</sup> which currently has 120 contracting parties, only applies to the Special Administrative Zones of Hong Kong and Macau, and not to Mainland China, which has neither signed nor ratified this international convention. The working group encourages evaluation of the benefits that signing and ratifying this international convention would bring to effective IPR protection, both for foreign and Chinese right holders alike.

#### Recommendations

- Apply in a coherent and predictable manner the existing provisions on exemptions for notarisation and legalisation for evidence produced outside of China and submitted in IPR civil litigation.
- Sign and ratify the Hague Convention on Abolishing the Requirement of Legalisation for Foreign Public Documents and abolish, or at least reduce/manage, the requirement of legalisation for foreign public documentation.

<sup>13</sup> *Several Provisions of the Supreme People's Court on Evidence in Civil Litigation Involving Intellectual Property Rights*, SPC, 16<sup>th</sup> November 2020, viewed 20<sup>th</sup> April 2022, <<https://www.court.gov.cn/zixun-xiangqing-272241.html>>

<sup>14</sup> Ibid.

<sup>15</sup> *Hague Convention on Abolishing the Requirement of Legalisation for Foreign Public Documents*, Hague Conference on Private International Law, 5<sup>th</sup> October 1961, viewed 25<sup>th</sup> April 2022, <<https://assets.hoch.net/docs/b12ad529-5f75-411b-b523-8eebe86613c0.pdf>>





## 4. Online IP Protection

### 4.1 Encourage E-Commerce Platforms to Accept Proof of IP Other Than Chinese IP Certificates 3

#### Concern

E-commerce platforms require Chinese IP certificates for enforcement, which is cumbersome for foreign rights holders.

#### Assessment

E-commerce platforms in China do not accept copyright or trademark infringement cases if there is no Chinese copyright registration certificate or Chinese trademark certificate. European right holders with an international trademark registration designating China often do not have Chinese trademark certificates.<sup>16</sup>

Copyright, according to the Berne Convention, exists the moment a work is made. China has created a copyright registration system in order to declare the holders of copyright recognised by the Chinese authorities, the China Trademark Office and the Trademark Review and Adjudication Board, which do not have a list of requirements regarding proof of copyright. Therefore, e-commerce platforms should not act as courts, but instead should uphold the right of the copyright owner in notice and takedown cases.

Furthermore, requesting IP certificates issued in China has no legal basis either in the E-commerce Law or in the *Reply of the SPC on Several Issues Concerning the Application of Law to IPR Infringement Disputes Involving the Internet*.<sup>17</sup> Both sets of rules only require “preliminary evidence of infringement” without limiting the scope of admissible evidence to Chinese IPR certificates. E-commerce platform operators should not be granted powers to set up higher requirements than those existing in civil litigation. In fact, Article 8.3 of the *Reply of the SPC on Several Issues Concerning the Application of Law to IPR Infringement Disputes Involving the Internet* “allows IPR holders to submit evidence formed outside of China without having to undergo notarisation and legalisation if this evidence consists of publications, patent documents, etc.” that can be obtained through official or other public

<sup>16</sup> Chinese trademark certificates must be applied for separately after the trademark has officially already been registered in China.

<sup>17</sup> *Reply of the SPC on Several Issues concerning the Application of Law to IPR Infringement Disputes Involving the Internet*, SPC, 12<sup>th</sup> September 2020, viewed 20<sup>th</sup> April 2022, <<https://www.court.gov.cn/fabu-xiangqing-254921.html>>

channels. Article 8.4 of this document further opens the scope of admissible evidence to evidence formed outside of China that can be authenticated by other evidence. It would be perfectly coherent with other recent attempts to restrain the growing influence of e-commerce platforms to extend these efforts to evidence of IPR ownership in e-commerce IPR infringement procedures.

#### Recommendations

- Prohibit e-commerce platform operators from rejecting IPR-related documentation produced outside of China that can be obtained through official or other public channels as sufficient proof of IPR ownership in e-commerce IPR infringement procedures.
- Allow an IPR established in one case to be immediately used across all other cases within the same e-commerce platform’s dispute resolution mechanism.

## 5. Trade Secrets

### 5.1 Clarify the Standard for ‘Prima Facie Evidence’ in Civil Litigation under the Anti-unfair Competition Law 3

#### Concern

The vagueness of ‘*prima facie* evidence’ leaves great discretion to the court, increases the burden of producing evidence for trade secret owners and hinders innovation.

#### Assessment

Article 32 of the Anti-unfair Competition Law provides for the transfer of burden of proof, where as long as a right holder provides “*prima facie* evidence”, the burden can be transferred to the defendant. However, the definition of what constitutes “*prima facie* evidence” is yet to be clarified and is currently subject to different interpretations among different courts and judges.<sup>18</sup> Neither do the *Provisions of the Supreme People’s Court on Several Issues Concerning the Application of Law in the Trial of Civil Cases Involving Trade Secret Infringement* provide a detailed standard.<sup>19</sup> In practice,

<sup>18</sup> *Anti-unfair Competition Law*, NPC, 7<sup>th</sup> May 2019, viewed 20<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/201905/9a37c6ff150c4be6a549d526fd586122.shtml>>

<sup>19</sup> *Provisions of the Supreme People’s Court on Several Issues Concerning the Application of Law in the Trial of Civil Cases Involving Infringements upon Trade Secrets*, SPC, 12<sup>th</sup> September 2020, viewed 20<sup>th</sup> April 2022, <<http://www.court.gov.cn/zixun-xiangqing-254751.html>>





a trade secret owner may only be able to provide limited clues, such as the digital copy of the infringer's tender document, to demonstrate a possibility of trade secret infringements, and the legality of such a clue itself is dubious. In reality, trade secret owners still face great difficulties in providing evidence to prove the infringement.

#### Recommendation

- Provide guidance to clarify the standard for 'prima facie evidence' and rules for burden of proof transfer through judicial interpretation and sample cases.

## 5.2 Allocate More Resources to the National Anti-monopoly Bureau (NAB) and Public Security Bureau (PSB) to Allow Them to Take Active Measures Against Trade Secret Infringement

#### Concern

The lack of stringent criminal liabilities leads to an absence of sufficient deterrents for infringers, which discourages innovation and creates dishonest working ethics.

#### Assessment

Before the PSB can accept a crime report on an alleged trade secret theft, right owners are usually required to provide information on where the suspected infringer stores the trade secrets, which can be very difficult for the right owners. The PSB often delays procedures or is even reluctant to accept cases due to the complexity of trade secrets infringement cases and the bureau's lack of resources.

The theft and misuse of trade secrets can lead to huge losses for right owners, particularly those whose businesses are based on such know-how. Such cases usually involve a former employee of the right owner. The working group is concerned that the current lack of stringent criminal liabilities not only causes infringers to disrespect the authority of the law, but also discourages innovation and creates dishonest working ethics in Chinese society.

As trade secret protection is stipulated in both the Anti-unfair Competition Law and the Criminal Law, it falls under the work scope of the NAB and the PSB respectively. The new NAB, inaugurated in November 2021, will draft anti-monopoly measures

and guidelines, organise anti-monopoly enforcement work, guide fair competition review work, and promote anti-monopoly enforcement international cooperation, which demonstrates the government's determination to improve the level of fair competition theoretically. In March 2022, the NAB issued the *Work Plan on National Trade Secrets Innovation Protection Pilots*,<sup>20</sup> which calls for joint efforts from multiple authorities to improve the level of trade secret protection. The working group will continue to monitor the administrative actions of the NAB in 2022, given it was established just a short time prior to the writing of this paper.

#### Recommendations

- Launch special action projects annually within the law enforcement authorities to investigate and crack down on trade secret infringements.
- Allocate more resources to the PSB and the NAB to process trade secret infringement reports, especially in cases involving former employees.
- Strengthen the connection between administrative enforcement and judicial protection.

## Abbreviations

CNIPA	China National Intellectual Property Administration
EU	European Union
IP	Intellectual Property
IPR	Intellectual Property Right
NAB	National Anti-monopoly Bureau
NPC	National People's Congress
PSB	Public Security Bureau
SPC	Supreme People's Court
TML	Trademark Law

<sup>20</sup> *Work Plan on National Trade Secrets Innovation Protection Pilots*, State Administration for Market Regulation, 2<sup>nd</sup> March 2022, viewed on 20<sup>th</sup> April 2022, <[https://gkml.samr.gov.cn/nsjg/fjjzj/202203/t20220307\\_340204.html](https://gkml.samr.gov.cn/nsjg/fjjzj/202203/t20220307_340204.html)>





# Inter-chamber Small and Medium-sized Enterprise Working Group

## Key Recommendations

### 1. Provide European Small and Medium-sized Enterprises (SMEs) in China with Better Access to Financing

- Enhance the implementation of lending strategies to assist all SMEs—both European and Chinese—operating in China.
- Increase incentives that encourage commercial banks to grant short-term overdrafts to SMEs facing temporary cash shortages.
- Publish specialised credit risk assessment procedures or systems for providing both local and international SMEs with loans.
- Develop a regulatory framework that encourages innovative financing support for SMEs, while limiting potential financial risks.
- Encourage China to establish national funds for financing partnerships between European and Chinese SMEs.
- Relax foreign exchange debt quota requirements to remove regulatory obstacles that limit SMEs', especially foreign-invested enterprises', access to credit financing.
- Expand green finance tools (such as green bonds) for foreign companies, especially SMEs.
- Organise seminars with local banks and financing intermediaries, and include financing options in a handbook on regulatory issues.
- Increase foreign SMEs' awareness of and accessibility to government incentives and funding instruments from local administrations.
- Publish English-language versions of notices about the availability of local research and development funds and grants, and communicate them in a timely manner.

### 2. Promote Coordination Between Different Administrative Departments and Improve the Transparency, Clarity and Integrity of All Relevant Regulations for SMEs

- Implement a 'one-stop-service' system in provincial/regional administrative departments to support all SMEs, both foreign and Chinese, in fulfilling their multiple registration and regulatory obligations, as well as matters related to their daily operations.
- Improve data sharing and general administrative coordination among both different city districts and different government departments.
- Continue efforts to alleviate administrative burdens for SMEs by reducing the number of government approvals required and simplifying the remaining approval and filing procedures.
- Ease COVID-related travel restrictions to allow foreign nationals to return to China or move within China, while upholding all necessary health and safety measures.
- Ease COVID-related logistical restrictions to allow smoother transportation of goods from China, to China, or within China.





### 3. Reduce the Financial Burden of SMEs to the Greatest Extent Possible, Including Through Measures Like Ensuring Reasonable Payment Terms and Enforcing Timely Payments 8

- Issue guidelines and implement effective industry supervision measures to ensure that state-owned enterprises (SOEs) and private sector players respect contractual payment terms when dealing with SMEs.
- Set a maximum payment term that is lawfully allowed to be included in contracts.
- Further encourage SOEs to sign contracts with SMEs that have reasonable payment terms.
- Improve legal debt collection procedures.
- Develop and implement further measures to encourage banks to provide financing solutions to SMEs based on accounts receivable.
- Continue to develop targeted measures that reduce the financial burden of SMEs, such as reducing social insurance costs and using an incremental approach for the allocation of corporate income tax rates.

### 4. Promote the Value of Intellectual Property Rights (IPR) Protection and Enforcement Mechanisms at the Consumer, Business and Local Government Levels 7

- Strengthen enforcement and consistency with regard to notice-and-take-down procedures.
- Engage local enforcement agencies, customs authorities and courts to take effective action against counterfeiting.
- Improve online access to IPR-related agencies in order to make it easier for SMEs to enforce their rights in a more affordable way.
- Facilitate the legalisation of foreign documents by Chinese embassies.
- Increase the State Administration of Market Regulation's power to enforce the European Union-China Geographical Indications Agreement.

## Introduction to the Working Group

The Inter-Chamber Small and Medium-sized Enterprise (SME) Working Group was established in 2014 as a new advocacy element of the European Union (EU) SME Centre (Phase Two),<sup>1</sup> with the objective of strengthening advocacy for European SMEs in China. The working group is based on the European Chamber's Small and Medium-sized Enterprise Forum. As SMEs are key contributors to the overall economic development and social welfare of countries, the working group aims to bring together European SMEs to create a strong channel through which concerns over the business challenges they face in China can be expressed.<sup>2</sup> The

working group regularly organises meetings that provide practical solutions and policy advice to European SMEs and their stakeholders.<sup>3</sup>

### Definition of SMEs in Europe and China

According to the European Commission's 2020 revised user guide regarding the definition of SMEs, an SME is an enterprise that employs less than 250 people and has an annual turnover not exceeding euro (EUR) 50 million, and/or total assets no greater than EUR 43 million. If an enterprise has access to significant additional resources, it might not be eligible for SME status.<sup>4</sup>

In China, SMEs are defined according to the SME

1 *About EU SME Centre*, EU SME Centre, viewed 26<sup>th</sup> April 2022, <<http://www.eusmecentre.org.cn/about-centre>>

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

3 Stakeholders include EU SME Centre implementation partners and EU Member State embassies, <[www.eusmecentre.org.cn](http://www.eusmecentre.org.cn)>

4 *SME Definition – User guide 2020*, European Commission, 8<sup>th</sup> September 2020, viewed 26<sup>th</sup> April 2022, <<https://ec.europa.eu/docsroom/documents/42921>>





Promotion Law as companies that “have a relatively small size in personnel and scope of business”.<sup>5</sup> The standards for classifying SMEs are formulated by relevant departments of the State Council, and the identification of a company as a micro, small or medium-sized enterprise is dependent upon a series of variables, such as the industry it belongs to, its operating income, its total assets and its number of employees.<sup>6</sup> For example, a medium-sized agricultural enterprise is required to hire a minimum of 500 people to qualify as an SME, while a small-sized construction enterprise can have a maximum business revenue of United States dollars (USD) 8.5 million.<sup>7</sup>

### EU SME Projects in China Implemented by the European Chamber

The EU SME Centre (Phase Three) started in October 2020, and ran until June 2022. Phase IV, funded by the Single Market Programme (SMP), has started on 1st July 2022 and will run for 36 months. Its main objectives are: assisting European SMEs to establish and develop a commercial presence in the Chinese market by providing EU added-value support services; improving corporate synergies and increasing best practice-sharing at the national and regional EU business association levels, with the ultimate goal of benefitting European SMEs intending to do business in China; and strengthening advocacy efforts on behalf of the European business community to help create a better business environment in China.<sup>8</sup>

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

### SMEs in China

SMEs play a very important role in China’s economic

and social development. Not only do they represent more than 90 per cent of all companies in China but they contribute to more than half of the country’s gross domestic product. They also create more than 80 per cent of the jobs, hold more than 70 per cent of the patents and contribute more than 50 per cent of the taxes.<sup>10</sup> Of the European SMEs either exporting to or investing and/or operating in China (or planning to do so), most are from the food and beverage, commercial services, education, information and communication technologies and healthcare sectors.

## Recent Developments

### Post-COVID-19 Era

The outbreak and spread of COVID-19 dominated 2020 and 2021, and the impact is still being felt in 2022. The recent EU SME Centre report, *Supply Chain in China: Challenges and Good Practices for SMEs within Industrial Goods*,<sup>11</sup> indicates that factors such as increasing costs, unstable supplier performance, external factors, and currency risks were of highest concern to foreign companies with sourcing activities in China. Following numerous outbreaks of the Omicron variant across the country in early 2022, China implemented more stringent containment measures in at least 45 cities (including full or partial lockdowns – most significantly Shanghai), causing disruption on a dramatic scale. According to the European Chamber’s *Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China*,<sup>12</sup> the main difficulties were in relation to logistics/warehousing, business travel and the ability to conduct face-to-face meetings.

In addition, the numbers of foreign nationals living in China has been dropping since the initial outbreak of COVID. At the time of writing, there are no indications when the pandemic will subside. While the central government’s extension of non-taxable allowances until the end of 2023 is a positive move that will help to stem the flow of foreign talent from China, travel restrictions remain onerous and currently constitute a highly significant barrier to foreign talent attraction and retention.

5 *Law of the People’s Republic of China on the Promotion of Small and Medium-sized Enterprises*, National People’s Congress, 2017, viewed 26<sup>th</sup> April 2022, <[http://www.npc.gov.cn/zgrdw/npc/xinwen/2017-09/01/content\\_2027929.htm](http://www.npc.gov.cn/zgrdw/npc/xinwen/2017-09/01/content_2027929.htm)>

6 *Statistical Criteria for the Classification of Large, Medium, and Small Micro-enterprises (2017)* [CN], National Bureau of Statistics, 1<sup>st</sup> March 2018, viewed 26<sup>th</sup> April 2022, <[http://www.stats.gov.cn/tjsj/tjbz/201801/t20180103\\_1569357.html](http://www.stats.gov.cn/tjsj/tjbz/201801/t20180103_1569357.html)>

7 *Number of SMEs in China 2012–2020*, Statista, 27<sup>th</sup> January 2022, viewed 29<sup>th</sup> April 2022, <<https://www.statista.com/statistics/783899/china-number-of-small-to-medium-size-enterprises/>>

8 *About Us*, EU SME Centre, viewed 26<sup>th</sup> April 2022, <<http://www.eusmeccentre.org.cn/about-centre/>>

9 *About Us*, China IPR SME Helpdesk, viewed 26<sup>th</sup> April 2022, <<http://www.china-iprhelpdesk.eu/content/about-hd>>

10 Blazyte, Agne, *Number of SMEs in China 2012-2020*, Statista, 27<sup>th</sup> January 2022, viewed 20<sup>th</sup> June 2022, <<https://www.statista.com/statistics/783899/china-number-of-small-to-medium-size-enterprises/>>

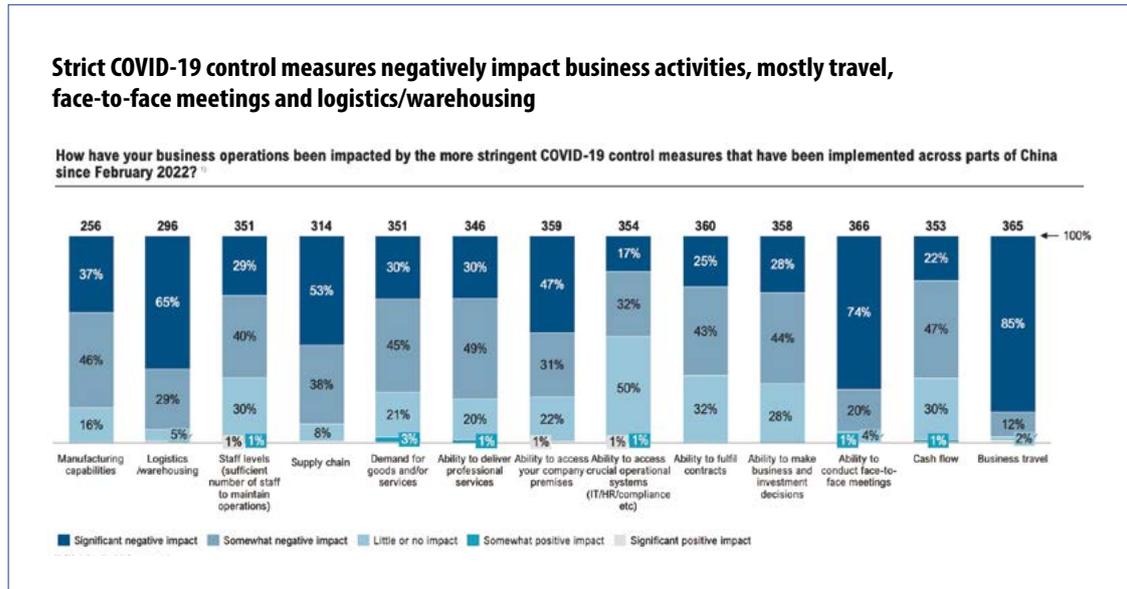
11 *Supply Chain in China: Challenges and Good Practices for SMEs within Industrial Goods*, EU SME Centre, 27<sup>th</sup> February 2022, viewed 19<sup>th</sup> May 2022, <<https://eusmeccentre.org.cn/report/supply-chain-china-challenges-and-good-practices-smes-within-industrial-goods>>

12 *Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China*, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 10<sup>th</sup> May 2022, <<https://www.european-chamber.com/en/press-releases/3431>>





Chart 1



Source: European Chamber Flash Survey

To regain confidence in the China market, European businesses need more predictability. The working group expects the Chinese Government to introduce measures to open further and ease COVID-related restrictions, while maintaining a robust response to the pandemic to minimise health risks.

### The 14<sup>th</sup> Five-year Plan (14FYP) for the Development of SMEs and 2022 Government Report

The working group was pleased to observe that a number of supportive measures for SMEs, in terms of reducing financial burdens, streamlining administrative procedures and financing, were announced in the *14FYP for Promoting the Development of SMEs* and the *2022 Government Work Report*.<sup>13&14</sup>

The *14FYP for Promoting the Development of SMEs* was jointly issued on 17<sup>th</sup> December 2021 by the Ministry of Industry and Information Technology (MIIT), along with the National Development and Reform Commission, the Ministry of Science and Technology, the Ministry of Finance (MOF) and 19 other departments, in an attempt to foster greater creativity among SMEs and a better business environment overall. Key targets include an above 18 per cent increase in SMEs' per capita

operating income, more than 10 per cent annual growth in small industrial enterprises' research and development (R&D) spending and more than 10 per cent annual growth in the number of SMEs' patent applications. By 2025, China aims to have developed a million innovative SMEs, 100,000 SMEs that specialise in niche sectors and 10,000 'little giant' companies that focus on a market niche and master key technologies with strong innovation capacity and a large market share.<sup>15</sup>

The 2022 plenary sessions of the National People's Congress (NPC) and the Chinese People's Political Consultative Conference (Two Sessions) took place from 4<sup>th</sup> to 11<sup>th</sup> March. During the Two Sessions, the *2022 Government Work Report* was released, proposing the following measures for SMEs:

- Extending tax and fee reduction policies to support manufacturing, small and low-profit enterprises, and self-employed businesses.
- Exempting small-scale taxpayers from value-added tax (VAT) for a period of time.
- Reducing by half the corporate income tax (CIT) liability of small and low-profit enterprises for the portion of taxable income exceeding Chinese yuan (CNY) 1 million but less than CNY 3 million, based on existing preferential policies.

13 *14FYP for the Development of SMEs*, State Council, 11<sup>th</sup> December 2021, viewed 27<sup>th</sup> April 2022, [http://www.gov.cn/zhengce/zhengceku/2021-12/17/content\\_5661655.htm](http://www.gov.cn/zhengce/zhengceku/2021-12/17/content_5661655.htm)

14 *Government Work Report*, State Council, 12<sup>th</sup> March 2022, viewed 27<sup>th</sup> April 2022, [http://english.www.gov.cn/premier/news/202203/12/content\\_WS622c96d7c6d09c94e48a68ff.html](http://english.www.gov.cn/premier/news/202203/12/content_WS622c96d7c6d09c94e48a68ff.html)

15 Ouyang Shijia, *New 5-year plan to turbocharge SMEs*, *China Daily*, 18<sup>th</sup> December 2021, viewed 27<sup>th</sup> April 2022, <<https://www.chinadaily.com.cn/a/202211/18/WS61bd4ea0a310cdd39bc7c269.html>>





- Raising the addition pre-tax deduction of R&D expenses of technology-based SMEs from 75 per cent to 100 per cent.
- Expanding the coverage of export credit insurance for foreign trade SMEs.
- Significantly increasing the return ratio of unemployment and work-related injury insurance premiums for micro- and SMEs.<sup>16</sup>

## Key Recommendations

### 1. Provide European SMEs in China with Better Access to Financing 8

#### Concern

European SMEs operating in China still struggle to access financing, an obstacle that prevents them from reaching their full potential and limits their ability to further contribute to China's economy.

#### Assessment

Having sufficient access to financing is crucial for enterprises' development, and it is well-known that SMEs in China face different challenges when accessing financing compared to larger companies. In the COVID-19 era, financing plays an even larger role in the business operations of companies. Although Chinese policymakers have repeatedly tried to create favourable conditions for SMEs to gain access to financing, in practice it still remains a major challenge, especially for international SMEs. The main reasons for this are that SMEs are generally considered high-risk/low-return clients, and because domestic companies tend to be preferred due to their closer relationships with local banks. This approach may have negative repercussions in the long-run as SMEs and start-ups are generally at the forefront of innovation.

The situation varies geographically. In the European Chamber Southwest China Chapter, members indicate that obtaining financing from domestic Chinese banks remains difficult in practice. For instance, the Chengdu High-Tech Zone and Tianfu New Area have more progressive policies compared to other city districts and municipalities, and foreign SMEs there can take advantage of some start-up benefits such as funding, cash-back and tax refunds, but noted that many benefits

<sup>16</sup> Huld, Arendse & Zhou, Qian, *China's 2022 Government Work Report: Highlights from the Two Sessions*, China Briefing, 7<sup>th</sup> March 2022, viewed 27<sup>th</sup> April 2022, <<https://www.china-briefing.com/news/chinas-2022-government-work-report-highlights-from-the-two-sessions/>>

still only apply to medium-sized businesses.<sup>17</sup> At the same time, SMEs from South China find it hard to access financing for basic infrastructure (machinery, equipment or vehicles), and the process is even more complicated when applying for a loan for salary payments. SMEs in Tianjin are more worried about opaque official information, as they are rarely provided with subsidy- and incentive-related information from the local government. According to an EU SME Centre report,<sup>18</sup> training sessions and workshops on incentive schemes and funding programmes are often organised—though sometimes not heavily publicised—by local administrations across China. Although dominated by domestic actors, incentives and funding instruments in China are also open to foreign-invested enterprises (FIEs). Awareness of these opportunities, however, remains overall low among European SMEs.

This contrasts with SMEs' perception of financing in Europe. According to the European Central Bank latest *Survey on the Access to Finance of Enterprises in the Euro Area*, access to finance remained among the least reported obstacles. Between April and September 2021, not only were there were significant rebounds in business activity and turnover, the availability of external finance and banks' willingness to provide credit to SMEs also improved. The main concern for EU-based SMEs continued to be the lack of skilled labour.<sup>19</sup>

In China, in addition to SMEs' difficulties in accessing financing, the options available are simply more limited compared to the variety of financial tools available in the EU. For foreign SMEs in China, these tools are considerably reduced despite the theoretical availability of funds back in their home countries. For example, bank loans for FIEs are generally obtained against guarantees from banks outside of China, which typically require further risk assessment by European headquarters. However, foreign exchange loans, which should be easier for FIEs to access, are limited by the so-called 'borrowing gap' – the difference between the total amount invested and the minimum amount of required capital that corresponds to the investment. Borrowing

<sup>17</sup> *Southwest China Position Paper 2021/2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> April 2022, viewed 27<sup>th</sup> April 2022, <<https://www.eurochamber.com.cn/en/press-releases/3428>>

<sup>18</sup> *Incentives, Subsidies and Funding for Tech SMEs in China*, EU SME Centre, 27<sup>th</sup> October 2021, viewed 9<sup>th</sup> June 2022, <<https://www.eusmcentre.org.cn/report/incentives-subsidies-and-funding-tech-smes-china>>

<sup>19</sup> *Survey on the Access to Finance of Enterprises in the Euro Area – April to September 2021*, European Central Bank, 24<sup>th</sup> November 2021, viewed 29<sup>th</sup> April 2022, <[https://www.ecb.europa.eu/stats/ecb\\_surveys/safe/html/index.en.html](https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/index.en.html)>





from domestic Chinese banks, though possible in theory, is extremely difficult for FIEs.<sup>20</sup> In addition, although the EU and China maintain regular exchanges on SME policies, bilateral financial support schemes are generally channelled through other sector or topic-specific programmes.

The working group is aware of the recent steps taken by the Chinese authorities to tackle issues with SMEs' access to financing. Measures include: creating the new Beijing Stock Exchange for innovation-orientated SMEs;<sup>21</sup> providing capital to local banks to issue loans to small businesses; rolling over a CNY 400 billion relending quota that supports inclusive financing; and ramping up long-term loans for manufacturing firms.<sup>22</sup> However, these measures have achieved very limited success in the case of foreign SMEs. Currently, the participation of foreign investors in the Beijing Stock Exchange is still relatively restricted; only qualified foreign institutional investors and *renminbi* (RMB) qualified institutional investors are eligible to trade stocks listed on the bourse.<sup>23</sup>

One area where China excels globally, and which could potentially ease the financing difficulties of SMEs operating in the country, is alternative online financing. An International Monetary Fund study on fintech credit risk assessments shows that not only are potential loan defaults from small companies predicted with higher accuracy with fintech—which goes some way towards addressing Chinese banks' concerns that loans to SMEs are inherently riskier—but also that the approach benefits smaller SMEs in third- and fourth-tier cities, as it fosters more inclusive financing.<sup>24</sup>

In recent years China has also rapidly developed its green financing system, and is now one of the world's largest issuers of green bonds. The latest version of

the People's Bank of China's *Green Bond Endorsed Projects Catalogue* was published in April 2021, and defines criteria and taxonomy of green bond projects in China in six sectors: energy-saving, clean production, clean energy, ecology and environment, green upgrading of basic infrastructure, and green services.<sup>25</sup> This latest version is more aligned with the EU's taxonomy compared to previous releases. Although it has become easier for foreign companies in China to issue RMB-denominated bonds, the number actively doing so (especially issuing green bonds) is very limited, and it is still very difficult for issuers to transfer proceeds freely, including overseas.

Aside from the damage caused by the COVID-19 crisis, there is also a need to increase SMEs' access to financing to help realise China's mid- and long-term goals of increasing its middle-income population, boosting innovation, and achieving its ambitious carbon neutrality goal. Therefore, existing measures and channels to support SMEs' access to financing should be improved, and the development of new methods considered.

#### Recommendations

- Enhance the implementation of lending strategies to assist all SMEs—both European and Chinese—operating in China.
- Increase incentives that encourage commercial banks to grant short-term overdrafts to SMEs facing temporary cash shortages.
- Publish specialised credit risk assessment procedures or systems for providing both local and international SMEs with loans.
- Develop a regulatory framework that encourages innovative financing support for SMEs, while limiting potential financial risks.
- Encourage China to establish national funds for financing partnerships between European and Chinese SMEs.
- Relax foreign exchange debt quota requirements to remove regulatory obstacles that limit SMEs', especially FIEs', access to credit financing.
- Expand green finance tools (such as green bonds) for foreign companies, especially SMEs.
- Organise seminars with local banks and financing intermediaries, and include financing options in a

20 For more information on funding limitations for foreign banks, please refer to the *Banking and Securities Working Group Position Paper 2022/2023*.

21 Hudd, Arendse, *The New Beijing Stock Exchange for SMEs – What You Need to Know*, China Briefing, 18<sup>th</sup> November 2021, viewed 29<sup>th</sup> April 2022, <<https://www.china-briefing.com/news/beijing-stock-exchange-for-smes-what-we-know/>>

22 *China adds new incentives for banks to lend to small businesses*, Reuters, 15<sup>th</sup> December 2021, viewed 29<sup>th</sup> April 2022, <<https://www.reuters.com/markets/rates-bonds/china-adds-new-incentives-banks-lend-small-businesses-2021-12-15/>>

23 These are programmes that allow foreign investment institutes that meet certain criteria to invest in A-shares (RMB shares listed on Mainland China stock exchanges that are only available to foreign investors through certain channels).

24 Huang, Yiping; Zhang, Longmei; Li, Zhenhua; Qiu, Han; Sun, Tao; Wang, Xue, *Working Paper: Fintech Credit Risk Assessment for SMEs: Evidence from China*, International Monetary Fund, 25<sup>th</sup> September 2020, viewed 26<sup>th</sup> April 2022, <<https://www.imf.org/en/Publications/WP/Issues/2020/09/25/Fintech-Credit-Risk-Assessment-for-SMEs-Evidence-from-China-49742>>

25 *Green Bond Endorsed Projects Catalogue (2021 Edition)*, People's Bank of China, 21<sup>st</sup> April 2021, viewed 29<sup>th</sup> April 2021, <<http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4342400/2021091617180089879.pdf>>





handbook on regulatory issues.

- Increase foreign SMEs' awareness of and accessibility to government incentives and funding instruments from local administrations.
- Publish English-language versions of notices about the availability of local R&D funds and grants, and communicate them in a timely manner.

## 2. Promote Coordination Between Different Administrative Departments and Improve the Transparency, Clarity and Integrity of All Relevant Regulations for SMEs



### Concern

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

### Assessment

Thanks to a number of measures aimed at improving the business environment rolled out over the past few years, foreign SMEs have reported advancements in areas such as a reduction in the time required for registering or closing down operations.

Although the efficiency of China's registration processes has generally improved, according to feedback from working group members, the time required to set up a business is still longer than the targets set by the government. The approval of the business scope for FIEs is subject to extensive scrutiny from the State Administration for Market Regulation (SAMR) and the Ministry of Commerce, as well as additional specific departments if special licensing is required. This process is especially difficult for smaller enterprises to navigate and can create additional costs, such as having to pay for office rental while licence applications are still pending.

Almost half of the European Chamber's *Business Confidence Survey 2022* respondents reported that they faced either direct barriers, such as the negative list, or indirect barriers, such as complex and time-consuming administrative approval requirements, and *de facto* barriers like obtaining operating licences. While ambiguous rules and regulations and market access

constraints are ranked as the top regulatory obstacles in several industries, administrative issues are more industry-specific.<sup>26</sup>

In Southwest China, overlapping regulations and a lack of interdepartmental coordination results in administrative processes that are so arduous they negatively impact SMEs' daily operations.<sup>27</sup> The working group believes that 'one-stop' service desks—such as those set up by the Chengdu Municipal Government—have the potential to provide support for matters beyond new company registration, such as those related to daily operations.<sup>28</sup> Working group members from Southwest China also say there is need for improvement on data sharing and general administrative coordination among both different city districts and different government departments. They also report a lack of consistency, with administrative processes differing depending on the industry sector. Within sectors where there is a heavy regulatory focus on safety standards, for example, the process for obtaining an operating licence is more complicated and information channels more opaque. Member companies expressed the opinion that this is in large part due to local officials not wanting to assume any unnecessary risk.

Similarly, European SMEs in Tianjin find the local administrative system uncoordinated and burdensome – different districts assume different roles, from environmental to COVID-related policies; while SMEs in South China face long trademark registration processes.

Not only did the pandemic bring to light inefficiencies in areas like administrative procedures that in the past might have gone unnoticed, it also added to the difficulties foreign companies encounter. A case in point is the inability of many SMEs' employees to return to China due to travel restrictions imposed in 2020 as COVID-19 control measures, making the hiring process and retention of both foreign and senior talent extremely

26 For example, licensing requirements/registration processes is less of an issue for those in professional services, automotive and education, but is a significant issue in industries such as medical devices, petrochemicals, and IT and telecommunications. Customs regulations also do not pose a significant barrier for a number of industries, but are a clear problem for industries such as transportation and logistics, machinery, food and beverage, and aviation and aerospace. *European Business in China Business Confidence Survey*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 21<sup>st</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

27 *Southwest China Position Paper 2021/2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> April 2022, viewed 27<sup>th</sup> April 2022, <<https://www.europeanchamber.com.cn/en/press-releases/3428>>

28 *Ibid*, pp. 11–12.





challenging. The lack of key personnel has caused a host of operational challenges for SMEs, and certain administrative procedures that require the physical presence of a legal representative or signatory have been rendered impossible. The inability to use certain online tools that are blocked in China only aggravates the situation. As of May 2022, despite China being 'open' to citizens holding valid residence permits, cross-border travel is not yet back to normal, with particular difficulties for those whose visas have expired in the interim, while quarantine processes are often unpredictable. Even business trips within China have become particularly difficult – provinces have established different entry and exit rules and regulations, as well as different quarantine measures. Likewise, logistical restrictions have led to continuous disruptions to supply chains and manufacturing.

The working group therefore encourages the Chinese Government to work with the European business community to find solutions to administrative challenges faced by SMEs—some specific to foreign companies—derived from or intensified by COVID-19, and ways to prevent such situations from arising in the future.

#### Recommendations

- Implement a 'one-stop-service' system in provincial/regional administrative departments to support all SMEs, both foreign and Chinese, in fulfilling their multiple registration and regulatory obligations, as well as matters related to their daily operations.
- Improve data sharing and general administrative coordination among both different city districts and different government departments.
- Continue efforts to alleviate administrative burdens for SMEs by reducing the number of government approvals required and simplifying the remaining approval and filing procedures.
- Ease COVID-related travel restrictions to allow foreign nationals to return to China or move within China, while upholding all necessary health and safety measures.
- Ease COVID-related logistical restrictions to allow smoother transportation of goods from China, to China, or within China.

### 3. Reduce the Financial Burden of SMEs to the Greatest Extent Possible, Including Through Measures Like Ensuring Reasonable Payment Terms and Enforcing Timely Payments

#### Concern

It is increasingly challenging for European SMEs to shoulder the financial burdens associated with doing business in China, with difficulties exacerbated by liquidity problems arising from an absence of maximum contractual payment terms, non-negotiable payment terms with state-owned enterprises (SOEs) or private sector players, and late/non-payments from clients.

#### Assessment

Since access to financing is limited for SMEs in general in China, and international SMEs in particular, substantial reserve assets are a prerequisite for their business operations in the country. Usually, SMEs have limited bargaining power during negotiations with clients for payments, often resulting in customers imposing onerous contractual payment terms. In addition, many customers simply do not comply with these terms and pay late.

In China, most industries lack guidelines to ensure that market players respect contractual payment terms, and so enterprises set a maximum payment term to be included in contracts. Unlike in the EU, Chinese law has limited provisions on late payments (existing ones are mostly referred to the Supreme Court's Interpretation on the Adjudication of Contract Disputes,<sup>29</sup> and the Civil Procedure Law<sup>30</sup>). Debt collection services are available, but are often not practical given the time and, most importantly, high costs involved.

Regionally, while SMEs in South China report unreasonable payment terms from their suppliers, which makes it very hard to buy materials upfront for the following few months, Tianjin SMEs often experience late payments from clients, which creates imbalance and uncertainty with regard to their cash flow.

<sup>29</sup> *Supreme Court's Interpretation on the Adjudication of Contract Disputes*, Hualv.com, 10<sup>th</sup> January 2019, viewed 26<sup>th</sup> April 2022, <<https://www.66law.cn/laws/131741.aspx>>

<sup>30</sup> The major flaw is that while the debtor may not dispute the debt, they may refuse to pay and then bring a claim that does not have to be substantiated in order for the court to dismiss the case, which leaves the creditor to pursue their claim through regular court proceedings. *Civil Procedure Law of the People's Republic of China*, MOFCOM, 9<sup>th</sup> April 1991, viewed 21<sup>st</sup> June 2022, <<http://english.mofcom.gov.cn/article/lawsdata/chineselaw/200211/20021100053380.html>>





On 1<sup>st</sup> July 2020, the State Council issued the *Regulation on Ensuring Payments to Small and Medium-Sized Enterprises (Payment Regulations)*.<sup>31</sup> The working group considers this a positive development in terms of developing a regulatory framework to address late payments, but notes that effective implementation, and clear and well-developed regulations, will be key. The working group is glad to see that, in December 2021, the MIIT issued the *Interim Measures for Handling Complaints on Safeguarding Payments to SMEs (Interim Measures)* to refine and implement the *Payment Regulations*. First, the *Interim Measures* clarify the departments and channels for receiving complaints regarding late payments to SMEs and define the scope of complaints. Second, the division of labour and time limits for handling complaints are clearly outlined. Third, a number of supporting and monitoring mechanisms are adopted.<sup>32</sup>

European SMEs report that actions taken by the Chinese Government to reduce the financial burden on small businesses—especially during COVID—such as the temporary suspension of enterprise charges; reductions or exemptions for tax payments and social welfare; and the extension of social insurance payment periods, have been beneficial. The working group welcomed the 24<sup>th</sup> March announcement by the MOF and the State Taxation Administration (STA) on VAT exemptions for small-scale VAT taxpayers from April to December 2022. Moreover, the taxable sales income of small-scale VAT taxpayers earned before 31<sup>st</sup> March 2022 will be taxed at a reduced rate.<sup>33</sup>

One area where room for improvement remains is social insurance. For instance, in the case of a person hired on a gross salary of CNY 15,000 per month in Beijing, the Chinese social insurance on this salary is outlined in Table 1.

Table 1

Company housing fund policy	Cost to the company (CNY)	Cost to the individual (CNY)	Total cost (CNY)	Percentage of salary
5 per cent (minimum)	4,743	2,328	7,071	47.14 per cent
12 per cent (maximum)	5,792	3,378	9,171	61.14 per cent

The working group also welcomed the *Announcement of Further Implementing Preferential Income Tax Policies for Low-margin, Small Enterprises*, which halved the corporate income tax (CIT) for small and low-profit enterprises (from 10 per cent to five per cent) for taxable income between CNY 1 million and CNY 3 million.<sup>34</sup> However, when profits go above CNY 3 million, the CIT rate jumps immediately to 25 per cent of total profits instead of taking an incremental approach.

Given the challenges small companies are facing, and will continue to face in the foreseeable future due to the uncertain economic situation, the working group encourages the Chinese authorities to continue developing SME-specific measures aimed at reducing their financial burden, particularly in the above-mentioned areas.

### Recommendations

- Issue guidelines and implement effective industry supervision measures to ensure that SOEs and private sector players respect contractual payment terms when dealing with SMEs.
- Set a maximum payment term that is lawfully allowed to be included in contracts.
- Further encourage SOEs to sign contracts with SMEs that have reasonable payment terms.
- Improve legal debt collection procedures.
- Develop and implement further measures to encourage banks to provide financing solutions to SMEs based on accounts receivable.
- Continue to develop targeted measures that reduce the financial burden of SMEs, such as reducing social insurance costs and using an incremental approach for the allocation of CIT rates.

31 *Regulations on Protecting Payments for Small and Medium-sized Enterprises*, State Council, 3<sup>rd</sup> July 2020, viewed 26<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2020-07/14/content\\_5526768.htm](http://www.gov.cn/zhengce/content/2020-07/14/content_5526768.htm)>

32 *Interim Measures for Handling Complaints on Safeguarding Payments to SMEs*, MIIT, 30<sup>th</sup> December 2021, viewed 29<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-12/30/content\\_5665561.htm](http://www.gov.cn/zhengce/zhengceku/2021-12/30/content_5665561.htm)>

33 *Notice on the exemption of value-added tax for small-scale taxpayers*, MOF and STA, 24<sup>th</sup> March 2022, viewed 29<sup>th</sup> April 2022, <[http://szs.mof.gov.cn/zhengcefabu/202203/t20220324\\_3797862.htm](http://szs.mof.gov.cn/zhengcefabu/202203/t20220324_3797862.htm)>

34 *Further Implementing Preferential Income Tax Policies for Low-margin, Small Enterprises*, MOF and STA, 18<sup>th</sup> March 2022, viewed 29<sup>th</sup> April 2022, <[http://szs.mof.gov.cn/zhengcefabu/202203/t20220317\\_3795819.htm](http://szs.mof.gov.cn/zhengcefabu/202203/t20220317_3795819.htm)>





#### 4. Promote the Value of IPR Protection and Enforcement Mechanisms at the Consumer, Business and Local Government Levels



##### Concern

Ineffective IPR enforcement at the local level continues to limit the impact of recent positive changes to China's IPR legislative environment.<sup>35</sup>

##### Assessment

Despite improvements in legislation and enforcement, difficulties related to navigating the Chinese IP system still pose a challenge for European companies.<sup>36</sup> The COVID-19 pandemic has further exacerbated other existing problems, such as issues relating to IP enforcement, document legalisation and handling of sensitive information.<sup>37</sup>

China's IP laws and regulations have significantly improved over the past four years as the country reviewed and updated its major IP laws. Trademark protection has been strengthened by the Trademark Law, which came into force on 1<sup>st</sup> November 2019 and bans bad faith applications.<sup>38</sup> Since its application, the China National Intellectual Property Administration has shown determination in tackling bad-faith applications and trademark squatting.<sup>39</sup> However, as legislation evolves, infringers have become more sophisticated, highlighting the need for more effective enforcement at state and local government levels.

Copyright and patent protection are also strengthened by the new Copyright Law and new Patent Law,<sup>40&41</sup> both

of which became effective in June 2021. These laws significantly adjust the amount of damages infringers must pay, modifications similar to those implemented in the Trademark Law and the Civil Code. Regardless, there is still room for improvement, as in large-scale infringements the damages granted by the courts generally do not cover the actual losses suffered by enterprises. The calculation of statutory damages often seems arbitrary to many European companies, which they report makes it difficult for them to accurately carry out risk assessment and management.<sup>42</sup>

China's E-commerce Law, which came into effect on 1<sup>st</sup> January 2019, strengthens IPR enforcement on e-commerce platforms.<sup>43</sup> However, the role of voluntary copyright registration certificates in the notice-and-take-down procedures remains inconsistent, as some e-commerce platforms do not consider the certificate as basis to commence procedures, while in some cases bad faith copyright registration certificates in fact facilitate trademark infringements. Furthermore, the notice-and-take-down procedures allow bad faith online sellers to provide a statement of not having committed an offence. While not being bad *per se*, such statements mandate the platforms to end the measures taken against the seller unless the claimant starts administrative or legal actions within 15 days, which imposes significant costs on rights holders. Moreover, the latest draft amendments of the E-commerce Law include a provision allowing sellers to provide a guarantee to the platforms for the amount of the estimated sales, to avoid temporary restrictions imposed by the platforms while the notice-and-take-down procedure is pending.<sup>44</sup> In practice, this significantly reduces the efficiency of the notice-and-take-down procedure during special sale promotions, when sales numbers are impossible to estimate, but are likely to be extraordinarily high.

<sup>35</sup> For more information on IP issues affecting European businesses, please refer to the *Intellectual Property Rights Working Group Position Paper 2022/2023*.

<sup>36</sup> *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 21<sup>st</sup> June 2022, <<https://www.eurochamber.com.cn/en/publications-business-confidence-survey>>

<sup>37</sup> *Protecting Intellectual Property in China during the COVID-19 Period*, United Kingdom Government, 3<sup>rd</sup> August 2020, viewed 13<sup>th</sup> May 2022, <<https://www.gov.uk/government/publications/protecting-intellectual-property-in-china-during-the-covid-19-period>>

<sup>38</sup> *Trademark Law*, NPC, 7<sup>th</sup> May 2019, viewed 26<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/201905/dac65eec798444e821a1e06a347f3ee.shtml>>

<sup>39</sup> *Report on the Implementation of China's Amended Trademark Law*, International Trade Mark Association, November 2021, viewed 13<sup>th</sup> May 2022, <[https://www.inta.org/wp-content/uploads/public-files/advocacy/committee-reports/CHINA-TRADEMARK-LAW-REPORT\\_120121.pdf](https://www.inta.org/wp-content/uploads/public-files/advocacy/committee-reports/CHINA-TRADEMARK-LAW-REPORT_120121.pdf)>

<sup>40</sup> *Decision of the Standing Committee of the National People's Congress on Amending the Copyright Law of the People's Republic of China*, NPC, 11<sup>th</sup> November 2020, viewed 26<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202011/272b72cdb759458d94c9b875350b1ab5.shtml>>

<sup>41</sup> *Decision of the Standing Committee of the National People's Congress on Amending the Patent Law of the People's Republic of China*, NPC, 18<sup>th</sup> October 2020, viewed 26<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2020-10/18/content\\_5552102.htm](http://www.gov.cn/xinwen/2020-10/18/content_5552102.htm)>

<sup>42</sup> "It is difficult for the right holder to prove his rights by means of litigation, which leads to the absolute dominant position in the application of statutory compensation rules. However, the scope of the amount of compensation awarded in the statutory compensation rules is determined by judicial discretion, which is uncertain for the protection of the rights and interests of the right holder. Although the loss rules and the benefits rules are feasible in theory, few cases apply to them because the right holder cannot obtain the relevant evidence. The loss rules, which requires the right holder to collect evidence, is a high cost for the small and medium enterprises.": Zhang, Jingchen, *China's Patent Law has Changed: How to understand and apply infringement damages under the new rules*, *Swiss Chinese Law Review Journal*, 19<sup>th</sup> April 2021, viewed 10<sup>th</sup> May 2022, <<https://www.sclalawreview.org/understanding-and-applying-the-infringement-damages-article-of-chinas-2020-patent-law/>>

<sup>43</sup> E-Commerce Law, NPC, 31<sup>st</sup> August 2018, viewed 26<sup>th</sup> April 2022, <[http://www.npc.gov.cn/zgrdw/npc/flzt/rlyw/2018-08/31/content\\_2060827.htm](http://www.npc.gov.cn/zgrdw/npc/flzt/rlyw/2018-08/31/content_2060827.htm)>

<sup>44</sup> *Public Consultation on the Decision on Amending the E-commerce Law of the People's Republic of China (Draft)*, SAMR, 31<sup>st</sup> August 2021, viewed 27<sup>th</sup> June 2022, <[https://www.samr.gov.cn/hd/zjdc/202108/t20210831\\_334252.html](https://www.samr.gov.cn/hd/zjdc/202108/t20210831_334252.html)>





Despite improvements in China's IP system, counterfeiting remains a major issue in China. According to the EU Agency for Law Enforcement Cooperation and the EU Intellectual Property Office, China is still the origin of around 76 per cent of all counterfeited products detained at the bloc's borders.<sup>45</sup>

On the enforcement side, China's IP Court system has progressed in recent years with the establishment and subsequent expansion of specialised IP Courts and Tribunals across China. The internet courts in Hangzhou, Beijing and Guangzhou have facilitated some IP-related dispute processes, and, the first blockchain-enabled notary opened in Beijing.<sup>46</sup> These developments are especially significant for SMEs, as they have the potential to considerably reduce the costs associated with IP dispute processes.

China's COVID-19 containment measures have complicated the registration and enforcement of IPR, especially those of foreign companies. Delays in the legalisation of documents, such as power of attorney, by Chinese embassies in companies' home countries has become one of the most significant obstacles for EU companies, as embassies in some countries can take weeks or even months to offer appointments.<sup>47</sup>

On the political front, there have been several high-level statements regarding the protection of IP in China,<sup>48</sup> and, more concretely, the condemnation of unfair technology transfers. Yet, in practice, policy guidance at the municipal or provincial level, as well as legal instruments such as joint venture requirements, continue to compel technology transfers. For example, guided by China Manufacturing 2025, local public tenders often include a 'made in China' requirement, pushing foreign companies into joint ventures in

exchange for market access.<sup>49</sup> In the European Chambers, *Business Confidence Survey 2022*, although there was a two percentage point year-on-year decrease in the number of European companies reporting being compelled to transfer technology, 14 per cent of respondents reported they were still compelled to transfer technology, more than two years after the implementation of the Foreign Investment Law, which should prohibit this practice.<sup>50</sup>

The EU-China Agreement on Geographical Indications (GIs), which came to force in March 2021, marked an important step for the protection of GIs within the China market, covering 100 key EU GIs, and with 175 more EU GIs to be included over the next four years. However, some EU GIs may be excluded from acquiring protection because of their generic names (for example, claims outside of the EU that 'feta' has become the generic name for a white cheese aged in brine) or prior trademarks.<sup>51</sup> These two exceptions can potentially endanger the success of future EU GI registrations. Therefore, strengthening the SAMR's powers to enforce the EU-China GI Agreement will be crucial to the success of the initiative.

#### Recommendations

- Strengthen enforcement and consistency with regard to notice-and-take-down procedures.
- Engage local enforcement agencies, customs authorities and courts to take effective action against counterfeiting.
- Improve online access to IPR-related agencies in order to make it easier for SMEs to enforce their rights in a more affordable way.
- Facilitate the legalisation of foreign documents by Chinese embassies.
- Increase the SAMR's power to enforce the EU-China GI Agreement.

45 *Intellectual Property Crime Threat Assessment 2022*, EUIPO and EUROPOL, updated 16<sup>th</sup> March 2022, viewed 10<sup>th</sup> May 2022, <<https://www.europol.europa.eu/publications-events/publications/intellectual-property-crime-threat-assessment-2022>>

46 *China's First Blockchain Notary Opens in Beijing*, *China Daily*, 19<sup>th</sup> April 2019, viewed 26<sup>th</sup> April 2022, <<http://tech.chinadaily.com.cn/a/201904/19/WS5cba56daa310e7f8b1577bf4.html>>

47 *Delays with Chinese Embassy Attestation*, Hague Apostille, 2021, viewed 13<sup>th</sup> May 2022, <<https://www.hagueapostille.co.uk/blog/delays-chinese-embassy-attestation>>; *Notice on the Application for Consular Legalisation to the Chinese Visa Application Service Centre in Madrid and Barcelona*, Embassy of China in Spain, 2021, viewed 13<sup>th</sup> May 2022, <[http://es.chineseembassy.org/esp/lqyw/aacc3/202105/t20210528\\_9041564.htm](http://es.chineseembassy.org/esp/lqyw/aacc3/202105/t20210528_9041564.htm)>; *Office Hours of Consular and Visa Section*, Embassy of China in Ireland, 2020, viewed 13<sup>th</sup> May 2022, <[http://ie.china-embassy.org/eng/lsfw/201512/t20151228\\_2238765.htm](http://ie.china-embassy.org/eng/lsfw/201512/t20151228_2238765.htm)>

48 *14<sup>th</sup> Five-Year Plan for the National Economic and Social Development and the Long-Range Objectives Through the Year 2035*, National Development and Reform Commission, 23<sup>rd</sup> March 2021, viewed 10<sup>th</sup> May 2022, <[https://www.ndrc.gov.cn/xqkj/zcfb/gwhb/202103/t20210323\\_1270124.html?code=&state=123](https://www.ndrc.gov.cn/xqkj/zcfb/gwhb/202103/t20210323_1270124.html?code=&state=123)>

49 *"Report on the protection and enforcement of intellectual property rights in third countries" Commission Staff Working Document*, European Commission, April 2021, viewed 10<sup>th</sup> May 2022, <[https://trade.ec.europa.eu/doclib/docs/2021/april/tradoc\\_159553.pdf](https://trade.ec.europa.eu/doclib/docs/2021/april/tradoc_159553.pdf)>

50 *European Business in China Business Confidence Survey*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 21<sup>st</sup> June 2022, <<https://www.european-chamber.com/en/publications-business-confidence-survey>>

51 GIs identified as potentially problematic include: Perigord, Szegedi teliszalami/Szegedi szalami, Prosciutto Toscano, Fontina, Munster, Nurnberger Bratwurst, Jambon de Bayonne and Beaufort; Hu, Weinian, *Dinner for Three: EU, China and the US Around the Geographical Indications Table*, Centre for European Policy Research, April 2020, viewed 26<sup>th</sup> April 2022, <[https://www.ceps.eu/wp-content/uploads/2020/04/PI2020-07\\_EU-China-and-the-US-around-the-geographical-indications-table.pdf](https://www.ceps.eu/wp-content/uploads/2020/04/PI2020-07_EU-China-and-the-US-around-the-geographical-indications-table.pdf)>





## Abbreviations

14FYP	14 <sup>th</sup> Five-year Plan
CIT	Corporate Income Tax
CNY	Chinese Yuan
EU	European Union
EUR	Euro
FIE	Foreign-Invested Enterprise
GI	Geographical Indication
IP	Intellectual Property
IPR	Intellectual Property Rights
MIIT	Ministry of Industry and Information Technology
MOF	Ministry of Finance
NPC	National People's Congress
R&D	Research and Development
RMB	<i>Renminbi</i>
SAMR	State Administration of Market Regulation
SME	Small and Medium-sized Enterprise
SOE	State-owned Enterprise
STA	State Taxation Administration
USD	United States Dollar
VAT	Value-added Tax



# Investment Working Group

## Key Recommendations

### 1. Implement the Foreign Investment Regime and Adhere to the Principle of National Treatment 3

- Continue to reduce the number of industry sectors on the negative lists in which foreign investment is either restricted or prohibited.
- Introduce reporting, mediation and dispute resolution mechanisms and avenues of recourse for foreign companies subject to compelled technology transfers.
- Implement and adhere to the principle of national treatment across government levels and nationwide (in particular in the area of government procurement).
- Abolish specific laws and regulations imposing investment restrictions only on foreign investors, including onshoring requirements and discriminatory requirements on licensing.
- Introduce legislation that allows for a national unified market aligned with international rules and best practices, and the unification of standards and policies in different regions and industries.

### 2. Enhance Market Competitiveness and Further a Level Playing Field with State-owned Enterprises (SOEs) 6

- Afford national treatment to all enterprises established in China, regardless of ownership and company type.
- Reduce complexities around business licences and permits, and improve transparency in the application of risk/return guidelines for SOE financing.

### 3. Streamline the Mergers and Acquisitions Process 3

- Formulate national-level guidance aimed at providing automatic, fast-track licensing for asset deals that adequately reflect business transfers.
- Allow foreign-invested enterprises (FIEs) access to China's capital market on an equal basis with local players.
- Adhere to a strict application of bankruptcy laws and eliminate arbitrary considerations in decisions involving informal reorganisation arrangements.
- Continue to harmonise the treatment of FIEs and domestic companies as per the Foreign Investment Law (FIL) and eliminate remaining barriers to foreign investment by creating a level playing field.

### 4. Further Open China's Capital Market to Foreign-invested Enterprises (FIEs) 9

- Expand FIEs access to China's capital market.
- Improve market regulation by the China Securities Regulatory Commission and its sister financial regulators.
- Create a fair and level playing field for FIEs seeking to issue debt securities, including bonds and asset-backed securities.
- Grant FIEs national treatment and allow them to list their shares on a Chinese stock exchange.
- Establish an 'international board' on the Shanghai Stock Exchange to allow international





- enterprises to achieve a secondary listing of their equity securities in China's A-share market.
- Simplify the rules for foreign investors selling shares of listed joint ventures as per the principle of national treatment highlighted by the FIL.
- Remove the additional disclosure requirements on investments by foreign investors in listed companies so as to correspond to the principle of national treatment

## Introduction to the Working Group

The Investment Working Group advocates for improvements in China's investment environment in terms of market access and regulatory environment. The working group's membership is comprised of service providers, including investment consultants, law firms, private equity and venture capital firms, and banks, as well as a range of large European manufacturers. The working group seeks to achieve a level playing field for foreign investors through the notion of reciprocity. It further provides a platform for knowledge exchange and expertise sharing among professional investment advisors in China.

## Recent Developments

In 2021, global foreign direct investment (FDI) recovered from exceptionally low levels in 2020. According to the United Nations Conference on Trade and Development, global direct investment flows rebounded by 77 per cent to exceed pre-pandemic levels.<sup>1</sup> In 2021, China attracted a record high of United States dollars (USD) 334 billion in net FDI, a 32 per cent surge from the previous year. Net FDI inflows are a major component of overall net overseas investment into China, which rose 13 per cent to USD 661.6 billion in 2021, according to the State Administration of Foreign Exchange (SAFE).<sup>2</sup> Foreign investment in China's high-technology manufacturing and services industries rose 10.7 per cent and 19.2 per cent year-

on-year, respectively.<sup>3</sup> Mergers and acquisitions (M&A) in China also surged to a new record-high of 12,790 transactions, up 21 per cent from 2020. However, a drop in 'mega-deals' in 2021 meant deal values fell by 19 per cent to USD 637 billion from 2020's record level of approximately USD 785 billion.<sup>4</sup>

### Negative Lists

On 27<sup>th</sup> December 2021, the National Development and Reform Commission issued the *Negative List of Foreign Investment (2021 version)*,<sup>5</sup> and the Ministry of Commerce (MOFCOM) issued the *Negative List of Foreign Investment for Pilot Free Trade Zones (2021 version)*.<sup>6</sup>

In the 2021 versions, the negative lists for foreign investment in China and pilot free trade zones are further reduced by two items to 31 and three items to 27 items respectively. In the automobile manufacturing sector, restrictions on foreign ownership in passenger car manufacturing and restrictions on the establishment of joint ventures in China for the production of the same vehicle products are abolished. The European Chamber welcomed the updates contained in the two negative lists, which came into effect on 1<sup>st</sup> January 2022.<sup>7</sup> Regarding market access in the pilot free trade zones, in the radio and television equipment manufacturing

1 Kratz, Agatha; Zenglein, Max J.; Sebastian, Gregor; & Witzke, Mark, *Chinese FDI in Europe 2021 Update*, Rhodium Group and MERICS, April 2022, viewed 27<sup>th</sup> April 2022, <<https://rhg.com/wp-content/uploads/2022/04/MERICS-Rhodium-Group-COFDI-Update-2022-2.pdf>>

2 Cheng, Kelsey, *Foreign Direct Investment in China Hit Record High in 2021*, *Caixin Global*, 28<sup>th</sup> March 2022, viewed 21<sup>st</sup> June 2022, <<https://www.caixinglobal.com/2022-03-28/foreign-direct-investment-in-china-hit-record-high-in-2021-101862479.html>>

3 *China's FDI inflow up 14.9% to record high in 2021*, National Development and Reform Commission, 29<sup>th</sup> January 2022, viewed 21<sup>st</sup> June 2022, <[https://en.ndrc.gov.cn/netcool/achievements/202201/20220129\\_1315532.html](https://en.ndrc.gov.cn/netcool/achievements/202201/20220129_1315532.html)>

4 *PwC M&A 2021 Review and 2022 Outlook Report*, PwC, February 2022, viewed 22<sup>nd</sup> June 2022, <<https://www.pwccn.com/en/services/deals-m-and-a/publications/ma-2021-review-2022-outlook.html>>

5 *Special Administrative Measures on Foreign Investment Access (Negative List) (2021 version)*, State Council, 27<sup>th</sup> December 2021, viewed 22<sup>nd</sup> June 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-12/28/content\\_5664886.htm](http://www.gov.cn/zhengce/zhengceku/2021-12/28/content_5664886.htm)>

6 *Special Administrative Measures on Foreign Investment Access (Negative List) (2021 version) for Pilot Free Trade Zones*, State Council, 27<sup>th</sup> December 2021, viewed 22<sup>nd</sup> June 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-12/28/content\\_5664887.htm](http://www.gov.cn/zhengce/zhengceku/2021-12/28/content_5664887.htm)>

7 *European Chamber Stance on the Liberalisation of Ownership Restrictions in the Automotive Sector*, European Union Chamber of Commerce in China, 11<sup>th</sup> January 2022, viewed 4<sup>th</sup> July 2022, <<https://www.eurochamber.com.cn/en/press-releases/3414>>





sector, restrictions on the production of ground receiving facilities and key components for satellite television and radio broadcasting were abolished. The working group views the updated *Negative List for Foreign Investment* as another small step forward in China's reform and opening up agenda.

### Zero-COVID Policy

Starting from February 2022, clusters of the Omicron variant of COVID-19 emerged in locations across China, including Jilin, Shandong, Guangdong, Hebei and Shanghai. Among them, Shanghai experienced the country's biggest outbreak since Wuhan in 2020. On 26<sup>th</sup> April 2022, Shanghai Commission of Disease Control (CDC) officials said that, as of the date, the cumulative count of local cases had exceeded 500,000.<sup>8</sup> The surge occurred despite China's long-held zero-COVID policy, which entailed strict social distancing, mass testing, lockdowns and largely closed borders. Strict COVID-19 containment policies continue to complicate China's economic interaction with the outside world, and with the significant uptick of Omicron variant infections in China, international travel restrictions are likely to remain in place for much of 2022.<sup>9</sup> This will further drag on the pace of deal-making and hinder due diligence processes.

Since China largely closed its borders to foreigners in March 2020, cross-border business trips between their headquarters (HQ) in Europe and China became an unobtainable corporate luxury for the majority of European companies, which is detrimental to timely communication between HQ and their China subsidiaries. China operations are becoming increasingly isolated due to China-based staff, both foreign and Chinese, being unable to travel to European HQ for information exchanges, networking, training and the sharing of expertise.<sup>10</sup> According to the results of a flash survey by the European Chamber on the impact of both COVID-19 containment measures and the Russian invasion of Ukraine, 23 per cent of respondents are

considering shifting current or planned investments outside of China.<sup>11</sup>

## Key Recommendations

### 1. Implement the Foreign Investment Regime and Adhere to the Principle of National Treatment

#### Concern

Inconsistent enforcement of the Foreign Investment Law (FIL) and restrictions imposed on foreign-invested enterprises (FIEs) continue to result in unequal treatment in the Chinese marketplace.

#### Assessment

Over two years after the promulgation of the FIL, China continues to differentiate between foreign and Chinese companies in the field of investment. As highlighted in the *Investment Working Group Position Paper 2021/2022*, the FIL does not fundamentally abolish the distinction between foreign and domestic investment.

The Investment Working Group maintains that no compelling reasons exist to regulate companies differently based on ownership structure or investor nationality. China's negative list system continues to either prohibit or restrict foreign investment in certain sectors. That being said, certain aspects of China's market access have improved marginally, including the lifting of ownership restrictions for manufacturers of passenger vehicles.<sup>12</sup>

However, despite the aforementioned easing of market access in China, foreign investors have lingering concerns, with 45 per cent of respondents to the European Chamber's *Business Confidence Report 2022* reporting having lost business opportunities due to market access barriers. What is most troubling is that a mere 12 per cent state that such hindrances are direct, like the negative lists, while one third report that they are indirect, as in opaque licensing procedures and

8 Shanghai CDC: Since the end of February, the total number of cases has exceeded 500,000, and the proportion of asymptomatic cases is about 90%, SINA Finance and Economics, 26<sup>th</sup> April 2022, viewed 4<sup>th</sup> July 2022, <<https://finance.sina.com.cn/china/djij/2022-04-26/doc-imcwiwst4085685.shtml>>

9 Shanghai CDC: Since the end of February, the total number of cases has exceeded 500,000, and the proportion of asymptomatic cases is about 90%, SINA Finance and Economics, 26<sup>th</sup> April 2022, viewed 4<sup>th</sup> July 2022, <<https://finance.sina.com.cn/china/djij/2022-04-26/doc-imcwiwst4085685.shtml>>

10 European Business in China Business Confidence Survey 2022, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 23<sup>rd</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

11 Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 23<sup>rd</sup> June 2022, <[https://www.europeanchamber.com.cn/en/publications-archive/973/Flash\\_Survey\\_COVID\\_19\\_and\\_the\\_War\\_in\\_Ukraine\\_The\\_Impact\\_on\\_European\\_Business\\_in\\_China](https://www.europeanchamber.com.cn/en/publications-archive/973/Flash_Survey_COVID_19_and_the_War_in_Ukraine_The_Impact_on_European_Business_in_China)>

12 For more information, please refer to the Recent Developments section of this position paper.





administrative approvals.<sup>13</sup>

### Foreign Investment Law and Technology Transfer

Despite China releasing the *Guidelines for Building a Powerful Intellectual Property Nation (2021-2035)* in September 2021,<sup>14</sup> intellectual property protection remains a significant concern for European companies as many are still being compelled to transfer technology to maintain market access.

Article 22 of the FIL states that "No administrative department or its staff member shall force any transfer of technology by administrative means."<sup>15</sup> In addition to which, under the *Implementing Regulations of the Foreign Investment Law of the People's Republic of China*, Article 24 states that "No administrative authority (including organisations with the function of managing public affairs as authorised by laws and regulations, the same below) or their working personnel may force directly or in a disguised way any foreign investor or foreign-invested enterprise to transfer its technology by virtue of implementing administrative licensing, administrative inspection, administrative punishment, administrative enforcement or other administrative means."<sup>16</sup>

However, this does not address the core problem. According to the *Business Confidence Survey 2022*, 14 per cent of respondents were compelled to transfer technology. Of those, one third said it took place in the past two years and another 30 per cent reported it was still taking place. This means that the majority of compelled technology transfers occurred after the FIL, which should prohibit this practice, went into effect on 1<sup>st</sup> January 2020. Most respondents report that the technology they were compelled to transfer was part of a commercial agreement or joint venture requirements, but 31 per cent report that it happened due to written policy requirements or verbal pressure from government

officials.<sup>17</sup> This suggests that the FIL has not been implemented to the letter of the law.

When envisioning possible solutions, the EU-China Comprehensive Agreement on Investment (CAI) contained a clear and comprehensive definition of forced technology transfers that covers most practices aimed at involuntary transfers of technology by various parties. Although the CAI is currently frozen,<sup>18</sup> the ongoing issues related to non-compliance by Chinese partners on compelled technology transfer could be reported and addressed under the umbrella of mediation and dispute resolution mechanisms which had been envisioned in the draft agreement. Establishing multiple channels of communication and dispute resolution mechanisms has the potential to benefit European businesses and their willingness to invest in the Chinese market, as these enterprises rely not only upon solid commitments, but also on linking these commitments to effective implementation and enforcement mechanisms.

If foreign companies are subjected to unfair technology transfers, an increased level of clarity on the avenues of recourse is required, as in practice, FIEs still encounter unequal treatment compared to their domestic competitors. This leaves the FIL provisions somewhat dulled and ineffectual considering general business practices.

### Public Procurement

Article 16 of the FIL states that, "The State shall guarantee that foreign-funded enterprises can participate in government procurement activities through fair competition. Products produced and services provided by foreign-funded enterprises within the territory of China shall be treated equally in a government procurement." However, *Business Confidence Survey 2022* findings indicate that in terms of unequal treatment and the much sought-after concept of national treatment, European companies experience differentiated treatment in a wide range of areas. While 42 per cent reported market access issues and 22 per cent licensing issues, echoing previous findings,

<sup>13</sup> *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 23<sup>rd</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

<sup>14</sup> *Guidelines for Building a Powerful Intellectual Property Nation (2021–2035)*, State Council, 22<sup>nd</sup> September 2022, viewed 4<sup>th</sup> July 2022, <[http://www.gov.cn/zhengce/2021-09/22/content\\_5638714.htm](http://www.gov.cn/zhengce/2021-09/22/content_5638714.htm)>

<sup>15</sup> Foreign Investment Law of the People's Republic of China, National People's Council (NPC), 15<sup>th</sup> March 2019, viewed 11<sup>th</sup> July 2022, <<http://www.npc.gov.cn/englishnpc/c23934/202012/5b80fe5055504efa93b6744f9272b3c2.shtml>>

<sup>16</sup> *Regulation on the Implementation of the Foreign Investment Law*, State Council, 26<sup>th</sup> December 2019, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2019-12/31/content\\_5465449.htm](http://www.gov.cn/zhengce/content/2019-12/31/content_5465449.htm)>

<sup>17</sup> *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 29<sup>th</sup> June 2022, <[https://www.europeanchamber.com.cn/en/publications-archive/1020/Business\\_Confidence\\_Survey\\_2022](https://www.europeanchamber.com.cn/en/publications-archive/1020/Business_Confidence_Survey_2022)>

<sup>18</sup> *European Chamber Stance on the European Parliament Freezing of the CAI Ratification Process*, European Union Chamber of Commerce in China, 28<sup>th</sup> May 2022, 11<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/press-releases/3342>>





that 21 per cent highlighted differentiated treatment in public procurement suggests this is becoming more of an issue in China. Respondents reported that their local competition is given tender details ahead of time, allowing them to assemble a highly competitive bid by the submission deadline.

### National Unified Market

On 10<sup>th</sup> April 2022, the Central Committee of the Communist Party of China and the State Council jointly released the *Opinions on Accelerating the Construction of the National Unified Market*.<sup>19</sup> This document outlines plans to create a “national unified market” to improve standardisation and consistency in the implementation of regulations across a wide range of industries in China.

The construction of a national unified market was first proposed in the 14<sup>th</sup> Five-year Plan (14FYP) in early 2021, which sets out the goal of “optimising the market environment by benchmarking against advanced international rules and best practices, promoting the coordination and unification of standards, rules, and policies in different regions and industries, and effectively eliminating local protectionism, industry monopoly, and market segmentation.”<sup>20</sup> The national unified market will target a range of industries through a variety of regulations, such as intellectual property rights (IPR) protection, market access and anti-monopoly regulations, as well as via various industry-specific standards.

While the *Opinions* are a welcome development, their desired effect of consistency for all enterprises is somewhat muted, as the *Opinions* do not constitute legislation, merely the means to spur further regulation and guidelines. In addition, the *Opinions* envision amending segmented inefficiencies across different local governments as opposed to more broad national-based issues concerning providing a level playing field to foreign investors.

### Recommendations

- Continue to reduce the number of industry sectors on

the negative lists in which foreign investment is either restricted or prohibited.

- Introduce reporting, mediation and dispute resolution mechanisms and avenues of recourse for foreign companies subject to compelled technology transfers.
- Implement and adhere to the principle of national treatment across government levels and nationwide (in particular in the area of government procurement).
- Abolish specific laws and regulations imposing investment restrictions only on foreign investors, including onshoring requirements, and discriminatory requirements on licensing.
- Introduce legislation that allows for a national unified market aligned with international rules and best practices, and the unification of standards and policies in different regions and industries.

## 2. Enhance Market Competitiveness and Further a Level Playing Field with State-owned Enterprises (SOEs) 6

### Concern

China’s SOEs continue to enjoy preferential treatment, to the detriment of privately-owned competitors and Chinese consumers.

### Assessment

Although SOEs constitute one strategic pillar of the Chinese economy, achieving long-term, sustainable development entails the creation of an efficient domestic market in which participation by all players is enabled and fair competition for the benefit of consumers ensured. Findings from the European Chamber’s *Business Confidence Survey 2022* reveal that unequal treatment persists for 46 per cent of respondents,<sup>21</sup> highlighting once again the need for SOE reform.

### SOE Reform

On 26<sup>th</sup> February 2021, the State-owned Assets Supervision and Administration Commission and the Ministry of Finance (MOF) jointly issued the *Management Measures for the Formulation of Articles of Association of State-owned Enterprises*, which will play a key role in the reform and future development of China’s SOEs.

19 *Opinions on Accelerating the Construction of the National Unified Market*, State Council, 25<sup>th</sup> March 2022, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/2022-04/10/content\\_5684385.htm](http://www.gov.cn/zhengce/2022-04/10/content_5684385.htm)>

20 *Outline of the 14<sup>th</sup> Five-Year Plan for National Economic and Social Development of the People’s Republic of China and the Long-term Goals for 2035*, State Council, 12<sup>th</sup> March 2021, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592681.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm)>

21 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 29<sup>th</sup> June 2022, <[https://www.europeanchamber.com.cn/en/publications-archive/1020/Business\\_Confidence\\_Survey\\_2022](https://www.europeanchamber.com.cn/en/publications-archive/1020/Business_Confidence_Survey_2022)>





Central SOEs are heavyweights in strategic industries, making government-led attempts to reform their structure especially challenging. Over the past few decades, most efforts have been directed toward reforming these SOEs. As a result, explicit and implicit barriers to competition remain pervasive at the local level, where SOEs are less spread out geographically than their central counterparts. The working group expects more focus on continuing SOE reform in a deeper, systematic fashion that could lead to tangible improvements in the local business environment.

### New Industries

The 14FYP sets environmental protection and technological advancement as top national priorities for the next five years. European companies are eager to support China in this pursuit, yet face barriers that risk impairing their ability to contribute to the investment goals in new industries. In the absence of fair competition, access to markets like green energy generation is limited for foreign companies, if not outright restricted in areas such as carbon capture and storage, and power generation and distribution.<sup>22</sup>

This situation is worsened by restrictive regulations that widen the gap between FIEs and local players. For example, data localisation requirements, although applicable to both local and foreign companies alike, affect foreign players the most and result in a duplication of data storage and management assets and processes.

A similar situation affects data-driven technology industries, including cloud computing and information and communications technology.<sup>23</sup> Here, the impact of a regulatory-induced market segmentation for foreign players is even more concerning, given that project success is closely tied to the ability to offer service bundling and data monetisation across service lines. Current limitations in digital industries not only add complexity to any merger and acquisition (M&A) investment but also prevent FIEs from deploying synergetic strategies that generate wealth and growth for domestic subsidiaries.

<sup>22</sup> See the *Environment Working Group Position Paper 2022/2023* for more information.

<sup>23</sup> See the *Information and Communication Technology Working Group Position Paper 2022/2023* for more information.

### Recommendations

- Afford national treatment to all enterprises established in China, regardless of ownership and company type.
- Reduce complexities around business licences and permits, and improve transparency in the application of risk/return guidelines for SOE financing.

## 3. Streamline the M&A Process

### Concern

M&A activity in China continues to be hindered by regulatory and bureaucratic requirements that make investment into China comparatively more expensive than in competing geographies.

### Assessment

#### Regulatory Burdens Affecting Inbound Investment

The legal regime governing acquisitions in China remains complicated and restrictive, and its application mostly unpredictable. Foreign investors have to overcome a number of restrictions under the *Provisions on Merger and Acquisition of Domestic Enterprises by Foreign Investors (M&A Rules)*<sup>24</sup> along with additional challenges, such as merger control filing and national security review. A typical inbound M&A investment, for example, can take anything between 10 weeks, in the absence of special approvals, and several years for transactions that require reapplication for certain permits. Moreover, foreign M&As are regulated by a dedicated set of rules issued by the MOFCOM as well as regulations applicable to general FDI in China, such as the negative lists and the FIL.

With regard to the regulatory burden for foreign investment into China, structural elements exist that make inbound M&As more resource-intensive and uncertain than in other legal systems. Among the structural elements most cited by European investors are unclear guidelines and uncertainty surrounding the implementation of regulations on bankruptcy, court disputes, and permit granting and renewal, which often vary from region to region and city to city. In consequence, many European companies estimate a higher risk premium for investments into China.

European investors also worry this comparative disadvantage will intensify in the near future, especially

<sup>24</sup> *Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (M&A Rules)*, MOFCOM, 24<sup>th</sup> July 2009, viewed 4<sup>th</sup> July 2022, <[http://www.gov.cn/jffg/2009-07/24/content\\_1373405.htm](http://www.gov.cn/jffg/2009-07/24/content_1373405.htm)>





in light of the growing geopolitical tensions, as investment progressively shifts towards a greater focus on technology-intensive assets, in particular those related to decarbonisation and overall environmental sustainability. In the green economy—an area in which European companies have much to offer to China—complexities in the context of permit granting, coupled with uncertainties surrounding standard setting, remain significant and risk hampering inbound investment – battery manufacturing is one compelling example of how standards keep changing almost on an annual basis, adding layers of difficulty for foreign investors.<sup>25</sup>

### Access to Capital Markets and Financing

Foreign entities in China often complain of a less-than-level playing field when it comes to access to capital markets and financing of M&A transactions. For example, current rules prevent the controlling shareholder of a listed company from owning ‘competing’ business outside of China, effectively requiring that entire global operations be listed in the country, not just the Chinese subsidiaries.<sup>26</sup> The unclear legal status of board members and top management in listed companies is also a concern for multinational corporations (MNCs) that would otherwise list domestic operations in Chinese stock markets. Further, capital endowment requirements and exchange controls place limitations on the ability of European companies investing into China to fund operations and capital investments through debt.

Foreign inbound M&A are still unlikely to obtain funding domestically in China. Most MNCs use offshore funds in their acquisitions; risk management by domestic Chinese banks generally hinges on the value of hard assets on the balance sheet, such as land and machinery. In fact, M&A funding by Chinese financial institutions is subject to hard assets pledges. This practice inevitably penalises MNCs that are looking to enter China, as they have less tangible assets onshore than their domestic counterparts. And in the rare instances where leveraged buy-out funding is provided in China, it is extended on the basis of parent companies’ guarantees. This constraint has become ever more critical with the emergence of new drivers of growth and further rebalancing of the

<sup>25</sup> See the *Automotive Working Group Position Paper 2022/2023* for more information.

<sup>26</sup> *Measures for the Administration of Acquisition of Listed Companies*, China Securities Regulatory Commission (CSRC), 31<sup>st</sup> July 2006, viewed 4<sup>th</sup> July 2022, <<http://www.csrc.gov.cn/csrc/c101864/c1024664/content.shtml>>

Chinese economy: contrary to a decade ago, inbound European investment is now mostly aimed at China’s value chains; new investment opportunities are also opening up in capital intensive growth areas, such as decarbonisation and the green economy. Investors that intend to focus on these new areas can expect, to a large extent, to compete with SOEs, which already have advantages in the capital allocation of domestic funds. *Vis-à-vis* these developments, the working group urges regulators to expand foreign investors’ access to financing on market-consistent terms.

### Recommendations

- Formulate national-level guidance aimed at providing automatic, fast-track licensing for asset deals that adequately reflect business transfers.
- Allow FIEs access to China’s capital market on an equal basis with local players.
- Adhere to a strict application of bankruptcy laws and eliminate arbitrary considerations in decisions involving informal reorganisation arrangements.
- Continue to harmonise the treatment of FIEs and domestic companies as per the FIL and eliminate remaining barriers to foreign investment by creating a level playing field.

## 4. Further Open China’s Capital Market to FIEs

### Concern

There are still many restrictions hampering FIEs’ access to China’s capital markets in their entirety, including equity, debt and structured products, which is detrimental to the Chinese economy.

### Assessment

FIEs still face many access restrictions to China’s capital markets – a situation that is detrimental to both them and the Chinese economy, for it contributes to the continued underdevelopment of the domestic capital market. This lack of access prevents many FIEs from further embedding themselves into the Chinese economy and society.

### A-share Markets

It is possible for an FIE to be listed on China’s established stock markets by incorporating itself as, or converting itself into, a foreign-invested company limited by shares (FICLS), and then applying for a listing on the exchange of its choice in accordance with





the relevant regulations. However, the requirements that FICLS and their investors must satisfy are more stringent than those that apply to domestic companies. Some examples, according to China's Company Law, include requiring at least half of the shareholders to be domiciled in China and maintaining a foreign shareholding of at least 10 per cent post-listing. Therefore, it is not possible to list a wholly foreign-owned enterprise (WFOE) on the A-share market.<sup>27</sup>

Even if it were possible to list WFOEs, regulations by the China Securities Regulatory Commission (CSRC) would require the listed entity to own its own IPR and be free to compete on a global basis. This essentially precludes an international company from listing a local subsidiary, which differs from common practices in other financial markets, where a foreign investor can raise capital as well as control and operate a locally-listed company without its global business being required to become a domestic public entity. In the reform of China's capital markets, the working group recommends that access be made available to all economic actors, including foreign investors operating successful local subsidiaries in Mainland China.

Additional requirements applying to FICLS and their investors should also be removed, and international businesses should be free to list on the A-share market in the same way as domestic companies. This would reflect the nationwide trend of harmonising regulatory requirements that are applicable to both domestic and international entities, and the removal of many filing requirements in the field of FDI. It would also encourage foreign private equity investment in domestic companies, by facilitating foreign investors' ability to subsequently exit their investments through a Chinese initial public offering.

To this end, domestic stock exchange listing rules should be amended to make it easier for foreign companies to list on Chinese stock exchanges, thereby increasing the attractiveness of China's capital markets while leading to greater diversification from new, high-quality issuers. This would also be conducive to establishing the much-anticipated international board on the Shanghai Stock Exchange, which would enable international enterprises to achieve a secondary listing

of their equity securities in China's A-share market. Removing specific listing requirements in China, limited to companies that already have listed in their home markets, could be a practical solution to overcome technicalities such as horizontal competition,<sup>28</sup> trademark or brand ownership, and on arm's length trade and services<sup>29</sup> arrangements.

On 25<sup>th</sup> March 2022, the CSRS approved the *Interim Measures for the Listing and Trading of Depository Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and Overseas Stock Exchanges*,<sup>30</sup> thereby expanding the link between the stock exchanges of Shanghai and London to include bourses in Germany, Switzerland and Shenzhen. The regulator also enabled European companies to sell new shares and raise funds from investors in mainland China, and simplified their financial-reporting and disclosure requirements.

### Debt Market

Since 2018, it has become easier for FIEs to routinely issue *renminbi* (RMB)-denominated debt securities, so-called 'panda bonds'. The People's Bank of China (PBOC) and the MOF jointly published interim administrative rules for bond issuance by foreign entities,<sup>31</sup> which, as well as clarifying and simplifying a number of issues, delegated registration of nonfinancial enterprises to the National Association of Financial Markets Institutional Investors (NAFMII). The rules also formally introduced the concept of 'equivalent accounting standards',<sup>32</sup> allowing enterprises reporting under non-Chinese accounting standards—such as the International Financial Reporting Standards—to access the panda bond market without converting their financial statements to Chinese Generally Accepted Accounting Principles.

In 2019, the PBOC took additional steps to open

27 Shi, Emilia, *Establishing a Business in China: Overview*, Thomson Reuters, 1<sup>st</sup> July 2019, viewed 14<sup>th</sup> April 2021, <[https://uk.practicallaw.thomsonreuters.com/1-623-4945?transitionType=Default&contextData=\(sc.Default\)&](https://uk.practicallaw.thomsonreuters.com/1-623-4945?transitionType=Default&contextData=(sc.Default)&)>

28 Horizontal competition refers to the rivalry to gain customer preference among entities at the same level, such as competition among competing wholesalers or competing retailers.

29 'Arm's length' trade and services refers to a business deal in which buyers and sellers act independently without one party influencing the other.

30 *Shanghai Stock Exchange Issues the Interim Measures for the Listing and Trading of Depository Receipts under the Stock Connect Scheme between Shanghai Stock Exchange and Overseas Stock Exchanges and Relevant Guidelines*, Shanghai Stock Exchange, 25<sup>th</sup> March 2022, viewed 20<sup>th</sup> April 2022, <<http://english.sse.com.cn/news/newsrelease/c5700281.shtml>>

31 *Announcement [2018] No. 16 of the PBOC and the MOF on Interim Administrative Measures for Bond Issuance by Overseas Institutions in the China Interbank Bond Market*, PBOC, 8<sup>th</sup> September 2018, viewed 15<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2019/content\\_5362059.htm](http://www.gov.cn/gongbao/content/2019/content_5362059.htm)>

32 Ibid.





China's financial sector and improve the rating quality of the bond industry by allowing foreign rating companies to conduct bond rating in the interbank bond market.<sup>33</sup> In December 2021, the PBOC and the SAFE solicited public opinions on the *Provisions on the Administration of Funds for Domestic Issuance of Bonds by Overseas Institutions (Draft for Comments)*.<sup>34</sup> The draft proposes that “funds raised by domestic bonds issued by overseas institutions can be remitted abroad or retained for domestic use. Those retained for domestic use shall comply with provisions on the administration of direct investment, foreign debt, etc. Overseas institutions are encouraged to collect, pay and use funds raised by domestic bond issuance in the form of RMB”.<sup>35</sup>

### Inclusion into Global Bond Indices

Important steps have been taken to internationalise China's debt capital markets through the inclusion of Chinese bonds into global indices.<sup>36</sup> Since October 2021, Chinese government bonds are now listed on all three major global bond indices: the FTSE World Government Bond Index; Bloomberg Global Aggregate Index and JPMorgan GBI-EM Global Diversified Index. As a result, China is now the world's second-largest bond market.<sup>37</sup> The working group welcomes such inclusions, which it believes will bring more overseas inflows into China, pushing the country's markets further into the mainstream for foreign investors.

### Recommendations

- Expand FIEs access to China's capital market.
- Improve market regulation by the CSRC and its sister financial regulators.
- Create a fair and level playing field for FIEs seeking

to issue debt securities, including bonds and asset backed securities.

- Grant FIEs national treatment and allow them to list their shares on a Chinese stock exchange.
- Establish an 'international board' on the Shanghai Stock Exchange to allow international enterprises to achieve a secondary listing of their equity securities in China's A-share market.
- Simplify the rules for foreign investors selling shares of listed joint ventures as per the principle of national treatment highlighted by the FIL.
- Remove the additional disclosure requirements on investments by foreign investors in listed companies so as to correspond to the principle of national treatment

### Abbreviations

14FYP	14 <sup>th</sup> Five-Year Plan
CAI	Comprehensive Agreement on Investment
CSRC	China Securities Regulatory Commission
EU	European Union
FDI	Foreign Direct Investment
FICLS	Foreign-invested Company Limited by Shares
FIE	Foreign-invested Enterprises
FIL	Foreign Investment Law
IPR	Intellectual Property Rights
M&A	Mergers and Acquisitions
MNC	Multinational Corporation
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
NAFMII	National Association of Financial Markets Institutional Investors
PBOC	People's Bank of China
RMB	<i>Renminbi</i>
SAFE	State Administration of Foreign Exchange
WFOE	Wholly Foreign-owned Enterprise

<sup>33</sup> NAFMII Issues Guidelines on Debt Financing Instruments of Overseas Non-Financial Enterprises (for Trial Implementation), NAFMII, 17<sup>th</sup> January 2019, viewed 15<sup>th</sup> April 2022, <[http://www.nafmii.org.cn/english/lawsandregulations/selfregulatory\\_e/201902/t20190201\\_75773.html](http://www.nafmii.org.cn/english/lawsandregulations/selfregulatory_e/201902/t20190201_75773.html)>; Anstey, Chris & Tu, Lianting, *China Opens to Foreign Credit Raters to Boost Bond Credibility*, Bloomberg, 27<sup>th</sup> February 2019, viewed 15<sup>th</sup> April 2022, <<https://www.bloomberg.com/news/articles/2019-02-27/china-opens-to-foreign-credit-raters-to-boost-bondcredibility>>

<sup>34</sup> Notice on Soliciting Public Comments on the Provisions on the Administration of Funds Issued by Overseas Institutions in China (Draft), PBOC and SAFE, 2<sup>nd</sup> December 2021, viewed 26<sup>th</sup> May 2022, <<http://www.pbc.gov.cn/tiaofa/si/144941/144979/3941920/4405194/index.html>>

<sup>35</sup> Two departments: encourage overseas institutions to issue bonds and raise funds in China to receive, pay and use cross-border in the form of RMB, EqualOcean, 2<sup>nd</sup> December 2021, viewed 26<sup>th</sup> May 2022, <<https://www.equalocean.com/briefing/20211202230099707>>

<sup>36</sup> Strohecker, Karin, *Index Inclusion May Boost China Bonds Flows to USD140bln in 2021 - Goldman Sachs*, Nasdaq, 15<sup>th</sup> January 2021, viewed 7<sup>th</sup> April 2022, <<https://www.nasdaq.com/articles/index-inclusion-may-boost-china-bonds-flows-to-%24140bln-in-2021-goldman-sachs-2021-01-15>>

<sup>37</sup> More policies luring investors to bonds, *China Daily*, 4<sup>th</sup> December 2021, viewed 27<sup>th</sup> May 2022, <<https://global.chinadaily.com.cn/a/202112/04/WS61aaa6b7a310cdd39bc7949a.html>>





# Legal and Competition Working Group

## Key Recommendations

### 1. Continue to Strengthen the Rule of Law to Sustain Fair Competition in the Domestic Market and Contribute to Global Economic Recovery Amid Uncertainties

- Continue to focus on advancing the rule of law and implement a fair competition review system to create and maintain a market-orientated business environment.
- Continue to standardise the judicial decision-making process to improve the standardisation and transparency of the application of discretion and ensure equitable, transparent, predictable and impartial implementation and enforcement of laws and regulations nationwide.
- Enhance the legislative quality and remove inconsistencies within the laws and regulations to provide a stable and predictable legal environment for businesses.
- Continue to standardise and maintain a compliant and transparent supply chain consistent with international standards.
- Enhance the protection of trade secrets and continue lowering the prerequisite with regard to loss estimation when initiating legal proceedings for infringements.
- Ensure prompt, comprehensive and correct enforcement of judicial decisions and arbitral awards by providing enforcers and intellectual property right owners with relevant information.
- Enhance compliance with terms and deadlines in court and administrative procedures.
- Standardise the public consultation process.
- Permit foreign nationals to attend civil and commercial hearings in the People's Courts without pre-registration.
- Support and promote the role of domestic and foreign lawyers in China's legal system.

### 2. Ensure Smooth Implementation of the Foreign Investment Law (FIL) and Its Implementing Regulations, and Minimise Potential Negative Impacts on Foreign Business

- Formulate in a timely manner necessary implementation rules to clarify the uncertainties and ambiguities caused by the introduction of the FIL, particularly the gaps created by abolishing old laws.
- Clarify national-security-related concerns at the working level.
- Adjust and consolidate all pertinent laws and regulations to maintain alignment of the whole legal framework in the field of foreign investment, including greenfield investment and mergers and acquisitions activities.
- Ensure transparency in the rule-making process by publishing a clear enactment and public consultation timeframe, including information on the stakeholders in charge, and allow sufficient time for public comments to reflect business concerns.
- Consider fundamentally changing the existing foreign investment management regime to eliminate differentiation between Chinese and foreign investment, and ensure a level playing field and non-discriminatory market access regime.



### 3. Develop an Export Control Regulatory Framework that is Clear, Proportionate and Aligned with Global Practices 2

- Clarify the supervision and enforcement governmental organs, and the rights and powers thereof, so as to facilitate direct dialogue and discussion between export control authorities and industry.
- Exempt commercial mass market products from export controls, focussing the export control system instead on items that have a direct and strategic bearing on China's national security.
- Ensure a practical and user-friendly licensing system featuring bulk and general licensing, and licensing exceptions for intra-company transfers.
- Update the current dual-use control list with designations based on the nature of controlled items.
- Narrowly define the scope of 'deemed exports' subject to licensing, and introduce reasonable export thresholds and exemption arrangements.
- Clarify the definition and management mechanism of "re-export".

### 4. Eliminate Restrictions on the Legal Services that Foreign Law Firms can Provide 11

- Allow foreign law firms to fully practice People's Republic of China (PRC) law in non-contentious areas through the employment of individuals who are qualified and licensed to practise PRC law.
- Allow lawyers in foreign law firms to fully represent their clients before Chinese government authorities as long as they have proper powers of attorney.
- Increase cooperation under the *Pilot Work Plan*, particularly in allowing easier access to this plan and permitting the establishment of more closely integrated Sino-foreign joint venture firms to practice both Chinese law and foreign law in their own name.
- Ensure consistent and transparent implementation and enforcement of laws and regulations concerning foreign investments.
- Streamline the registration procedures and requirements for foreign lawyers.

### 5. Adopt Regulations that Encourage Fair Enforcement of the Anti-monopoly Law (AML) 15

- Ensure that the AML is implemented and enforced equally among all companies, domestic or foreign, including in the area of merger control enforcement and conduct issues.
- Ensure that all notified transactions are reviewed on a fair and timely basis, particularly transactions involving markets that are regarded as sensitive or of strategic importance to China.
- Ensure that the application and enforcement of the AML is consistent with the policy objectives of the fair competition review mechanism.
- Adopt centralised publication channels, such as websites, for all information relevant to AML enforcement, including new measures and decisions both from the State Administration for Market Regulation and local Administrations for Market Regulation.
- Clarify further and refine the conditions of AML enforcement and judicial practice.

### 6. Develop a Regulatory Framework that Enables All Aspects of Sustainability to Permeate Corporate Governance and Supply Chains, and Strengthen Cooperation with the European Union (EU) on Green Transition

- Plan ahead and develop an advanced regulatory framework which enables all aspects of sustainability,





including not only environmental but also social and governance (ESG) aspects, to permeate corporate governance and supply chains in China.

- Review and reinforce China's signature and ratification of existing international treaties relevant to sustainability and ESG matters.
- Support awareness and enhance training of key players in the different industrial sectors, including state-owned enterprises and private companies, for a deeper understanding of ESG matters and in preparation for new sustainability challenges in global supply chains.
- Strengthen cooperation with the EU and EU Member States to create a sophisticated set of shared rules and standards, such as the taxonomy projects, that could act as a benchmark for other countries.

## Introduction to the Working Group

Created in 2000, the Legal and Competition Working Group fosters greater legal transparency and awareness of legal developments that affect foreign trade and investment in China. It also advocates for the strengthening of the rule of law in China and foreign businesses' better access to the Chinese market, including the legal services market. It is now comprised of approximately 480 individuals that represent over 270 member companies.

## Recent Developments

A number of welcome developments were carried out by the legislative, regulatory and judicial bodies in China in 2021 and early 2022, such as granting legislative power to local governments to promote high-level reform and opening up. For example, on 10<sup>th</sup> June 2021, the Standing Committee of the 13<sup>th</sup> National People's Congress (NPCSC) adopted the decision on authorising the Shanghai Municipal People's Congress and its Standing Committee to formulate regulations for the Pudong New Area. In addition, on 15<sup>th</sup> July 2021, the Chinese Communist Party's (CPC) Central Committee and the State Council issued guidelines on supporting reform and opening up in the Pudong New Area and making it a 'pioneer area' for socialist modernisation. The Pudong Government was also granted significant autonomy in local legislation and stronger administrative power.

Changes and progress on the rule of law also took place over the past year. China issued a series of plans focussing on legal framework construction

during the 14<sup>th</sup> Five-year Plan period, to develop a law-based government and market-orientated society. However, some of these legislations, such as the Anti-foreign Sanctions Law, the Data Security Law (DSL) and the Personal Information Protection Law (PIPL), may greatly impact the daily operations of European companies based in China.

### Anti-foreign Sanctions Law

On 10<sup>th</sup> June 2021, the NPCSC passed the Anti-foreign Sanctions Law, which took effect immediately.<sup>1</sup> The law targets those involved in forming and implementing sanctions against China, outlining the circumstances for applying countermeasures, establishing a coordination mechanism for countermeasures and countersanctions, and the obligations of relevant organisations and individuals. The law does not establish a separate entity for implementation of foreign sanctions and countermeasures, while the ways countermeasures will be carried out will depend on the implementation rules.

### Data Security Law and Personal Information Protection Law

The DSL and PIPL were enacted on 1<sup>st</sup> September and 1<sup>st</sup> November 2021 respectively, marking China's first legislation dedicated to data protection and personal information protection.<sup>2&3</sup> The laws are part of a larger

1 Anti-foreign Sanctions Law, NPCSC, 10<sup>th</sup> June 2021, viewed 18<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202106/d4a714d5813c4ad2ac54a5f0f78a5270.shtml>>

2 Data Security Law, NPCSC, 1<sup>st</sup> September 2021, viewed 15<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202106/7c9af12f51334a73b56d7938f99a788a.shtml>>

3 Personal Information Protection Law, NPCSC, 1<sup>st</sup> November 2021, viewed 16<sup>th</sup> April, 2022, <<http://www.npc.gov.cn/npc/c30834/202108/a8c4e3672c74491a80b53a172bb753fe.shtml>>



security framework under the Cybersecurity Security Law (CSL), which came into force in 2017. The DSL regulates data activities in Mainland China, with the aim of ensuring data security, promoting data development and use, protecting the lawful rights and interests of natural persons and organisations, and safeguarding national sovereignty, security and development interests. The PIPL introduces new grounds for processing personal information, such as that related to human resources. However, data localisation requirements and cross-border data transfer restrictions remain, while detailed guidelines and implementation rules are still lacking, such as on important data catalogues, the administrative review process for data/ infrastructure security and overseas data transfer, and contract templates for overseas processing, among others. The working group recommends providing clear and transparent guidelines that will enable companies to efficiently achieve compliance.

## Key Recommendations

### 1. Continue to Strengthen the Rule of Law to Sustain Fair Competition in the Domestic Market and Contribute to Global Economic Recovery Amid Uncertainties



#### Concern

European companies still face challenges, including ambiguous legal requirements, inadequate law/policy implementation as well as a lack of guidance on inter-market conflicts, especially against the current backdrop of geopolitical tensions and COVID-19.

#### Assessment

Since joining the World Trade Organization in 2001, China has gradually improved its implementation of the rule of law and convergence with international standards, thus contributing to a legal system that supports a fair and just market environment. At the same time, there is still a lack of transparency and impartiality in law enforcement in certain areas of trade and investment. The COVID-19 pandemic and geopolitical uncertainties further complicate and exacerbate the challenges European businesses face in China. The Legal and Competition Working Group therefore expects further improvements in the following areas:

#### 1) Continue to focus on advancing the rule of law and enforce a unified domestic market that is non-discriminatory and fair for foreign companies

China's ambition to create a fair and united market was outlined in the *Opinion on Accelerating the Establishment of a Unified Domestic Market (Opinion)*, issued by the State Council on 10<sup>th</sup> April 2022.<sup>4</sup> The *Opinion* explicitly calls for eradication of all policies that compromise fair competition between companies. The working group therefore calls for an immediate and robust implementation of the *Opinion* at all levels, through for example, transforming requirements into legal and regulation systems, enhancing the fair competition review, reducing the *Negative List for Foreign Investment* and ensuring non-discriminatory enforcement of anti-trust law.<sup>5</sup>

#### 2) Standardise the enforcement of laws and regulations

Despite the significant improvements already achieved by China, European companies still encounter inconsistencies in the application and enforcement of laws and regulations. This is often due to discretionary implementation, which can vary depending on the parties involved, the location or the sector. The working group expects the government to continue standardising all judicial and administrative proceedings to create a more predictable, transparent and impartial legal system. To achieve this, the authorities should reduce the adoption and application of open clauses in legislation, publish enforcement details and related decision-making processes, and enhance and expand existing law enforcement monitoring and reporting systems, among other methods.<sup>6,7</sup>

4 *Opinion on Accelerating the Establishment of a Unified Domestic Market*, CPCCC and State Council, 10<sup>th</sup> April 2022, viewed 16<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2022-04/10/content\\_5684388.htm](http://www.gov.cn/xinwen/2022-04/10/content_5684388.htm)>

5 *Negative list for Foreign Investment*, MOFCOM, 28<sup>th</sup> December 2021, viewed 29<sup>th</sup> June 2022, <<http://er.mofcom.gov.cn/article/jmxxw/202112/20211203232425.shtml>>

6 Since early 2021, regulatory documents and drafts aimed at improving law enforcement quality and limiting discretionary judgments in some areas have been subsequently released, such as the *Guidance for Improvement of Law Enforcement Effectiveness in Ecosystem and Environment Protection*, Ministry of Ecology and Environment (MEE), 6<sup>th</sup> January 2021, viewed 16<sup>th</sup> April 2022, <[http://www.mee.gov.cn/xxgk2018/xxgk/xxgk03/202101/t20210114\\_817353.html](http://www.mee.gov.cn/xxgk2018/xxgk/xxgk03/202101/t20210114_817353.html)>; *Guidance for Differentiated Law Enforcement based on Affirmative List in Ecosystem and Environment Protection*, MEE, April 6<sup>th</sup> 2021, viewed 16<sup>th</sup> April 2022, <<http://www.tjhx.gov.cn/zwgk/zfxxgk/zfgbm/qsthjj/fdzdkgknr/zdmsxx/hjbh/202110/P020211029478194648929.pdf>>; and the *Trial Standard for Discretionary Administrative Penalty on Fishing in Oceans*, Ministry of Agriculture and Rural Affairs and China Coast Guard, 26<sup>th</sup> November 2021, viewed 16<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-12/23/content\\_5664119.htm](http://www.gov.cn/zhengce/zhengceku/2021-12/23/content_5664119.htm)>

7 One example of good practice is a compliance system set up by the Ministry of Justice (MOJ) for the public to report law enforcement issues, viewed 16<sup>th</sup> April 2022, <<http://www.12348.gov.cn/sfbxzzf/#/suggestion/suggestion>>





### 3) Enhance legislative quality and remove inconsistencies within laws and regulations to provide a stable and predictable legal environment for businesses

Consistency within the legal framework is of fundamental importance for business to plan operations and exercise their legal rights. However, several stipulations in Chinese legislations are inconsistent with or even contradictory to their upper-level laws or regulations. For instance, the *Regulation on the Administration of Human Genetic Resources*<sup>8</sup> stipulation that patent rights will be shared is in discord with the *Civil Code* and the Patent Law, which allow contractual terms to define intellectual property (IP) allocation.<sup>9</sup> Stricter enforcement of the Legislation Law and the associated legislative review to amend or repeal contradictions and inconsistencies within legal and regulation systems could provide and sustain a stable and coherent legal environment for companies.<sup>10</sup>

### 4) Continue to standardise and maintain transparent supply chain regulations consistent with international standards

Global supply chains have been in turmoil not only because of COVID-19 but also due to geopolitical tensions. The interdependence between countries in a globalised supply chain promotes adherence to international rules and, where possible, harmonisation of regulations across international markets. The working group acknowledges China's continued levelling up of its supply chain towards international standards, which, through dialogue and cooperation with other countries, can create and maintain a green, transparent and ethical supply chain that is up to global standards.

8 Article 24 states that patents developed in international research using Chinese human genetics shall be co-owned by the Chinese organisation and the foreign counterparty, viewed 16<sup>th</sup> April 2022: *Regulation of the People's Republic of China on the Administration of Human Genetic Resources*, State Council, 1<sup>st</sup> July 2019, viewed 22<sup>nd</sup> June 2022, <[http://www.gov.cn/zhengce/2020-12/27/content\\_5574163.htm](http://www.gov.cn/zhengce/2020-12/27/content_5574163.htm)>

9 The *Civil Code* (Articles 859-860) and the Patent Law (Art. 8) both allow contracts as the base for IP allocation between counterparties. *Civil Code*, National People's Congress (NPC), 28<sup>th</sup> May 2020, viewed 16<sup>th</sup> April 2022, <<https://flk.npc.gov.cn/detail2.html?ZmY4MDgwODE3MjlkMWVmZTAxNzI5ZDUwYjVjNTAwYmY%3D>>; Patent Law, NPC, 1<sup>st</sup> June 2021, viewed 16<sup>th</sup> April 2022, <<https://flk.npc.gov.cn/detail2.html?ZmY4MDgwODE3NTJlNzQ0MzAxNzVlNDY1MWNiZDE1NDc%3D>>.

10 The Legislation Law (amended in March 2015) requires amendment or repeal of lower-level laws/regulations that contradict with upper-level ones (Art. 96) and provides legislative review process for consistency check (articles 68 and 77, and Chapter 5), Legislation Law, NPC, 15<sup>th</sup> March 2015, viewed 16<sup>th</sup> April 2022, <[http://www.npc.gov.cn/zgrdw/npc/dbdhhy/12\\_3/2015-03/18/content\\_1930713.htm](http://www.npc.gov.cn/zgrdw/npc/dbdhhy/12_3/2015-03/18/content_1930713.htm)>

### 5) Enhance trade secret protection

There were several significant developments in laws addressing trade secrets in 2020,<sup>11</sup> in particular, the punitive damages rules, the shifting of the burden of proof of non-violation onto the infringer, and a more precise scope of what constitutes as 'trade secrets'. The working group expects the continuous improvement of trade secret protection by allowing right holders to use remedial costs instead of established actual losses to initiate criminal proceedings for an infringement, as well as permitting an individual to be held liable for trade secrets misappropriation. Once fully implemented, the improved IP protection regime with respect to trade secrets will increase the safety and sustainability of foreign investment, especially for those devoted to generating innovative products. For more information on trade secrets, please refer to the *Intellectual Property Rights Working Group Position Paper* on page 74.

### 6) Ensure enforcement of judgments and awards

Problems related to the enforcement of judgments and arbitral awards in China are still quite common, as the People's Courts and the winning parties in proceedings are too often not provided with the adequate means to follow up on enforcement proceedings.

### 7) Strengthen compliance with terms and deadlines in court and administrative procedures

Stipulated terms and deadlines in court and administrative procedures are crucial for companies to know when they can seek legal recourse and damages during complex disputes. The current uncertainty of judicial and administrative proceedings may cause companies to doubt their ability to obtain procedural justice, while seeing their costs increase. Thus, the working group hopes that measures will be taken by the relevant authorities to strengthen adherence to terms and deadlines, and make available a recourse/appeals mechanism to resolve non-compliance issues.

### 8) Improve the public consultation process

Public consultation is a crucial element in the law-making process, as it facilitates resolving potential problems in the practical implementation of laws before their official promulgation, and therefore ensures better legislation. Despite efforts to improve transparency,

11 For instance, the Supreme People's Court (SPC) issued the *Provisions of the Supreme People's Court on Several Issues Concerning the Application of Law in the Trial of Civil Cases Involving Infringements upon Trade Secrets*, SPC, 11<sup>th</sup> September 2020, viewed 16<sup>th</sup> April 2022, <<http://www.court.gov.cn/zixun-xiangqing-254751.html>>



and the Ministry of Justice's (MOJ's) work to maintain its public consultation website, many other ministries and commissions—especially at the provincial level and below—still do not allow a period of at least 30 days for public consultation on draft regulations. Failure to do so is also contrary to commitments made in the *Interim Regulation on Major Administrative Decision-making Procedures*.<sup>12</sup> In addition, the public consultation process should be made more transparent by sharing a working plan with enough lead time and providing alerts of forthcoming public consultation exercises. Legislators should also publish major contributions received from stakeholders, together with feedback from regulators on the stakeholders' comments, in a manner similar to the European Commission website.<sup>13</sup>

### 9) Provide access to judicial judgments and participation in court hearings

European businesses welcome the increase in transparency and publicity of court judgments, as well as improvements to the websites of the Supreme People's Court (SPC) and local courts,<sup>14&15</sup> through which numerous court judgments are now available, pursuant to Article 156 of the Civil Procedure Law. The publication of guiding cases by the SPC is also a welcome step towards developing a comprehensive approach to jurisprudence and should contribute to more consistent interpretation and implementation of laws and regulations nationwide.<sup>16</sup> The working group encourages the courts to continuously consolidate and disclose cases and judgments from all levels, and expects that—as is common practice in European jurisdictions—foreign nationals could have full public access to commercial and civil hearings in the People's Courts without the need to pre-register or be specially authorised.

12 *Interim Regulation on Major Administrative Decision-making Procedures*, State Council, 8<sup>th</sup> May 2019, viewed 16<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2019-05/08/content\\_5389670.htm](http://www.gov.cn/zhengce/content/2019-05/08/content_5389670.htm)>

13 For example, the Public Consultation Section of the European Commission website, viewed 16<sup>th</sup> April 2022, <[https://ec.europa.eu/info/consultations\\_en](https://ec.europa.eu/info/consultations_en)>

14 For example, the website of the SPC has special sections for publishing court decisions and judicial enforcement, viewed 16<sup>th</sup> April 2022, <<https://www.court.gov.cn/fabu-gengduo-15.html>>

15 For example, Beijing local court's website, viewed 16<sup>th</sup> April 2022, <<https://bjgy.chinacourt.gov.cn/paper.shtml>>

16 Please see the 'Guiding Cases' section on the China Courts' website, viewed 16<sup>th</sup> April 2022, <<https://www.chinacourt.org/article/index/id/MzAwNDAwMjAwMSACAAA.shtml>>

### 10) Promote the role of domestic and foreign lawyers

Legal professionals—including private practice lawyers and in-house counsels, domestic and foreign lawyers—play a pivotal role in enhancing and strengthening the rule of law in its formal, procedural and substantive aspects, both domestically and at an international level. Therefore, the working group expects recognition and support for all legal professionals, in view of their importance to business.

#### Recommendations

- Continue to focus on advancing the rule of law and implement a fair competition review system to create and maintain a market-orientated business environment.
- Continue to standardise the judicial decision-making process to improve the standardisation and transparency of the application of discretion and ensure equitable, transparent, predictable and impartial implementation and enforcement of laws and regulations nationwide.
- Enhance the legislative quality and remove inconsistencies within the laws and regulations to provide a stable and predictable legal environment for businesses
- Continue to standardise and maintain a compliant and transparent supply chain consistent with international standards
- Enhance the protection of trade secrets and continue lowering the prerequisite with regard to loss estimation when initiating legal proceedings for infringements.
- Ensure prompt, comprehensive and correct enforcement of judicial decisions and arbitral awards by providing enforcers and IP right owners with relevant information.
- Enhance compliance with terms and deadlines in court and administrative procedures.
- Standardise the public consultation process.
- Permit foreign nationals to attend civil and commercial hearings in the People's Courts without pre-registration.
- Support and promote the role of domestic and foreign lawyers in China's legal system.

## 2. Ensure Smooth Implementation of the Foreign Investment Law (FIL) and Its Implementing Regulations, and Minimise Potential Negative Impacts on Foreign Business 4

#### Concern

Although the FIL and its implementing regulations have been effective since 1<sup>st</sup> January 2020, there is still room





for improvement in China's legal regime for foreign investment in terms of creating a level playing field.

#### Assessment

The FIL addresses many key concerns of foreign investors, such as IP protection, equal support policies, participation in government procurement, and pre-establishment national treatment and negative-list management. However, many regulations under the FIL—and to some extent substantiated by its implementing regulations—require more detailed rules to ensure operability, as well as to link with relevant laws and regulations, to truly reflect the intention of the law.

The working group is encouraged by the MOF's publication on 20<sup>th</sup> October 2021 of the *Notice on Implementing the Policies on Equal Treatment of Domestic and Foreign-invested Companies in Government Procurement Activities*,<sup>17</sup> which states that “government procurement shall give equal treatment to products domestically produced in China (including the services provided) by local and foreign enterprises.” This regulation marks the first official call in writing for equal treatment of domestic and foreign companies' products in government procurement. In addition, the *Regulations on Optimising the Business Environment* explicitly oblige governmental agencies at all levels to treat all market entities in a non-discriminatory way, regardless whether domestic or foreign.<sup>18</sup> The working group expects further similar efforts from relevant stakeholders to facilitate successful implementation of the FIL, as well as its supporting regulations.

However, restrictions in other foreign investment regulations, rules and policies remain. According to the European Chamber *Business Confidence Survey 2022* (BCS), more than 40 per cent of respondents missed out on business opportunities due to market access restrictions, a figure that has stayed much the same for the past seven years.<sup>19</sup> Regulations imposing these

direct and indirect barriers focus on areas such as re-investment of FIEs based in China; foreign-invested holding/investment companies; the administration of total investment, registered capital and foreign debt of FIEs; and mergers and acquisitions (M&A) by foreign investors of domestic enterprises. The working group hopes that, in the course of implementing the FIL, such restrictions under other regulations will be also abolished to create a truly level playing field for foreign investors. The working group further hopes that transparency in the FIL implementation process will be maintained by publishing a clear enactment timeframe, including information on the respective stakeholders responsible for rule-making, and allowing sufficient time for public comments to reflect business concerns.

Although the FIL reiterates the concept of national treatment for foreign companies, it still does not fundamentally abolish the distinction between foreign and domestic investment, which means that a level playing field cannot be achieved in practice. The European Chamber believes there are no compelling reasons to regulate companies differently due to their ownership structure or by the nationality of their investors. To do so creates unnecessary complexities in practice, as there are always cases where differentiating foreign investment from domestic investment is very difficult (such as ‘variable interest entity structure’ cases). By contrast, the European Union (EU) and EU Member States market economies do not have a special law specifically treating foreign capital differently. Considering China is the world's second largest economy, and is increasingly sharing and leading international responsibilities in more and more areas, real consideration should be given to fundamentally changing the existing foreign investment management regime in favour of a more confident and open attitude. In particular, this should entail ceasing to differentiate between Chinese and foreign investment.

Furthermore, The working group is particularly concerned over the national security review (NSR) mechanism within the FIL framework, as it could be influenced by global political tensions. In addition, on 20<sup>th</sup> December 2020, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) jointly issued the *Foreign Investment Security Review Measures (Review Measures)*.<sup>20</sup>

<sup>17</sup> *Notice on Equal Treatment of Domestic and Foreign-invested Companies in Government Procurement Activities*, MOF, 13<sup>th</sup> Oct 2021, viewed on May 18<sup>th</sup> 2021, <[http://www.gov.cn/zhengce/zhengceku/2021-10/26/content\\_5644953.htm](http://www.gov.cn/zhengce/zhengceku/2021-10/26/content_5644953.htm)>

<sup>18</sup> *Regulations on Optimising the Business Environment*, State Council, 1<sup>st</sup> October 2020, viewed on May 18<sup>th</sup>, <[http://www.gov.cn/zhengce/content/2019-10/23/content\\_5443963.htm](http://www.gov.cn/zhengce/content/2019-10/23/content_5443963.htm)>

<sup>19</sup> *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 20<sup>th</sup> June 2022, <<https://www.eurochamber.com.cn/en/publications-business-confidence-survey>>

<sup>20</sup> *Foreign Investment Security Review Measures*, MOFCOM & NDRC, 20<sup>th</sup>



Although the *Review Measures* provide more detail on the NSR mechanism, the list of sensitive areas that could potentially trigger a NSR remains quite vague and general. While the NDRC has made efforts to assist businesses—for example, setting up a contact point for NSR-related consultancy—it is necessary for additional relevant stakeholders to provide more clarity on this topic. According to the *Business Confidence Survey 2022*, ambiguity in rules and regulations has been cited by European Chamber member companies for six consecutive years as the most significant regulatory obstacle to doing business in China, highlighting once again the need for regulatory reform, as well as improved communication between government and industry.<sup>21</sup>

#### Recommendations

- Formulate in a timely manner necessary implementation rules to clarify the uncertainties and ambiguities of the FIL, particularly the gaps created by abolishing old laws.
- Clarify national security-related concerns at the working level.
- Adjust and consolidate all pertinent laws and regulations to maintain alignment of the whole legal framework in the field of foreign investment, including greenfield investment and M&A activities.
- Ensure transparency in the rule-making process by publishing a clear enactment and public consultation timeframe, including information on the stakeholders in charge, and allow sufficient time for public comments to reflect business concerns.
- Consider fundamentally changing the existing foreign investment management regime to eliminate differentiation between Chinese and foreign investment, and ensure a level playing field and non-discriminatory market access regime.

### 3. Develop an Export Control Regulatory Framework that is Clear, Proportionate and Aligned with Global Practices 2

#### Concern

China's Export Control Law needs implementation regulations that are clear, proportionate and aligned

with global practices in order to minimise disruption to business operations.

#### Assessment

With the enactment of the Export Control Law on 1<sup>st</sup> December 2020, China's export control legal system came under global focus, due to increasingly complex political and economic frictions domestically and abroad, and reconstruction of the global industrial chain following the bilateral tariffs imposed between the United States and China. However, detailed judicial implementation rules and plans on the law, including corresponding supplemental guidance rules, remain unclear. The Legal and Compliance Working Group expects the following improvements:

#### 1) Supervision structure and mechanism

According to the Export Control Law, China intends to adopt a unified export control system, which will be subject to administration through a control list and export licensing. However, the mere promulgation of the Export Control Law is far from sufficient for the contemplated unification.

Previously, the Foreign Trade Law and relevant regulations and rules from various governmental authorities formulated export limitations. Therefore, China's current export control management is co-regulated among multiple enforcement organs with different management concepts. For example, controlled export goods, technologies and dual-use items are managed by the Department of Foreign Trade, the Department of Trade in Services and Commercial Services, and the Bureau of Industry, Security, Import and Export Control under the MOFCOM respectively, each of which has a separate regulatory system.

#### 2) Scope of controlled items

The applicable scope of the Export Control Law is set out in Article 2, which covers relevant goods, technologies and services, as well as technical information related to controlled items. Although the Export Control Law lists the forms of controlled items, it does not provide further clarity on sources, content and exceptions that may apply and other specific applications. Given the diversity of current international trade supply chains and cross-border research and development (R&D) activities, these definitions may not meet the requirements for identification of controlled

December 2020, viewed 6<sup>th</sup> April 2022, <<http://www.mofcom.gov.cn/article/jjylj/202012/20201203024706.shtml>>

21 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 20<sup>th</sup> June 2022, <<https://www.eurochamber.com.cn/en/publications-business-confidence-survey>>





items in the daily operations of enterprises.

The working group is concerned about industrial policy elements being incorporated into a national security-orientated Export Control Law, and recommends that the proposed export control system focus only on items that have direct and strategic significance to national security. Globally, a very small fraction of goods and technology are subject to export controls. The proposed Chinese system should not attempt to restrict commercial mass market items that, by volume or distribution, are not susceptible to control, and instead provide for licensing exceptions, including intra-company transfers.

### 3) Controlled activities

The Export Control Law explicitly includes ‘deemed export’ and ‘re-export’ as controlled activities for the first time, greatly expanding the scope of controlled activities. However, uncertainty remains over how to interpret these new concepts.

According to Article 2 of the Export Control Law, ‘deemed export’ refers to the provision of controlled items by citizens, legal persons and other non-incorporated organisations of China to foreign organisations and individuals. Such control measures may trigger concerns for multinational companies (MNCs) that conduct R&D activities in China, as an export is ‘deemed’ to be taking place when data is released to a foreign national, despite their physical presence in China. The working group recommends narrowly defining the export licenses’ application scope with reasonable Chinese export thresholds, and establishing certain exemption arrangements to allow MNCs to apply for an automatic general licence or facilitative licence.

While Article 45 of the Export Control Law contains a provision on ‘re-export’, it is widely acknowledged that, one simple provision is far from adequate for such a complex activity. Detailed and delicate regulation arrangements are needed to guide companies on how to comply with this control.

### 4) Export licence mechanism

Though a licensing system for the export of controlled items is confirmed in the Export Control Law, the detailed rules need further refinement and clarity. The authorities should implement a practical and

user-friendly licensing system, including leveraging procedures (such as special bulk and general licensing mechanisms with multi-year expirations), licence exceptions (such as intra-company licence exceptions) and other implementation and management methods. A flexible licensing system could minimise uncertainty over control status, thereby reducing unnecessary regulatory burdens for both exporters and the Chinese authorities. For example, general licences or licence exceptions could authorise exporters to export dual-use items and technology to a specific destination based on clearly defined parameters. The working group also recommends that licence requirements be based on classification level rather than product level, given the export volume and scale of companies.

### Recommendations

- Clarify the supervision and enforcement governmental organs, and the rights and powers thereof, so as to facilitate direct dialogue and discussion between export control authorities and industry.
- Exempt commercial mass market products from export controls, focussing the export control system instead on items that have a direct and strategic bearing on China’s national security.
- Ensure a practical and user-friendly licensing system featuring bulk and general licensing and licensing exceptions for intra-company transfers.
- Update the current dual-use control list with designations based on the nature of controlled items.
- Narrowly define the scope of ‘deemed exports’ subject to licensing, and introduce reasonable export thresholds and exemption arrangements.
- Clarify the definition and management mechanism of ‘re-export’.

## 4. Eliminate Restrictions on the Legal Services that Foreign Law Firms can Provide

### Concern

The working group continues to be concerned about the restrictions placed on foreign lawyers and foreign law firms operating in China, including those that apply in any area of practice and those that apply in instances of cooperation with and/or hiring of Chinese firms and lawyers.



## Assessment

The Legal and Competition Working Group welcomes the registration and control of foreign law firms and lawyers by the appointed authorities. However, the failure to eliminate restrictions on the provision of legal services, at least in certain areas of the law—including foreign investment, contractual and commercial matters, employment matters, M&A, competition law, banking and finance law, and capital markets law (i.e., ‘non-contentious areas’)—is an increasingly significant issue when it comes to fostering economic progress and working relationships between EU Member States and China. Further opening up the legal services sector—especially cooperation between foreign and Chinese law firms and the practice of non-contentious areas—in cross-border investments, would afford Chinese clients and companies better access to the guidance of international laws and practices. It would also support international clients in their investments into China, through provision of integrated Chinese and international legal advice.

### 1) Employment of Chinese-licensed lawyers by European law firms and foreign partners of Chinese firms

Currently, when European law firms operating in Mainland China hire licensed People’s Republic of China (PRC) lawyers, those individuals’ qualifications and licences to practice PRC law in non-contentious areas are suspended. At the same time, foreign lawyers are not allowed to become partners of Chinese firms. Removal of these restrictions will provide clients—both Chinese and foreign—with faster, more cost-effective and efficient access to legal advice, both locally and in the international arena. This will also broaden the career prospects of both PRC and EU lawyers, allowing them to grow and gain expertise in local and international environments, which will benefit cross-border investors from both China and the EU.

### 2) Participation of lawyers from foreign law firms in Chinese Government meetings

Appearance, participation and representation by lawyers from foreign law firms (including PRC-licensed lawyers) before Chinese government authorities and other public, non-judicial, authorities on behalf of their clients are only permitted occasionally and on a case-by-case basis. The lack of a transparent and consistently enforced right of access and representation for lawyers working in foreign law firms reduces the

quality of the information exchanged with the Chinese authorities, limits the sharing of experience by foreign law firms with European investors, and sometimes results in misunderstandings between the Chinese authorities and European investors. As a result, it is often difficult for foreign investors to understand the Chinese Government’s proceedings.

### 3) Developing relationships and dialogues with supervising authorities

In almost all jurisdictions, lawyers and firms are registered as ‘special professionals’, with stricter conduct codes and special requirements for practice. As registered lawyers and representatives of firms registered in the EU, working group members value very much the guidance of, and dialogues with, EU supervision authorities at the central level. The working group would like to have such exchanges with the MOJ and other competent departments at the central level in China. Such open channels enable valuable exchanges among professionals that are practicing law in different areas, including private practitioners, in-house counsels, public administration and legislative bodies, either foreign or Chinese.

### 4) Access to joint venture (JV) firms

Commitments between Mainland China and the Hong Kong and Macao special administrative regions,<sup>22&23</sup> and for pilot plans of JVs between domestic and foreign law firms,<sup>24</sup> indicate that China is looking at opening at least part of its legal market. While a few pilot JV firms have been established since 2015, existing rules have not yet been deployed nationally, and only allow a ‘one office, two teams’ model, not a ‘fully integrated JV model’, which combines the strengths of the Chinese and foreign firms’ partners. Also, under the Shanghai pilot, the thresholds for forming a JV firm is much higher than for domestic law firms, which prevents small and

22 *Agreement on Trade in Services to the Mainland and Hong Kong Closer Economic Partnership Arrangement*, MOFCOM, 27<sup>th</sup> November 2015, viewed 28<sup>th</sup> April 2022, <[https://www.devb.gov.hk/filemanager/en/content\\_164/Agreement\\_on\\_Trade\\_in\\_Services\\_EN\\_19Oct2017.pdf](https://www.devb.gov.hk/filemanager/en/content_164/Agreement_on_Trade_in_Services_EN_19Oct2017.pdf)>

23 *Agreement on Trade in Services to the Mainland and Macao Closer Economic Partnership Arrangement*, MOFCOM, 2<sup>nd</sup> July 2007, viewed 28<sup>th</sup> June 2021, <[https://www.dsedt.gov.mo/public/docs/CEPA\\_ACBLCS/index/en/main\\_text.pdf](https://www.dsedt.gov.mo/public/docs/CEPA_ACBLCS/index/en/main_text.pdf)>

24 *Official Reply of the Ministry of Justice on Approving the Work Plan for the Pilot Program of Exploring the Manner of and Mechanisms for Closer Business Cooperation between Chinese and Foreign Law Firms in China (Shanghai) Pilot Free Trade Zone*, MOJ, 27<sup>th</sup> January 2014, viewed 28<sup>th</sup> April 2022, <<http://www.china-shftz.gov.cn/PublicInformation.aspx?GID=e86e7a98-b9c0-4901-b874-d3e0011b6d2&CID=953a259a-1544-4d72-be6a-264677089690&MenuType=>>>





medium-sized China operations of foreign law firms from benefiting from this scheme.

### 5) Registration procedures and requirements

Registration of a new foreign lawyer in the PRC can take several months, as the procedure is still two-fold; i.e., local and central. Requirements for a chief representative to have at least three years of foreign bar registration and six months' domicile in the PRC, plus the requirement of at least two foreign representatives for each firm, are more stringent than immigration requirements for foreign representatives working in other sectors, and are very burdensome in comparison to international practices.

#### Recommendations

- Allow foreign law firms to fully practice PRC law in non-contentious areas through the employment of individuals who are qualified and licensed to practise PRC law.
- Allow lawyers in foreign law firms to fully represent their clients before Chinese government authorities as long as they have proper powers of attorney.
- Increase cooperation under the *Pilot Work Plan*, particularly in allowing easier access to this plan and permitting the establishment of more closely integrated Sino-foreign JV firms to practice both Chinese law and foreign law in their own name.
- Ensure consistent and transparent implementation and enforcement of laws and regulations concerning foreign investments.
- Streamline the registration procedures and requirements for foreign lawyers.

## 5. Adopt Regulations that Encourage Fair Enforcement of the Anti-monopoly Law (AML)

#### Concern

Although some enforcement issues have been clarified in the amendment of the AML, there are ambiguities that require further clarification.

#### Assessment

On 24<sup>th</sup> June 2022, the Standing Committee of the 13<sup>th</sup> National People's Congress voted to adopt the decision on amending the AML, effective from 1<sup>st</sup> August 2022.<sup>25</sup>

<sup>25</sup> Decision of the Standing Committee of the National People's Congress on Amending the AML of the People's Republic of China, NPC, 24<sup>th</sup> June 2022, viewed 27<sup>th</sup> June 2022 <<http://www.npc.gov.cn/npc/c30834/202206/e42c256f>

This is the first amendment to the law since it was issued in 2008. The Legal and Competition Working Group welcomes the adoption of the amendment, as it highlights the government's commitment to promote market-orientated reforms and safeguard fair competition in line with China's reform agenda, as laid down in the third and fourth plenums of the 18<sup>th</sup> CPC Congress. However, the amendment does not revise the whole AML, therefore, uncertainty remains among businesses regarding enforcement in certain areas. This uncertainty stems from the lack of clarity with regard, but not limited, to:

- 1) The standards, fairness and proportionality of proceedings. For example, the amendment introduces a new prohibition on organising or facilitating entry into anti-competitive agreements. The precise scope of organisation or facilitation is also unclear, leaving room for discretionary and inconsistent application of the law. The amendment also suggests that anti-competitive conduct could be subject to criminal liability without specificity. In the area of merger control, given the proposed increase of fines to up to 10 per cent of a business' turnover for violations, clear and transparent standards are more important than ever before. Fairness and proportionality are also critical considerations if restrictive conditions are imposed in order to allay businesses' concerns that restrictive conditions can be driven by non-competition considerations, especially where the transaction involves sensitive or strategically important markets in China.
- 2) The introduction of a 'suspension' mechanism in the calculation review period for the concentration of undertakings is expected to address the high percentage of refiled transactions and to avoid the review period being prolonged arbitrarily in practice. However, businesses remain concerned that this may not fully address the underlying concerns about the relative unpredictability of merger reviews, especially under the standard case procedure. At the same time, a significant proportion of transactions are currently reviewed under the 'simple case' procedure, which enables the SAMR to review and approve transactions quickly, and has resulted in a higher level of transparency. The Legal and Competition Working Group encourages the SAMR

[af7049449cdfaabf374a3595.shtml](http://af7049449cdfaabf374a3595.shtml)



to expand the benefits of this system (for example, by introducing higher market share thresholds consistent with those in the EU).

- 3) The relationship between administrative enforcement by the SAMR and enforcement through the courts is not addressed. In particular, it still leaves the divergence between administrative enforcement and judicial rulings on the treatment of resale price maintenance unresolved, which creates uncertainty for businesses on the appropriate legal test to apply.
- 4) While the Legal and Competition Working Group commends the SAMR for including the fair competition review mechanism as a core pillar of AML enforcement, it remains concerned that, in practice, certain Chinese policies create the potential for discrimination between domestic and foreign companies (for example, granting subsidies, or bank guarantees or loans, on preferential terms to support overseas acquisitions or public procurement projects).
- 5) The working group calls for the creation of a centralised publication channel for all decisions, laws and regulations related to the AML. As local AMRs become more active in enforcing the AML, a centralised repository and timely publication of local measures or decisions are critical to ensure transparency and full compliance by businesses. In this regard, the working group welcomes the adoption of sector-specific guidelines since late 2020 (notably related to the automobile sector, active pharmaceutical ingredients and digital platforms), as well as compliance guidelines at central and local levels.

#### Recommendations

- Ensure that the AML is implemented and enforced equally among all companies, domestic and foreign, including in the areas of merger control enforcement and conduct issues.
- Ensure that all notified transactions are reviewed on a fair and timely basis, particularly transactions involving markets regarded as sensitive or of strategic importance to China.
- Ensure that application and enforcement of the AML is consistent with the policy objectives of the fair competition review mechanism.
- Adopt centralised publication channels, such

as websites, for all information relevant to AML enforcement, including new measures and decisions both from the SAMR and local AMRs.

- Clarify further and refine the conditions of AML enforcement and judicial practice.

## 6. Develop a Regulatory Framework that Enables All Aspects of Sustainability to Permeate Corporate Governance and Supply Chains, and Strengthen Cooperation with the EU on Green Transition

### Concern

Mismatches among rules and regulations between the EU and China will cause further disruption to global supply chains and additional difficulties in cross-border investments.

### Assessment

The working group welcomes the developments in new EU legislation on sustainability, also in the corporate governance sphere. Such sophisticated regulations, however, also bring complex challenges in terms of due diligence on supply chains and responsibilities of corporate board members.

Several pieces of legislation have been proposed or adopted by the EU to support its sustainability efforts. Some of those rules—such as the proposed Directive on sustainable corporate governance—will pose challenges to both European and Chinese companies. The planned enhanced duties of businesses will cover more than just listed companies, and will likely cascade in the supply chain to foreign suppliers, as well as Chinese companies operating in the EU with revenues over a certain level. Furthermore, the mismatch between the new EU regime and the Chinese business and legal environment will put both FIEs in China and Chinese suppliers in a complex position in terms of compliance obligations and with regard to competition.

Therefore, China should prepare a legislative framework that can comply with such corporate sustainability regulations. While current Chinese legislation covers non-financial reporting by listed companies and disclosure of environmental matters and efforts, China could also benefit from more sophisticated sustainability legislation covering all environmental, social and governance (ESG) matters. This would also assist





China in realising its goals to peak carbon emissions by 2030 and reach carbon neutrality by 2060, as well as allowing a level playing field for all business entities, including state-owned enterprises, private companies and foreign companies.

Building a complete sustainability legislative regime and compliance thereof will be a long and bumpy road, and therefore an early start is suggested, to give all stakeholders time to understand and comply.

#### Recommendations

- Plan ahead and develop an advanced regulatory framework which enables all aspects of sustainability, including not only environmental but also social and governance aspects, to permeate corporate governance and supply chains in China.
- Review and reinforce China's signature and ratification of existing international treaties relevant to sustainability and ESG matters.
- Support awareness and enhance training of key players in the different industrial sectors, including state-owned and private companies, for a deeper understanding of ESG matters and in preparation for new sustainability challenges in global supply chains.
- Strengthen cooperation with the EU and EU Member States to create a sophisticated set of shared rules and standards, such as the taxonomy projects, that could act as a benchmark for other countries.

## Abbreviations

AML	Anti-monopoly Law
CPC	Communist Party of China
CSL	Cybersecurity Law
DSL	Data Security Law
ECL	Export Control Law
ESG	Environmental, Social and Governance
EU	European Union
FIE	Foreign-invested Enterprise
FIL	Foreign Investment Law
IP	Intellectual Property
JV	Joint Venture
M&A	Mergers and Acquisitions
MNC	Multinational Corporation
MOFCOM	Ministry of Commerce
MOF	Ministry of Finance
MOJ	Ministry of Justice
NDRC	National Development and Reform Commission
NPC	National People's Congress
NPCSC	Standing Committee of the National People's Congress
PIPL	Personal Information Protection Law
SAMR	State Administration for Market Regulation
SPC	Supreme People's Court



# Research and Development Working Group

## Key Recommendations

### 1. Encourage Foreign-invested Enterprises (FIEs) to Contribute to Research and Development (R&D) in China by Optimising the Financial Incentives Framework and Improving International R&D Cooperation 🌐 4

- Establish a common, reciprocal, transparent and efficient mechanism to facilitate European Union (EU)-China R&D cooperation with the participation of European companies based in China.
- Publish notices about R&D fund and grant applications in a timely manner, allowing an appropriate response period.
- Remove restrictions that hinder multinational corporations from applying for High and New Technology Enterprise status.
- Develop comprehensive regulations based on local governments' best practices that encourage the development of foreign-funded R&D centres.

### 2. Facilitate the Mobility of International Talent To and From China 🌐 4

- Provide a single window to consult on topics related to foreign talent and actively communicate policy changes via various channels, including industrial associations and organisations, in a timely manner.
- Increase foreign enterprises' autonomy in issuing invitations to international talent and establish a preferential visa policy targeting R&D personnel for important projects.
- Clarify existing policy requirements for recruiting foreign nationals as interns.
- Encourage special visa facilitation for young researchers in general.

### 3. Facilitate Multinational Enterprises' Digital Innovation in China 🌐 3

- Publish a list of open databases that foreign enterprises can access, and clarify whether FIEs can establish and manage their own public database independently.
- Promote the harmonisation of Chinese and international information and communication technology standards to incentivise international companies to increase R&D investments in China.
- Integrate investment in information technology infrastructure in state-level economic and technological development zones into the development plans for local digital economies.

### 4. Invest More in R&D of Green and Sustainable Technology to Accelerate Along the Path Towards Carbon Neutrality and Realise China's Overall Environmental Goals 🌐 4 🌱

- Provide enterprises with additional incentives that focus on the long-term development of new breakthroughs in green technologies.
- Facilitate the creation of pilot and demonstration areas and projects for low-carbon and sustainable technologies and their scale-up and commercialisation.
- Enhance EU-China collaboration in R&D of low-carbon and circular technologies.
- Provide more transparency for China's carbon technology roadmap and R&D programmes, like the *Action Plan for Carbon Dioxide Peaking Before 2030* and the EU-China joint research funding agreement.





## 5. Strengthen Protection of R&D—Including Intellectual Property (IP)-related Aspects—to Develop a World-class Innovation Environment 4

- Consult with universities, foreign research institutions, and Chinese and international companies' R&D departments when drafting new policies related to innovation and intellectual property rights (IPR) protection.
- Increase technical expertise and avoid local protectionism in local courts, and establish a more centralised jurisdiction for IPR-related cases related to innovation and R&D.
- Enhance the enforcement of IPR legislation to avoid compelled technology transfers or technology transfer difficulties.
- Allow the existence of co-ownership of IP between the parent company and local affiliates (or ownership of the parent company) in R&D projects funded by the Chinese Government.

## Introduction to the Working Group

The European Chamber's Research and Development (R&D) Working Group provides a platform for exchanging information, experiences and best practices among member companies. It also promotes the dialogue about, and transparency of, Chinese R&D policies. The working group developed from the former Research and Development Forum, as members felt the need to engage directly with Chinese authorities at both central and local levels to advocate on issues related to conducting R&D in China. The working group is comprised of professionals directly involved in R&D, with representatives from more than 50 European multinational corporations (MNCs) that have R&D operations in China. Various industries are represented in the working group, including automotive, petrochemicals, chemicals and refining, information and communications technology (ICT), aerospace, energy and pharmaceuticals, among others. Many of the working group's activities are aimed at helping China to strengthen its global science and technology (S&T) cooperation with the international R&D community, in order for China to reach its goal of becoming a world S&T power by 2049,<sup>1</sup> leaping from 'Made in China' to 'Created in China'.

## Recent Developments

The 2021 *Global Innovation Index*, published by the World Intellectual Property Organization (WIPO), ranks

China 12<sup>th</sup> out of 132 countries.<sup>2</sup> In 2021, China's whole-of-society R&D spending grew by 14.2 per cent year-on-year to 2.79 trillion yuan over 2020, with R&D intensity hitting 2.44 percent whole-of-society research and development (R&D) investment reached Chinese yuan (CNY) 2.79 trillion.<sup>3</sup>

On 1<sup>st</sup> June 2021, the Patent Law of the People's Republic of China (2021 Revision) came into force.<sup>4</sup> This revision strengthens the protection of the rights and interests of patent holders. It also regulates the patent application process and improves the implementation of the patent authorisation system. This revision also strengthens protection of the rights and interests of scientific researchers and reduces the need for repeated R&D, thereby helping to promote innovation.

On 10<sup>th</sup> June 2021, the Standing Committee of the National People's Congress passed the Data Security Law,<sup>5</sup> which came into effect on 1<sup>st</sup> September 2021. It functions as the highest-level administration of China's data security regime. To further implement this law, on 4<sup>th</sup> November 2021, the Cyberspace Administration of China issued the *Regulations on Network Data*

1 *Building a World Power in Science and Technology*, *Xinhua*, 30<sup>th</sup> May 2018, viewed 10<sup>th</sup> March 2022, <[http://www.xinhuanet.com/politics/xxjxs/2018-05/30/c\\_1122908666.htm](http://www.xinhuanet.com/politics/xxjxs/2018-05/30/c_1122908666.htm)>

2 *Global Innovation Index 2021*, WIPO, 2021, viewed 10<sup>th</sup> June 2022, <[https://www.wipo.int/global\\_innovation\\_index/en/2021/](https://www.wipo.int/global_innovation_index/en/2021/)>

3 *China's basic research spending rises to 6.09% of entire R&D expenditure in 2021, a step closer to 2025 goal of 8% globally*, *Global Times*, 25<sup>th</sup> February 2022, viewed 16<sup>th</sup> April 2022, <<https://www.globaltimes.cn/page/202202/1253194.shtml>>

4 Patent Law of the People's Republic of China (2021 Revision), National People's Congress (NPC), 19<sup>th</sup> November 2020, viewed 16<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202011/82354d98e70947c09dbc5e4eeb78bdf3.shtml>>

5 Data Security Law of the People's Republic of China, State Council, 10<sup>th</sup> June 2021, viewed 16<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-06/11/content\\_5616919.htm](http://www.gov.cn/xinwen/2021-06/11/content_5616919.htm)>





*Security Management (Draft for Comments)*.<sup>6</sup> On 10<sup>th</sup> February 2022, the Ministry of Industry and Information Technology (MIIT) issued the *Measures for the Administration of Data Security in the Informatization Field (Draft for Comments)*.<sup>7</sup> These regulations put forward new requirements for cross-border data transfer and require enterprises to conduct regular security audits and backups. The working group is concerned about implementation as many important terms, such as ‘core data’, ‘important data’ and ‘general data’, are not clearly defined within these measures. Furthermore, their implementation will affect cross-border R&D data flows, which may significantly increase compliance costs.

On 26<sup>th</sup> October 2021, the State Council released the *Action Plan for Carbon Dioxide Peaking Before 2030*.<sup>8</sup> It serves as a guiding document for China to establish a low-carbon regulatory framework and develop a clean and efficient domestic industrial structure until 2030. The plan clarifies the Chinese Government's intention to peak carbon emissions by 2030, and at the same time clearly encourages companies to undertake major national green and low-carbon science and technology projects.

On 24<sup>th</sup> December 2021, the Standing Committee of the National People's Congress (NPCSC) issued the Science and Technology Progress Law.<sup>9</sup> It reiterates the goals of enhancing independent innovation capacity and building an innovative country. Furthermore, it mentions that China will increase investment in S&T and make special efforts to increase the technological progress of enterprises. The working group welcomes the announcement of the law and looks forward to its further implementation to the benefit of both Chinese and international companies with R&D operations.

In June 2022, the European Chamber published the report *China's Innovation Ecosystem: Right for many, but not for all*, based on a member survey and

in-depth interviews. It revealed that 73 per cent of survey respondents increased their China-based R&D spending from 2020 to 2021, and that 77 per cent of respondents intend to increase R&D spending further in 2022.

The report explains how China's innovation ecosystem is attractive to larger companies in industries in which investment is encouraged by China due to the number and variety of collaboration partners, which range from established national champions to companies that are part of China's vibrant start-up ecosystem as well as inventive scientists and researchers. Survey respondents also widely praised the size of the market and the fast pace of commercial application of R&D results.<sup>10</sup> However, negative aspects were also reported, including weak IPR protection systems; an unlevel playing field for foreign companies; negative sentiment in companies' home markets towards R&D in China; and insufficient local talent, which specifically referred to challenges in finding suitable hardware engineers, as reported by many of the interviewees. The report also revealed the benefits that European companies can derive from their participation very much depends on the sector they are in. Companies that are in industries or sectors in which investment in China is not encouraged—like ICT and all things digital—find themselves increasingly squeezed out of the market, and are struggling with local R&D as a result.

## Key Recommendations

### 1. Encourage Foreign-invested Enterprises (FIEs) to Contribute to R&D in China by Optimising the Financial Incentives Framework and Improving International R&D Cooperation

#### Concern

Compared with local Chinese enterprises, FIEs still face greater difficulties both acquiring high and new technology enterprise (HNTE) status, and obtaining access to public funding and grants for R&D.

#### Assessment

China has a solid set of incentives in place to stimulate

6 *Regulations on Network Data Security Management (Draft for Comment)*, Cyberspace Administration of China, 4<sup>th</sup> November 2021, viewed 16<sup>th</sup> April 2022, <[http://www.cac.gov.cn/2021-11/14/c\\_1638501991577898.htm?ivk\\_sa=1024320u](http://www.cac.gov.cn/2021-11/14/c_1638501991577898.htm?ivk_sa=1024320u)>

7 *Measures for the Administration of Data Security in the Informatization Field (Draft for Comment)*, MIIT, 13<sup>th</sup> February 2022, viewed 16<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2022-02/13/content\\_5673340.htm](http://www.gov.cn/xinwen/2022-02/13/content_5673340.htm)>

8 *Action Plan for Carbon Dioxide Peaking Before 2030*, State Council, 26<sup>th</sup> October 2021, viewed 16<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2021-10/26/content\\_5644984.htm](http://www.gov.cn/zhengce/content/2021-10/26/content_5644984.htm)>

9 *Science and Technology Progress Law of the People's Republic of China*, MOST, 24<sup>th</sup> December 2021, viewed 16<sup>th</sup> April 2022, <[http://www.most.gov.cn/xxgk/xinxi fenlei/fdzdgknr/fgzc/ffg/202201/20220118\\_179043.html](http://www.most.gov.cn/xxgk/xinxi fenlei/fdzdgknr/fgzc/ffg/202201/20220118_179043.html)>

10 *China's Innovation Ecosystem: Right for many, but not for all*, European Union Chamber of Commerce in China, 8<sup>th</sup> June 2022, viewed 29<sup>th</sup> June 2022, <[https://www.europeanchamber.com.cn/en/publicationsarchive/1019/China\\_s\\_Innovation\\_Ecosystem\\_Right\\_for\\_Many\\_But\\_Not\\_for\\_All](https://www.europeanchamber.com.cn/en/publicationsarchive/1019/China_s_Innovation_Ecosystem_Right_for_Many_But_Not_for_All)>





innovation, including 'strategic support' (long-term structural incentives like HNTe status and a super-deduction scheme for reducing costs) and 'tactical support' (focussed grants for projects with a definite scope and target). The criteria for HNTe status recognition were revised in 2016 by the Ministry of Science and Technology (MOST), the Ministry of Finance (MOF) and the State Administration of Taxation (SAT).<sup>11</sup> Although certain requirements were somewhat relaxed, such as the minimum R&D expense ratio and the level of academic qualifications of technical personnel, those relating to IP ownership were tightened, with the applicant needing to own the core IP of their product or service.

Although FIEs run some of China's largest R&D operations, in many cases their core technologies were originally developed outside of China, thus they lack IP ownership within China. Even if FIEs are willing to re-register for patents in China, patent priority will only be granted if applicants submit the relevant applications within 12 months of the date when the patent was first filed, and only if the country which it was first filed has an agreement signed or an international treaty with China. Applicants must also submit examination information from the country of origin within a prescribed time limit, or the application will be deemed as having been withdrawn.<sup>12</sup> This will not only increase FIEs' operating costs, but also raises the risk of infringement. Given these challenges, the working group recommends that the authorities agree to accept globally-registered patents as part of the HNTe application process.

Frameworks allowing international R&D cooperation between China and other countries exist in abundance, for example, the EU-China S&T Co-funding Agreement,<sup>13</sup> through which, academic and industry members from Europe and China have jointly developed innovative technologies of common interest. However, there has been a lack of coordination between the Chinese Government and the EU in terms of funding, project timelines and approval processes. FIEs often face opaque or unclear application information and

procedures for relevant programmes, and struggle to access relevant information. R&D cooperation between EU and China has great potential. On the one hand, in the fields of agriculture, food and biotechnology, climate change and biodiversity, China and the EU share the same goals. Strengthening scientific research cooperation between the two sides would help to integrate existing scientific research resources and stimulate researchers on both sides. On the other hand, China and the EU are also important trading partners to each other. Strengthening relevant scientific research cooperation would help to facilitate quicker commercialisation of scientific research results. In order to further promote international R&D cooperation, China and the EU should hold open discussions on establishing a common, reciprocal, transparent and efficient mechanism.

Regarding Chinese domestic R&D grant applications, there are indications that MNCs are disadvantaged due to the preference of some local authorities for 'domestic champions'. For example, considering the amount and complexity of the required materials, application and announcement periods are often extremely short. This leaves very little time for FIEs to translate documentation and send to their European headquarters for input.

The Chinese Government's commitment to allow international businesses to participate in national S&T projects and to offer national treatment outside the negative list, as stated in the *Notice of the State Council on Several Measures for Promoting Growth of Foreign Investment*—is positive.<sup>14</sup> The working group is pleased to note that provincial policies encouraging foreign-funded R&D centres were passed in the past few years. Shanghai published a set of comprehensive regulations in November 2020 on foreign-funded R&D centres, which cover numerous topics, from tax and funding support, customs clearance and cross-border finance facilitation to talent acquisition and development.<sup>15</sup> These policies and programmes provide FIEs with many R&D-related convenience under certain circumstances. It is very encouraging to see such support mechanisms

11 *Regulation on the Determination and Administration of High and New-Technology Enterprise (2016 Revision)*, MOST, MOF and SAT, 2016, viewed 16<sup>th</sup> April 2022, <[http://www.most.gov.cn/kjzc/gjkjzc/qyjsjb/201706/t20170629\\_133827.html](http://www.most.gov.cn/kjzc/gjkjzc/qyjsjb/201706/t20170629_133827.html)>

12 Patent Law of the People's Republic of China (2021 Revision), NPC, 19<sup>th</sup> November 2020, viewed 16<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202011/82354d98e70947c09dbc5e4eeb78bdf3.shtml>>

13 *China and EU sign new round of joint research funding agreement*, MOST, 26<sup>th</sup> April, viewed 28<sup>th</sup> April 2022, <[http://www.most.gov.cn/kjbgz/202204/t20220426\\_180342.html](http://www.most.gov.cn/kjbgz/202204/t20220426_180342.html)>

14 *Notice of the State Council on Several Measures for Promoting Growth of Foreign Investment*, Ministry of Commerce, 16<sup>th</sup> August 2017, viewed 16<sup>th</sup> April 2022, <<http://www.mofcom.gov.cn/article/ae/ai/201708/20170802627851.shtml>>

15 *Regulations of Shanghai Municipality on Encouraging the Establishment and Development of Foreign-funded Research and Development Centres*, Shanghai Municipal Commission of Commerce, 1<sup>st</sup> December 2020, viewed 6<sup>th</sup> April 2022, <[https://en.www.sh.gov.cn/2020-12/01/c\\_424414.htm](https://en.www.sh.gov.cn/2020-12/01/c_424414.htm)>



from local governments for FIEs, and it is hoped similar initiatives will be expanded throughout China in the long-term.

### Recommendations

- Establish a common, reciprocal, transparent and efficient mechanism to facilitate EU-China R&D cooperation with the participation of European companies based in China.
- Publish notices about R&D fund and grant applications in a timely manner, allowing an appropriate response period.
- Remove restrictions that hinder MNCs from applying for HNTe status.
- Develop comprehensive regulations based on local governments' best practices that encourage the development of foreign-funded R&D centres.

## 2. Facilitate the Mobility of International Talent to and from China 4

### Concern

International enterprises engaged in R&D struggle to recruit and retain international talent, especially young researchers.

### Assessment

Some previous concerns related to the acquisition and retention of talent have been addressed through policy adjustments, such as permitting visas for foreign interns and permanent residence for senior talent or long-term employees. A series of changes to policies governing Chinese work permits and permanent residency status for foreign nationals were also introduced in 2017 and 2018, and policies related to talent acquisition that had been piloted in free trade zones (FTZs) were rolled out nationwide in 2019.

However, since 2020, the mobility of talent has been severely impacted by pandemic-related travel restrictions. Although the Ministry of Foreign Affairs announced in June 2022 that PU letters are no longer required for foreign nationals applying for Z visas and business visas, and that accompanying foreign family members may apply for a dependent visa, multiple other long-standing obstacles remain.

Efforts have been made to facilitate the development of R&D through measures related to hiring foreign nationals. However, the complexity of policies that

have been released, coupled with the fact that multiple government agencies—including the Human Resources and Social Security Bureau, the S&T Commission Talent Service Office and the Foreign Expert Office—release information through their own channels, it is challenging for FIEs to follow and clearly understand them.

Existing policies also need to be clarified. For example, currently, only "well-known domestic enterprises" are allowed to hire foreign interns, but the definition of a "well-known domestic enterprise" is not clear. Furthermore, rules such as "only Fortune 500 companies can hire qualified foreign interns"<sup>16</sup> should be rescinded. All companies should be at liberty to hire whichever interns they identify as potential future talent, in the interests of creating a more favourable and stimulating R&D and innovation environment in China.

Chinese visa policies are currently strongly biased in favour of fresh graduates and interns from top global universities and senior foreign talent that has achieved specific accolades during their careers. However, the number of people that this applies to is limited. A great deal of young talent has adequate education and are capable, qualified and, importantly, willing to come to China to contribute and gain experience. According to a 2019 EURAXESS survey, over 95 per cent of European researchers working in China (some currently in higher positions) moved here early in their career and stayed for approximately seven to 10 years.<sup>17</sup> This suggests that early exposure to the Chinese market and innovation ecosystem encourages long-term commitment. Therefore, the working group encourages adapting a more friendly visa policy to welcome all young talent.

### Recommendations

- Provide a single window to consult on topics related to foreign talent and actively communicate policy changes via various channels, including industrial associations and organisations, in a timely manner.
- Increase foreign enterprises' autonomy in issuing invitations to international talent and establish a

<sup>16</sup> *The National Immigration Administration Promotes the Replication of 12 Policies on Immigration and Immigration Facilitation in the FTZs Nationwide*, Ministry of Public Security, 17<sup>th</sup> July 2019, viewed 23<sup>rd</sup> April 2022, <<https://www.mps.gov.cn/n6557558/c6613913/content.html>>

<sup>17</sup> *Results of a survey on the internationalisation of Chinese universities*, EURAXESS, 16<sup>th</sup> April 2021, viewed 23<sup>rd</sup> April 2022, <<https://euraxess.ec.europa.eu/worldwide/china/results-survey-internationalisation-chinese-universities>>





preferential visa policy targeting R&D personnel for important projects.

- Clarify existing policy requirements for recruiting foreign nationals as interns.
- Encourage special visa facilitation for young researchers in general.

### 3. Facilitate Multinational Enterprises' Digital Innovation in China

#### Concern

The lack of access to open data sources, the requirements for international companies to establish databases in China, and the lack of harmonisation between Chinese and international IT standards discourage international companies from both carrying out IT R&D and transferring technologies to China.

#### Assessment

In order to encourage domestic innovation, China has promoted several notable policies over the past decade, such as Made in China 2025,<sup>18</sup> the Platform for Action to Promote Big Data Development,<sup>19</sup> and the New Generation Artificial Intelligence (AI) Development Plan.<sup>20</sup> Implementation of these policies helped to accelerate the development of AI and big data in China. As a result, there has been a proliferation of new digital tools and apps in recent years, with many maturing and being widely adopted, such as the digital codes used for health kits throughout China as part of the COVID-19 tracking and tracing efforts. However, the participation of foreign companies in the development of them has so far been minimal. This is of detriment to the market, as deeper participation from FIEs can stimulate the market through increased competition, resulting in better products. Therefore, the participation of FIEs in developing the national or regional digital tools and apps should be encouraged.

Innovation depends on access to open data sources and the freedom to create and manage databases. However, FIEs face many hurdles to access such resources in China. In 2020, the National People's Congress (NPC) released the *Guidance on the*

*Development of Industrial Big Data (Guidance)*, which includes new measures to accelerate data pooling, promote data sharing and deepen data application.<sup>21</sup> The following recommendations included in the *Guidance* were notable:

- "Facilitate international collaboration..."; and
- "Boost exchange and collaboration on big industrial data in policies, technologies, standards, talent, and enterprises at a more comprehensive deeper level."

Despite this, there are still no clear guidelines on how FIEs can access and use such data resources.

China's "autonomous and controllable"<sup>22</sup> guidelines are also having an impact on European R&D operations. For example, with implementation of the Data Security Law, the Cyberspace Administration of China issued the *Regulations on Network Data Security Management (Draft for Comments)*, which was passed by the NPCSC on 11<sup>th</sup> June 2021.<sup>23</sup> On 10<sup>th</sup> February 2022, the MIIT issued the *Measures for the Administration of Data Security in the Informatisation Field (Draft for Comments)*. These measures put forward new requirements for cross-border data transfer and require enterprises to conduct regular security audits and backups. The Chinese Government's purpose of maintaining national data security is understandable but companies still have legitimate concerns that the implementation of these measures will both negatively impact cross-border R&D-related data flows and increase compliance costs. Companies in the ICT sector have expressed concern that they may in the future be forced to either increase R&D activities in China to comply with these policies and maintain market share, or leave the market altogether.<sup>24</sup> Data management rules in China also raise major concerns. While China's sheer size makes it an attractive data pool too big to ignore, this data loses value when

<sup>21</sup> *Guidance on the Development of Industrial Big Data*, NPC, 8<sup>th</sup> April 2020, viewed 23<sup>rd</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2020-05/15/content\\_5511867.htm](http://www.gov.cn/zhengce/zhengceku/2020-05/15/content_5511867.htm)>

<sup>22</sup> 'Autonomous and controllable' (also referred to as 'secure and controllable') is a concept put forward in several recent laws and regulations whereby the government would have broad discretion on deciding how it protects information networks, devices and data deemed critical to national and economic security. This concept is closely linked to the development and use of Chinese indigenous products and technologies instead of foreign ones.

<sup>23</sup> Data Security Law of the People's Republic of China, State Council, 10<sup>th</sup> June 2021, viewed 16<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-06/11/content\\_5616919.htm](http://www.gov.cn/xinwen/2021-06/11/content_5616919.htm)>

<sup>24</sup> *Decoupling: Severed Ties and Patchwork Globalisation*, European Union Chamber of Commerce in China and the Mercator Institute for China Studies (MERICS), January 2021, viewed 23<sup>rd</sup> April 2022, <<http://european-chamber.com.cn/en/publications-decoupling>>

<sup>18</sup> *Notice from the State Council on Made in China 2025*, NPC, 2<sup>nd</sup> June 2020, viewed 23<sup>rd</sup> April 2022, <[http://www.gov.cn/zhengce/content/2015-05/19/content\\_9784.htm](http://www.gov.cn/zhengce/content/2015-05/19/content_9784.htm)>

<sup>19</sup> *Platform for Action to Promote Big Data Development*, *People.cn*, 5<sup>th</sup> September 2015, viewed 23<sup>rd</sup> April 2022, <<http://politics.people.com.cn/n/2015/0905/c1001-27545655.html>>

<sup>20</sup> *New Generation Artificial Intelligence Development Plan*, NPC, 20<sup>th</sup> July 2017, viewed 23<sup>rd</sup> April 2022, <[http://www.gov.cn/zhengce/content/2017-07/20/content\\_5211996.htm](http://www.gov.cn/zhengce/content/2017-07/20/content_5211996.htm)>





companies encounter barriers to dynamic and effective cross-border data transfer processes.

The Research and Development Working Group and the Standards and Conformity Assessment Working Group are both recommending that China further harmonise domestic and international IT standards, and involve FIEs in the process.<sup>25</sup> Even though the *Regulation for Implementing the Foreign Investment Law* stipulates that FIEs must be consulted equally on the formulation and revision of national, industrial, local and group standards,<sup>26</sup> most standard-setting bodies currently only allow limited participation from international companies.<sup>27</sup> Aligning rules with the international community would help to raise the international profile of China's innovative sectors, bring global recognition for China's R&D capacity and improve the reputation of Chinese products in international markets.

Article 15 of the *Notice to Promote Innovation in State-level Economic and Technological Development Zones to Create a New Plateau for Reform and Opening-up (Notice)* encourages all kinds of capital to invest in IT infrastructure in state-level economic and technological development zones to promote the development of a digital economy.<sup>28</sup> The Research and Development Working Group and the Standards and Conformity Assessment Working Group recommend that the *Notice* be rolled out nationwide as soon as possible in order for it to serve its intended purpose of boosting innovation in China.<sup>29</sup>

#### Recommendations

- Publish a list of open databases that foreign enterprises can access, and clarify whether FIEs can establish and manage their own public database independently.
- Promote the harmonisation of Chinese and international ICT standards to incentivise international companies to increase investment in R&D in China.

25 For more information, please see the *Standards and Conformity Assessment Working Group Paper 2022/2023*.

26 *Regulation for Implementing the Foreign Investment Law*, State Council, 26<sup>th</sup> December 2019, viewed 23<sup>rd</sup> April 2022, <[http://www.gov.cn/zhengce/content/2019-12/31/content\\_5465449.htm](http://www.gov.cn/zhengce/content/2019-12/31/content_5465449.htm)>

27 For more information, please see the *Standards and Conformity Assessment Working Group Paper 2022/2023*.

28 *Notice to Promote Innovation in State-level Economic and Technological Development Zones to Create a New Plateau for Reform and Opening-up*, State Council, 28<sup>th</sup> May 2019, viewed 23<sup>rd</sup> April 2022, <[http://www.gov.cn/zhengce/content/2019-05/28/content\\_5395406.htm](http://www.gov.cn/zhengce/content/2019-05/28/content_5395406.htm)>

29 For more information, please see the *Standards and Conformity Assessment Working Group Position Paper 2022/2023*.

- Integrate investment in IT infrastructure in state-level economic and technological development zones into the development plans for local digital economies.

#### 4. Invest More in R&D of Green and Sustainable Technology to Accelerate Along the Path Towards Carbon Neutrality and Realise China's Overall Environmental Goals

##### Concern

The Chinese Government does not currently provide sufficient support for either R&D of green and sustainable technologies or the commercial application of subsequent results, which may hinder China's overall green development and slow its progress towards carbon neutrality.

##### Assessment

Green development is a national strategy of China.<sup>30</sup> On 22<sup>nd</sup> September 2020, President Xi Jinping stated in his speech at the 75<sup>th</sup> General Debate of the United Nations General Assembly that China will increase its nationally determined contributions, adopt more targeted policies and measures, and "strive to reach its peak carbon dioxide emissions by 2030, and strive to achieve carbon neutrality by 2060 (30/60 Goals)."<sup>31</sup>

Adopted in 2021, China's 14<sup>th</sup> Five-year Plan (14FYP) emphasised the development of action plans to achieve peak carbon emissions by 2030. On 26<sup>th</sup> October 2021, the State Council released the *Action Plan for Carbon Dioxide Peaking Before 2030*. The plan clarifies the Chinese government's determination to achieve carbon peaking in 2030, and at the same time clearly encourages companies to undertake major national green and low-carbon science and technology projects, and showed the willingness to open facilities, data and other resources. The working group looks forward to seeing the further implementation of the plan, and at the same time hopes to strengthen further communication with relevant departments, so that FIEs can better help China to achieve its 30/60 Goals.

While the introduction of a national emissions trading

30 *China's National Plan on Implementation of the 2030 Agenda for Sustainable Development*, Ministry of Foreign Affairs, September 2016, viewed 29<sup>th</sup> June 2022, <[https://www.fmprc.gov.cn/mfa\\_eng/zxxx\\_662805/W020161014332600482185.pdf](https://www.fmprc.gov.cn/mfa_eng/zxxx_662805/W020161014332600482185.pdf)>

31 Matt McGrath, *Climate Change: China aims for 'carbon neutrality by 2060'*, BBC News, 22<sup>nd</sup> September 2020, viewed 29<sup>th</sup> June 2022, <<https://www.bbc.com/news/science-environment-54256826>>





system (ETS) is a positive development, achieving the 30/60 Goals will require a comprehensive green and low-carbon transition, which in turn will need a comprehensive and transparent roadmap and a complementary legal and regulatory system that takes into consideration the characteristics of different regions and industries.<sup>32</sup> This will require extensive financial support to support the transition. By November 2021, the People's Bank of China (PBOC) already issued the carbon-reduction supporting tools,<sup>33</sup> and will guide financial institutions through the tools available to provide low-cost loans to firms in crucial carbon-reduction fields. However, this support is mostly provided to industrial carbon-reduction activities.

Measures that motivate enterprises to participate in the R&D of low-carbon technologies will also be needed. Given that a significant amount of investment is required in these areas, additional non-monetary incentives are needed for companies to engage in R&D and application of breakthrough low-carbon and clean technologies. The transition from the laboratory to market needs to be accelerated in order to increase success rate of such technologies. These could include creating open R&D cooperation platforms, and establishing pilot and demonstration areas.

The EU and China are currently preparing the EU-China Joint Roadmap for Future Science, Technology and Innovation Cooperation, with both sides anticipating that it will be updated on a regular basis to take into account new developments.<sup>34</sup> Given the EU's relatively well-established legal and regulatory framework, its determination to develop green technologies and halve emissions by 2030, as well as the related advanced technology of European companies, the Research and Development Working Group recommends increasing EU-China collaboration in this area.

### Recommendations

- Provide enterprises with additional incentives that focus on the long-term development of new breakthroughs in green technologies.

32 *Climate Change 2020 Green Paper Launch and Green Low Carbon Development Summit Forum Held in Beijing*, NetEase, 30<sup>th</sup> November 2020, viewed 29<sup>th</sup> June 2022, <<https://www.163.com/dy/article/FSMNQ11S05446XON.html>>

33 *Announcement of the carbon-reduction supporting tools*, PBOC, 8<sup>th</sup> November 2021, viewed 29<sup>th</sup> June 2022, <<http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4384182/index.html>>

34 *China and EU sign new round of joint research funding agreement*, MOST, 26<sup>th</sup> April, viewed 28<sup>th</sup> April 2022, <[http://www.most.gov.cn/kjbgz/202204/t20220426\\_180342.html](http://www.most.gov.cn/kjbgz/202204/t20220426_180342.html)>

- Facilitate the creation of pilot and demonstration areas and projects for low-carbon and sustainable technologies and their scale-up and commercialisation.
- Enhance EU-China collaboration in R&D of low-carbon and circular technologies.
- Provide more transparency for China's carbon technology roadmap and R&D programme, like the *Action Plan for Carbon Dioxide Peaking Before 2030* and the EU China joint research funding agreement.

## 5. Strengthen Protection of R&D—Including IP-related Aspects—to Develop a World-class Innovation Environment

### Concern

Despite continuous improvements to China's overall IP protection system, European companies still struggle to protect their IPR related to R&D, which discourages them from investing in cutting-edge technological innovation in China.

### Assessment

Enhancing IP protection and enforcement in China is crucial for developing an innovative country,<sup>35</sup> with innovation-driven enterprises and that promotes high-quality economic growth. China's new Patent Law, which went into force on 1<sup>st</sup> June 2021, should contribute to developing a more favourable R&D environment. In addition, the Science and Technology Progress Law (revised in 2021) was officially promulgated on 24<sup>th</sup> December 2021, with the aim of establishing and improving China's IP system at the legal level, boosting social awareness of IPR, protecting IPR and encouraging independent innovation. Furthermore, with local governments being tasked with optimising their respective business environments, all regions are carrying out actions with the aim of strengthening IP enforcement.

To further China's goal of creating a better technological innovation environment, the function, value and impact of its patent system needs to be adjusted so that it balances existing right holders and new market entrants. Fostering R&D in new technologies, such as biotechnology and AI, requires that the related IP legal framework and patent system is able to swiftly and strategically respond to the challenges that

35 *Opinions of the Supreme People's Court on Comprehensively Strengthening the Judicial Protection of Intellectual Property Rights*, Invest in China, 15<sup>th</sup> April 2020, viewed 23<sup>rd</sup> April 2022, <<http://www.court.gov.cn/zixun-xiangqing-226491.html>>





arise. In order to realise these changes in the most effective way, it would be beneficial to consult with experts from the private sector and the academic and scientific communities. In order to prevent potential misjudgements, it is also recommended that the interpretation of the newly revised Patent Law be strengthened before being actively communicated to local governments and enforcement authorities.

Disputes need courts with a high level of technical competence. However, while China has established several specialised IP Courts—and general courts in Tier-1 cities tend to have more experience in hearing IPR-related cases and can count on better prepared judges and experts—this level of expertise is not available in all local courts. One way to expand the range of IPR cases that can be heard by such courts could be to have a more centralised system for adjudication, which would alleviate pressure in technically-complex cases while also reducing local protectionism. It would also improve the ability of local courts to hear IP-related cases by establishing a complete expert hearing system, and promoting the progress of IP-related cases nationwide.

Technology transfers, both from FIEs to ‘indigenous’ Chinese companies and the other way round, is challenging. On 2<sup>nd</sup> March 2019, the State Council repealed three controversial articles within the *Technology Import and Export Administrative Regulation*,<sup>36</sup> a positive development in controlling compelled technology transfer from a legal perspective. Yet the repeal of these articles does not automatically mean that compelled technology transfers are not still taking place. It remains of significant concern that European companies are still being compelled to transfer technology to maintain market access—as reported by 14 per cent of respondents to the European Chamber’s *Business Confidence Survey 2022*—even after the Foreign Investment Law, which expressly prohibits unfair technology transfers, took effect on 1<sup>st</sup> January 2020. While the Foreign Investment Law has banned administrative tools from compelling technology transfers, this does not address the core problem. Modern transfers are compelled not through administrative means but by market access

36 *Administrative Decree No. 709*, State Council, 2<sup>nd</sup> March 2019, viewed 23<sup>rd</sup> April 2022, <[http://www.gov.cn/zhengce/content/2019-03/18/content\\_5374723.htm](http://www.gov.cn/zhengce/content/2019-03/18/content_5374723.htm)>

requirements.<sup>37</sup> It is clear that there is still a need for further enhancement of IPR-related legislation. Integrating international companies’ feedback can help to improve China’s overall IPR protection framework,<sup>38</sup> which will help to encourage increased investment in R&D, eventually increasing China’s innovation capacity.

The process for transferring IP from Chinese firms to foreign parties has become progressively tighter, with transfers being strictly reviewed if they affect ‘national security’ or core technology in strategic fields.<sup>39</sup> New IP produced by projects that receive Chinese state funding require: 1) approval from the relevant government authorities if IP is to be transferred or exclusively licensed to non-Chinese entities, including international project partners that contribute background IP; and 2) that the first licence of the newly produced IP be in China. A certain degree of relaxation of such restrictions can incentivise FIEs to participate in China’s innovation projects, as IP owned by FIEs could prove essential background IP in some projects. For example, without self-owned IP rights, enterprises are not eligible for China’s HNTe benefits, due to the patent requirement.<sup>40</sup>

#### Recommendations

- Consult with universities, foreign research institutions, and Chinese and international companies’ R&D departments when drafting new policies related to innovation and IPR protection.
- Increase technical expertise and avoid local protectionism in local courts, and establish a more centralised jurisdiction for IPR-related cases related to innovation and R&D.
- Enhance the enforcement of IPR legislation to avoid compelled technology transfers or technology transfer difficulties.
- Allow the existence of co-ownership of IP between the parent company and local affiliates (or ownership of the parent company) in R&D projects funded by the Chinese Government.

37 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 20<sup>th</sup> June 2022, p. 34, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

38 For more information, please see the *Intellectual Property Rights Working Group Paper 2022/2023*.

39 *External Transfer of Intellectual Property Rights Measures (Trial Implementation)*, State Council, 18<sup>th</sup> March 2018, viewed 23<sup>rd</sup> April 2022, <[http://www.gov.cn/zhengce/content/2018-03/29/content\\_5278276.htm](http://www.gov.cn/zhengce/content/2018-03/29/content_5278276.htm)>

40 *Measures for the Administration of Recognition of High-tech Enterprises*, MOST, 14<sup>th</sup> April 2008, viewed 6<sup>th</sup> July 2022, <[http://www.most.gov.cn/xxgk/xinxifenlei/fdzdgnr/fgzcf/gfxwj/gfxwj2010before/200811/20081129\\_65744.html](http://www.most.gov.cn/xxgk/xinxifenlei/fdzdgnr/fgzcf/gfxwj/gfxwj2010before/200811/20081129_65744.html)>





## Abbreviations

CNY	Chinese Yuan
EU	European Union
ETS	Emissions Trading System
FIE	Foreign-invested Enterprise
FTZ	Free Trade Zone
HNTE	High and New Technology Enterprise
IP	Intellectual Property
IPR	Intellectual Property Right
ICT	Information and Communications Technology
IT	Information Technology
MIIT	Ministry of Industry and Information Technology
MNC	Multinational Corporation
MOF	Ministry of Finance
MOST	Ministry of Science and Technology
NPC	National People's Congress
PBOC	People's Bank of China
R&D	Research and Development
S&T	Science and Technology
STA	State Taxation Administration
WIPO	World Intellectual Property Organization



# Standards and Conformity Assessment Working Group

## Key Recommendations

### 1. Implement the Principles of the World Trade Organization Agreement on Technical Barriers to Trade (WTO/TBT) Related to Standards, Technical Regulations and Conformity Assessment Procedures 15

- Ensure proper notification of all mandatory standards that may impact market access, and enlarge the scope to cover all mandatory market access requirements.
- Continue to limit the scope of technical regulations and mandatory standards to issues related to the protection of the environment, health and safety, in accordance with the WTO/TBT Agreement.
- Rescind mandatory industry standards or convert them to recommended or mandatory national standards as soon as possible.
- Provide English versions of the notified documents.

### 2. Review Mandatory Market Access Requirements, Including the Simplification of Testing and Certification Procedures 15

- Optimise the synchronisation of mandatory standards, compulsory certification schemes and administrative licensing schemes.
- Support the recognition of test reports at both the national and international levels.
- Allow more manufacturers to use their own testing laboratories, provided they meet all necessary accreditation requirements.
- Ensure all mandatory-type approval schemes for market access are based only on national mandatory standards and supervised by one standardisation committee to avoid breaching China's WTO obligations.
- Simplify the designation processes for China Compulsory Certificate testing laboratories and certification bodies to allow international laboratories or certification bodies to join the system.

### 3. Ensure that all Relevant Stakeholders Enjoy Equal Access and Participation Rights in Standardisation Work 15

- Grant fair access to all technical committees (TCs) for interested stakeholders.
- Grant equal rights to all organisations/companies participating in TCs.
- Encourage open and extensive industry involvement in all types of standardisation work, including the development of standardisation strategies and participation in international standardisation activities.
- Ensure transparency with regards to membership requirements, participation or sponsorship fees, and disclosure of financial information in standardisation projects.
- Support foreign enterprises applying for standardisation revision project registration.

### 4. Continue the Current Reform of the Chinese Standardisation System and Increase Harmonisation Efforts

#### Mandatory national standards 7

- Expand the standardisation reform to include exempted areas.





- Introduce reasonable transition periods for mandatory standards in a transparent manner and implement the European concept of transition periods in more industries.
- Accelerate the revision of traditional standards to match new technological developments.
- Avoid referring to recommended standards in mandatory standards.

#### **Recommended national standards**

- Avoid implementing recommended standards as mandatory standards.
- Avoid referring to recommended standards in law enforcement and market surveillance.
- Follow the same notification procedure of mandatory standards and provide sufficient transition periods in cases where recommended standards must be implemented as mandatory.

#### **Social organisation standards**

- Stick to the policy of independent development and free use of social organisation standards and strictly avoid the inclusion of such standards in administrative measures.
- Establish proper procedures to facilitate the transformation of social organisation standards into national and industry standards.
- Ensure there is transparency in processes related to social organisation standards, and that equal access is granted to all relevant players.
- Formulate in a timely manner an intellectual property (IP) management system to disclose necessary patent-related information.
- Obtain the authorisation of copyright owners in cases where their standards are referenced, and clearly mention the referencing of such standards in the published document.

#### **Enterprise standards**

- Clarify the definition of 'enterprise standards' in the context of self-declaration obligations.
- Clarify the disclosure or format requirements for enterprises, and limit the scope of the self-declaration mechanism to mandatory national standards adopted by enterprises.
- Improve the enterprise standards online service platform by making it more user-friendly.
- Allow enterprises to make self-declarations of enterprise standards on their own websites.
- Ensure the enterprise standards 'top runner' system is fair, open, transparent and follows a reliable scientific process.
- Protect the intellectual property rights (IPR) of enterprise standards.

#### **Industry standards**

- Enhance coordination between industry standards and other standards to avoid overlaps.

#### **International standards**

- Continue participating in international standards-setting activities and increase the adoption rate of identical international standards.

## **5. Ensure Fair and Transparent Market Surveillance** 15

- Align market surveillance and market access requirements.
- Limit administrative penalties in market surveillance to the violation of laws, regulations, mandatory standards and certification schemes, and make non-mandatory requirements in market surveillance subject only to civil liability.
- Increase the number of product categories to be checked in the market.
- Increase market surveillance efforts and impose more strict verification requirements for e-commerce platforms.
- Increase market surveillance in the case of certain enterprise standards.
- Provide diverse channels for reporting non-compliance.



- Intensify follow-up market checks and develop processes and penalties that serve as effective deterrents.
- Allow commercial organisations that meet accreditation requirements to join market surveillance.

## Quality and Safety Services Sub-working Group

### 1. Ensure Equal and Fair Treatment in Government Procurement Activities for Foreign-invested Testing, Inspection and Certification (TIC) Agencies

- Regulate government procurement by establishing a fair, transparent, impartial and efficient management system.
- Remove all conditions that are not related to the capabilities necessary to perform the bid, and provide a platform for fair competition among testing and inspection service providers.

### 2. Accelerate Market-orientated Reforms of Government-affiliated TIC Agencies, and the Establishment of a Fair, Open TIC Market System

- Continue accelerating market-orientated reform of government-affiliated TIC agencies.
- Reduce excessive and unclear market access barriers and adopt international norms for assessment.
- Provide true national treatment for foreign-invested TIC agencies.

### 3. Allow Foreign-invested TIC Agencies to Provide Container Inspection Services

- Allow foreign-invested TIC agencies to provide container inspection services.

### 4. Accelerate the Marketisation Process of Special Equipment Inspection Services

- Establish a market competition mechanism and allow enterprises to freely choose inspection agencies for statutory inspections.
- Enhance the diversity of inspection entities to provide both greater consumer choice and space for non-government-affiliated inspection agencies to grow.

### 5. Establish and Implement in a Timely Manner a System for Customs to Accept Inspection Results from Third-party Agencies for Imported Commodities, Including Imported Bulk Commodities

- Create and implement a system for customs to accept third-party inspection results for imported and exported commodities as soon as possible.
- Open up the market and accept evaluations by all inspection agencies, including foreign-invested, private and state-owned agencies, and grant equal treatment to foreign-invested inspection agencies.





## Introduction to the Working Group

The Standards and Conformity Assessment (SCA) Working Group was founded in 2008. Its members come from various industry sectors including automotive, automotive components, construction, cosmetics, healthcare equipment, electrical equipment, information and communication technology and machinery. It contains the Quality and Safety Services Sub-working Group. The Standards and Conformity Assessment Working Group aims to support the development of China's SCA systems in order to facilitate China's integration into the global economy. As China opens its door wider to the world, SCA will be essential to facilitating cooperation between the European Union (EU) and China in investment, trade, environment, healthcare and production activities.

## Recent Developments

### China's Updated Standardisation Strategy

On 10<sup>th</sup> October 2021, the Central Committee of the Communist Party of China and the State Council released the *National Standardisation Development Outline (Outline)*, setting new targets for China's standardisation system until 2035.<sup>1</sup> On 6<sup>th</sup> December 2021, the *14<sup>th</sup> Five-year Plan for the Construction of the National Standard System for Promoting High-Quality Development (14FYP on Standardisation)* was published.<sup>2</sup> The overarching objectives of these strategies include: achieving a standardisation system that promotes the high-quality development of both state and market-led standards by 2025; establishing a whole-of-society standardisation system, with a focus on standardisation development in the fields of agriculture, industry (particularly emerging technologies), the service sector and climate; promoting enhanced integration between innovation and research and development (R&D) activities and standardisation; and strengthening the coordination between domestic and international standardisation.

<sup>1</sup> *The Central Committee of the Communist Party of China and the State Council issued the National Standardisation Development Outline*, State Council, 10<sup>th</sup> October 2021, viewed 18<sup>th</sup> March 2022, <[http://www.gov.cn/zhengce/2021-10/10/content\\_5641727.htm](http://www.gov.cn/zhengce/2021-10/10/content_5641727.htm)>

<sup>2</sup> *Notice on Printing and Distributing the "14<sup>th</sup> Five year Plan for the Construction of the National Standard System for Promoting High-Quality Development"*, State Administration for Market Regulation (SAMR), 6<sup>th</sup> December 2021, viewed 18<sup>th</sup> April 2022, <[https://gkml.samr.gov.cn/nsjg/bjzss/202112/t20211214\\_338077.html](https://gkml.samr.gov.cn/nsjg/bjzss/202112/t20211214_338077.html)>

## The Involvement of European Business in China's Standardisation System

On 2<sup>nd</sup> December 2021, the European Chamber, together with the Swedish Institute of International Affairs, published the report *The Shape of Things to Come: The Race to Control Technical Standardisation*, which examines China's standardisation system and European businesses engagement in standardisation activities in China.<sup>3</sup> The report used quantitative data from the European Chamber's *European Business in China Business Confidence Survey 2020 (BCS 2020)*<sup>4</sup> and a dedicated questionnaire developed for the report as well as qualitative input from more than 30 interviews with business and government stakeholders. Some of the key data points of the survey are as follows:

- 37 per cent of respondents to the BCS 2020 reported being involved in standardisation activities in China.
- The survey conducted for the standardisation report—specifically aimed at member companies involved in standardisation activities in China—indicated that considerations about technical standards are important for 54.8 per cent of respondents when assessing investment opportunities.
- A majority of respondents to the survey view state and state-linked stakeholders (Chinese state institutions, research centres and state-owned enterprises) as key players in the standardisation bodies they participate in.
- 67.7 per cent of respondents planned to either maintain or increase resources dedicated to standardisation activities in China.

## Key Recommendations

### 1. Implement the Principles of the World Trade Organization Agreement on Technical Barriers to Trade (WTO/TBT) Related to Standards, Technical Regulations and Conformity Assessment Procedures

#### Concern

China's practices do not fully comply with WTO/TBT

<sup>3</sup> Rühlig, Tim, *The Shape of Things to Come: The Race to Control Technical Standardisation*, European Union Chamber of Commerce in China and the Swedish Institute of International Affairs (UI), 2<sup>nd</sup> December 2021, viewed 19<sup>th</sup> April 2022, <<https://www.europeanchamber.com.cn/en/publications-standardisation-report>>

<sup>4</sup> *European Business in China Business Confidence Survey 2020*, European Union Chamber of Commerce in China, p. 64, 10<sup>th</sup> June 2020, viewed 19<sup>th</sup> April 2022, <[http://www.europeanchamber.com.cn/en/publications-archive/774/European\\_Business\\_in\\_China\\_Business\\_Confidence\\_Survey\\_2020](http://www.europeanchamber.com.cn/en/publications-archive/774/European_Business_in_China_Business_Confidence_Survey_2020)>





Agreement principles and create unnecessary obstacles for foreign enterprises trying to access the Chinese market.

#### Assessment

#### a) Proper notification of mandatory standards, technical regulations and conformity assessment procedures—including administrative licensing—required for market access

According to the WTO/TBT Agreement, government bodies of signatory countries and regions are obliged to notify other WTO members about proposed technical regulations and conformity assessment procedures at an early stage. The goal is to ensure that these regulations and procedures do not create unnecessary obstacles to trade or foster protectionism. While the working group recognises the positive progress made by China in this regard, there are still many cases where either no notification was given or the information was incomplete.

Currently, many mandatory market access schemes in China have never been notified to the WTO despite affecting market access for the products they cover. Examples include the *Certification of Critical Network Equipment and Security-specific Products*, the *Licence for Sale of Computer Information System Security-specific Products*, and the *Technical Review on the Compliance of On-vehicle Terminals and Platforms of Satellite Positioning Systems*. The working group recommends that the government take meaningful steps to address this issue.

The working group also suggests that English versions of the notified standards be published for reference. In this regard, commitments made in both the *14FYP on Standardisation* and the *Outline* to increase the number of English language versions of mandatory national standards are a welcome step.

#### b) Limiting the scope of technical regulations and mandatory standards to issues related to the protection of the environment, health and safety (EHS), according to the WTO/TBT Agreement

The WTO/TBT Agreement allows countries to take necessary measures to fulfil legitimate objectives, such as national security requirements, the prevention of deceptive practices, and the protection of EHS. The

working group is pleased to note that China intends to limit the scope of mandatory standards to the above-mentioned objectives and recommends that China continue to fulfil its commitments in this regard, by either rescinding mandatory industry standards, or converting them to either recommended or mandatory national standards.<sup>5</sup>

#### Recommendations

- Ensure proper notification of all mandatory standards that may impact market access, and enlarge the scope to cover all mandatory market access requirements.
- Continue to limit the scope of technical regulations and mandatory standards in accordance with the WTO/TBT Agreement.
- Rescind mandatory industry standards, or convert them to recommended or mandatory national standards as soon as possible.
- Provide English versions of the notified documents.

## 2. Review Mandatory Market Access Requirements, Including the Simplification of Testing and Certification Procedures



#### Concern

Market access barriers are created when certain products have to fulfil multiple requirements published by different authorities that are not coordinated with one another, while certain testing and certification procedures place unnecessary burdens on manufacturers by increasing costs, and hinder the import of technology and services without increasing product safety.

#### Assessment

#### a) The concurrent existence of mandatory standards, compulsory certification and administrative licensing schemes

According to the Standardisation Law, many products must comply with mandatory standards.<sup>6</sup> In addition, other regulations require certain products to comply with specific mandatory certification schemes and individual administrative licensing schemes. Although

<sup>5</sup> For more sector-specific information linked to WTO/TBT notification and exemptions, please see Key Recommendation (KR) 1 of the *Fashion and Leather Desk Working Group Position Paper 2022/2023*, p. 234.

<sup>6</sup> Standardisation Law of the People's Republic of China, National People's Congress (NPC), 4<sup>th</sup> November 2017, viewed 20<sup>th</sup> June 2022 <<http://www.npc.gov.cn/npc/c30834/201711/04d8afd2637d4f68bea84391e46d986f.shtml>>





the Standardisation Law and subsequent regulations provide for the streamlining of standards, some areas like environmental protection, engineering and medical devices are exempted. Furthermore, the lack of coordination between these regulations results in overlapping testing requirements, which leads to additional costs for manufacturers and can even delay product launches.

Part of the reason for this lack of cohesion is that these regulations have been formulated by different ministries and government authorities that work independently from one another. Therefore, improved coordination among relevant authorities would help to eliminate any overlap or conflict between the various mandatory standards, compulsory certification schemes and administrative licensing systems, and could ensure these schemes are only based on mandatory standards. It would also allow for reductions in waiting times for companies to access the latest technologies and increase manufacturing efficiency, which in turn would help to revitalise the Chinese economy.

#### **b) Recognition of test reports at both national and international levels, and increasing the efficiency of testing and certification processes**

Currently, there are various unified testing and certification schemes for different products in China, such as the China Compulsory Certificate (CCC) and the urban transit equipment certification. In addition, some domestic certification systems adopt the same technical standards as international certification systems, for example, the CCC for explosion-proof products and equipment for potentially explosive atmospheres (ATEX). However, European companies still find that some test reports issued by testing laboratories are not accepted by other testing laboratories for identical tests of the same product. In such cases, manufacturers have to re-test their products, which wastes company resources and ultimately results in delayed product launches, increased costs and reduced efficiency.

Ensuring nationwide recognition of test reports for the same technical qualifications would avoid product test repetition and facilitate business at both national and international levels. This will require certain testing requirements to be clearly defined, to ensure testing equivalence across China. The working

group recommends that China use the procedures already established for existing certification bodies as a model to follow. Part of these efforts could be managed by the relevant authorities in China, and could, for example, facilitate the use of test reports documenting manufacturers' in-house testing or third-party type testing for medical device product registration. In addition, where products comply with international standards that have been identically adopted domestically, relevant testing reports should also be recognised in China. Finally, the working group recommends that the designation process for certification bodies is simplified in order to allow globally-recognised entities to access the system.

Since September 2020, according to the *Opinions of the General Office of the State Council on Supporting the Transfer of Export Products to Domestic Sales*, in order to support development of the domestic market for export products and ease the administrative burden of foreign enterprises, companies are allowed to sell products developed before 2021 if they provide a self-declaration that the products conform to mandatory national standards.<sup>7</sup> Enterprises can make this declaration through the enterprise standard information public service platform, or in the form of product instructions, factory certificates and product packaging, among others. The working group welcomes these measures and hopes that they will remain in place.

#### **c) Recommended standards used as market access requirements**

Recommended standards by definition should remain voluntary. Unfortunately, some have either become *de facto* mandatory after being chosen as the basis for mandatory certification and administrative licensing schemes, or include some mandatory terms. The practice of using recommended standards in mandatory certification schemes is still widespread in China. The lack of transparency in these instances causes problems for enterprises that must comply with multiple mandatory market access schemes.

#### **Recommendations**

- Optimise the synchronisation of mandatory standards, compulsory certification schemes and administrative

<sup>7</sup> *Opinions of the General Office of the State Council on Supporting the Transfer of Export Products to Domestic Sales*, State Council, 22<sup>nd</sup> June 2020, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2020-06/22/content\\_5521078.htm](http://www.gov.cn/zhengce/content/2020-06/22/content_5521078.htm)>





licensing schemes.

- Support the recognition of test reports at both national and international levels.
- Allow more manufacturers to use their own testing laboratories, provided they meet all necessary accreditation requirements.
- Ensure all mandatory-type approval schemes for market access are based only on national mandatory standards and supervised by one standardisation committee to avoid breaching China's WTO obligations.
- Simplify the designation processes for CCC-testing laboratories and certification bodies to allow international laboratories or certification bodies to join the system.

### 3. Ensure That all Relevant Stakeholders Enjoy Equal Access and Participation Rights in Standardisation Work

#### Concern

Even though numerous pieces of Chinese legislation stipulate that all relevant stakeholders shall be granted equal access and participation rights in standardisation work, there is still a gap in implementation.

#### Assessment

Equal participation in standardisation work in China is a long-standing concern for foreign-invested enterprises (FIEs). Although this principle has been enshrined in multiple pieces of Chinese legislation, like the Foreign Investment Law and more recently the *Outline* and the *14FYP for Standardisation*, there is still room for improvement when it comes to implementation. For instance, at the macro level, opportunities for providing feedback on major standardisation strategies, such as China Standards 2035 and its final iteration, the *Outline*, in their development/drafting phases, have remained at best limited for international players.

Access to technical committees (TCs) is one area in which some encouraging progress has been made throughout the past few years. However, the principle of granting equal access to TCs to all stakeholders has not been fully implemented. Both the survey and subsequent interviews conducted for the European Chamber report *The Shape of Things to Come: The Race to Control Technical Standardisation*, show that while direct barriers—such as instances of companies being expressly denied participation in TCs—seem to

have reduced and now only occur in a limited number of sectors (such as cryptography and rail), European Chamber member companies continue to experience a variety of indirect barriers (see Figure 1).<sup>8</sup>

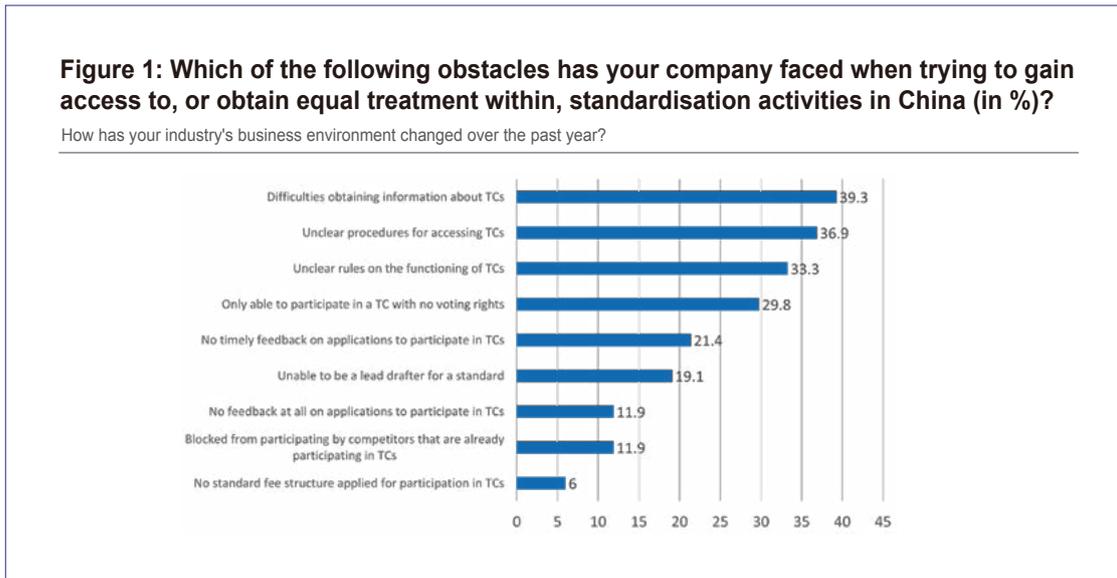
Another issue encountered by members is linked to local standards projects. The approval of such projects must be confirmed with the relevant local standardisation department. However, applications led by foreign-funded enterprises for local standards projects can be difficult, and often result in failure. One of the main reasons is that when government-commissioned research projects purchase services, associated tenders often have rigid requirements for participating institutions to include in their bids personnel with professional titles, including senior professional titles. These stringent requirements can often be difficult for foreign-funded institutions and enterprises to meet because, while in many cases their personnel have the required knowledge and experience, they do not have the equivalent professional titles. The working group thus recommends that authorities expand the eligibility criteria for these projects to ensure that a higher number of qualified stakeholders can participate.

Both the *Outline* and the *14FYP for Standardisation* commit to ensuring open, inclusive and transparent standardisation processes for all stakeholders. In this new phase of standardisation reform, the working group recommends that the Chinese Government step up its efforts to encourage FIEs' equal participation in domestic standardisation activities. This includes being able to hold the secretariat of a TC, lead the drafting of Chinese standards, participate in or lead China's international standardisation activities in certain technical fields, and access incentive policies from governments at all levels. In addition, the standardisation behaviour of social groups—such as associations, industry alliances and federations—should be supervised to ensure fair and equal access, and participation rights, of all stakeholders.<sup>9</sup>

<sup>8</sup> Rühlig, Tim, *The Shape of Things to Come: The Race to Control Technical Standardisation*, European Union Chamber of Commerce in China and the Swedish Institute of International Affairs, 2<sup>nd</sup> December 2021, viewed 19<sup>th</sup> April 2022 <<https://www.europeanchamber.com.cn/en/publications-standardisation-report>>

<sup>9</sup> For more sector-specific information on European business access to and participation in standardisation activities in China, please see KR3 of the *Rail Working Group Position Paper 2022/2023* on p. 300, and KR3 of the *Automotive Working Group Position Paper 2022/2023* on p. 187.





Source: European Chamber member survey on standardisation

### Recommendations

- Grant fair access to all TCs for interested stakeholders.
- Grant equal rights to all organisations/companies participating in TCs.
- Encourage open and extensive industry involvement in all types of standardisation work, including the development of standardisation strategies and participation in international standardisation activities.
- Ensure transparency with regard to membership requirements, participation or sponsorship fees, and the disclosure of financial information in standardisation projects.
- Support foreign enterprises bidding for local standardisation projects by expanding tender eligibility requirements for qualified experts.

## 4. Continue Reforming the Chinese Standardisation System and Increase Harmonisation Efforts

### Concern

Neither the revised Standardisation Law nor other relevant standardisation reforms have been completely implemented in all technical fields, and the transparency and fairness of existing standard-setting procedures still need to be improved.

### Assessment

#### a) Mandatory national standards

The working group has observed progress in China's streamlining and consolidation of mandatory national

standards over the past few years, as well as in establishing processes for the management of such standards. As a result, the working group expects the following:

- Notification of all mandatory national standards in accordance with WTO procedures.
- Alignment with international standards.
- No conflicting mandatory requirements and standards.
- A reduction of mandatory standards to a minimum.
- Guarantees that, before listing and drafting any mandatory national standard, calls for comments involving key industry stakeholders will be open for two months.
- Basing new standards projects on technological developments and the need to unify technical requirements instead of non-technology-based considerations.
- The establishment of clear work processes, roles and responsibilities for both industry authorities and the Standardisation Administration of China (SAC) in organising the drafting of mandatory national standards.
- Equal participation rights in the drafting of mandatory national standards for domestic and international stakeholders.
- That recommended standards will no longer be referred to in any mandatory national standards.
- Acceleration of the revision of traditional standards to match new technological developments.
- Stipulation of reasonable transition periods between



issuance and implementation dates for mandatory national standards.

The working group recommends that European best practices are followed with regard to transition periods, to ensure that the time allowed is reasonable and that products manufactured according to the old standard can be sold in the market after the implementation date of the new standard. This would involve either taking the implementation date of the new mandatory standard as the time at which production is switched, rather than the time to switch products being sold, or combining the grace period with an additional transition period for sales. Either solution would give foreign manufacturers more time to make necessary changes across their supply chains and for testing laboratories to adapt their facilities, and prevent both an unnecessary waste of resources and additional costs for companies.

European companies observe that in some cases the official released standard specifies a shorter transition period than the previous draft made available to foreign companies, which causes serious problems for them. For instance, in the case of imports, different transition periods can result in insufficient lead time for companies to be compliant with mandatory requirements and thus delay the import of affected products. To avoid these issues, greater transparency in standard setting is required.

### b) Recommended national standards

In the past few years, some recommended standards have been directly adopted as mandatory requirements without relevant stakeholders being clearly notified or given a sufficient transition period. In some cases, these voluntary standards have even been used in market surveillance. The authorities should avoid implementing recommended standards as market access requirements. If recommended standards are utilised, then sufficient industry research and the same notification procedure as for mandatory standards should be carried out before implementation. Furthermore, a reasonable transition period should be provided.

In addition, some TCs have also tried to formulate industry standards or recommended national standards instead of mandatory standards, to both reduce the time dedicated to this process and avoid having to notify

the WTO, but—as alluded to in KR 2—these standards have subsequently been implemented as mandatory, a practice that should not be permitted.<sup>10</sup>

### c) Social organisation standards

One of the key points of the *Provisions on the Administration of Social Organisation Standards* is that if standards formulated by associations meet the stipulated requirements, the association can apply to have them converted into national, industry or local standards.<sup>11</sup> Government bodies are also encouraged to apply social organisation standards in industrial policy formulation, administrative management, government procurement, and testing and certification, as well as bidding. When social organisation standards are transformed into national or industry standards, an open and inclusive process in which all stakeholders have equal opportunities to provide feedback should be guaranteed. Similarly, when a social organisation standard is transformed into a mandatory national standard, the relevant standard-setting and WTO/TBT procedures should be followed.<sup>12</sup>

Currently, some associations favour their own interests through the formulation of social organisation standards by means of requiring membership fees, charging for the formulation of standards or simply refusing access to FIEs. The working group believes that FIEs and domestic companies should have equal access to all Chinese social organisations.

Finally, the working group recommends that the relevant authorities formulate an intellectual property (IP) management system to disclose necessary patent-related information in a timely manner, particularly for standard-essential patents. The Chinese authorities should also ensure that copyright owners' authorisation is obtained in cases where their standards are referenced within other standards, and that the referencing of such standards is clearly mentioned in the published document.

<sup>10</sup> For more sector-specific information on the importance of ensuring recommended standards are implemented while taking into consideration their voluntary nature, please see KR1 of the *Information and Communication Technology Working Group Position Paper 2022/2023*, p. 338.

<sup>11</sup> *Provisions on the Administration of Social Organisation Standards (Trial Implementation)*, National Social Organisation Standards Information Platform, 26<sup>th</sup> December 2017, viewed 19<sup>th</sup> April 2022, <<http://www.ttbz.org.cn/Home/>>

<sup>12</sup> For more sector-specific information on the experiences of European businesses with the social organisation standards system, please see KR3 of the *Rail Working Group Position Paper 2022/2023*, p. 300.





#### d) Enterprise standards

The Standardisation Law defines enterprise standards as individual companies' proprietary product or service specifications, which detail product features and/or how a company puts together its products and services. These details—in particular the testing methods—often contain confidential information protected through IP rights (IPR). However, Article 27 of the Standardisation Law states that the function and performance indicators of products need to be disclosed. While the principle of making limited standards disclosures for the sake of adherence to customer protection requirements or for limited marketing purposes is acceptable, companies should not be required to disclose confidential information that could potentially put their IP at risk. In that respect, the working group welcomes the clauses in the draft *Measures for Promotion of Enterprise Standardisation* issued by the State Administration for Market Regulation (SAMR) on 24<sup>th</sup> November 2021, which permit enterprises to not disclose testing or inspection methods that contain commercial secrets, and hopes that this clause will be maintained in the final document.

The current written guidelines and definitions under the system are not sufficient to direct enterprises from a compliance point of view. However, during market surveillance by the Chinese authorities, some European companies have reported being strongly encouraged to follow the format for national standards and include all information (including type test and factory inspection) in the disclosed standards, even if the company already meets quality compliance requirements. This is concerning, as it points towards more stringent and extensive disclosure requirements. Therefore, the working group suggests limiting the scope of the self-declaration mechanism to mandatory national standards, and that the disclosure and format requirements of enterprise standards be clarified, with any potential requirements that could lead to involuntary disclosure of IP to the public avoided by all means.

With regard to the enterprise standards management system, an online service platform has been set up, and manufacturers are encouraged to make disclosures online and sign the self-declaration of conformity. However, to be more user-friendly, the platform still needs improvement in certain areas, such as the categories of products listed. Although it is impossible

to list all categories on the platform, this remains a mandatory selection item, raising compliance risks post-market surveillance if the correct category is not available. The working group is pleased to note that the draft *Measures for the Promotion of Enterprise Standards* allow enterprises to self-declare enterprise standards via channels other than the national enterprise standards online service platform. However, the draft *Measures* do not provide practical guidance on how to indicate enterprises' own disclosure channel on the national service platform, which needs to be clarified, either in the final iteration of the regulation or through other relevant documents.

Schemes such as the 'top runner' system have also raised concerns among the business community, partly because of questions regarding the scientific nature of the assessment method, and partly because of the involvement of the government in a system that—according to the spirit of standardisation reform—should be based on market competition and encourage market-led processes.<sup>13</sup> Members of the working group are also concerned about the possibility of some companies developing advanced standards for the 'top runner' system purely as a marketing tool, and do not necessarily reflect the actual quality of the products in the market. The working group therefore recommends that the government take steps to ensure the system is fair, open and transparent, and follows a reliable scientific process that includes measures to check the real situation in the market.

#### e) Industry standards

The Standardisation Law has clarified that industry standards are voluntary standards; yet, some industry standards remain mandatory, such as the YY series standards for medical devices. Furthermore, while the number of mandatory national standards has been reduced, the amount of industry, market-driven social organisation and enterprise standards is sky-rocketing. This situation has created numerous overlaps among different standards. One of the stated goals of the SAC's *Guiding Opinions on the Further Strengthening*

<sup>13</sup> In 2018, an enterprise standard 'top runner' system was established to encourage enterprises to proactively set and implement advanced standards. This system materialised with the joint issuing of the *Opinions on Implementing the Enterprise Standards 'Top Runner' System (Opinions)* by eight regulatory agencies. According to the *Opinions*, third party institutions will assess the quality of different enterprise standards and rank them: *Eight departments, including the State Administration for Market Regulation, issue Opinions on the Implementation of the 'Top-Runner' System*, SAC, 3<sup>rd</sup> July 2018, viewed 27<sup>th</sup> June 2022, <[http://www.sac.gov.cn/xw/bzhxw/201807/t20180703\\_342614.htm](http://www.sac.gov.cn/xw/bzhxw/201807/t20180703_342614.htm)>





*Management of Industry Standards* is to optimise the industry standard supply structure and improve coordination.<sup>14</sup> The working group hopes that the *Administrative Measures for Industry Standards*—which had been originally included in the SAMR's 2021 and 2022 legislative workplans but still were not published as of June 2022—can provide further guidance for the effective implementation of this goal, and recommends that harmonisation efforts be expanded to the whole standards system.<sup>15</sup>

## f) International standards

Key policy documents like the revised Standardisation Law, the *Outline* and the *14FYP for Standardisation*, have consistently pointed towards the Chinese Government's willingness to increase its participation in international standardisation activities and to continue to adopt international standards. In that regard, the targets in the *Outline* and the *14FYP for Standardisation* to achieve an 85 per cent adoption rate of international standards, and ensuring that 85 per cent of domestic TCs mirror international ones are seen as a positive step by the working group.<sup>16</sup> In 2021, the overall percentage of new international standards issued by China reached the same levels as the 2013 peak, making up 33 per cent of total standards issued. The number of standards identical to their international counterparts also increased in 2021.<sup>17</sup> The authorities should continue to increase the issuance and the adoption rate of identical international standards. The working group also recommends that the authorities clarify the methodology of the calculations used to establish the adoption rate of international standards in order to enhance transparency and accountability.<sup>18</sup>

<sup>14</sup> *Guiding Opinions on Further Strengthening Management of Industry Standards*, SAC, 10<sup>th</sup> April 2020, viewed 19<sup>th</sup> April 2022, <<http://www.sac.gov.cn/sbgs/sytz/202004/P020200415371585800963.pdf>>

<sup>15</sup> *2021 Legislative Work Plan*, SAMR, 1<sup>st</sup> April 2021, viewed 19<sup>th</sup> April 2022, <[http://gkml.samr.gov.cn/nsjg/fgs/202104/t20210401\\_327476.html](http://gkml.samr.gov.cn/nsjg/fgs/202104/t20210401_327476.html)>; and *2022 Legislative Work Plan*, SAMR, 28<sup>th</sup> April 2022, viewed 29<sup>th</sup> April 2022, <[https://gkml.samr.gov.cn/nsjg/fgs/202204/t20220427\\_344262.html](https://gkml.samr.gov.cn/nsjg/fgs/202204/t20220427_344262.html)>

<sup>16</sup> *The 14<sup>th</sup> Five-year Plan for the National Economic and Social Development of the People's Republic of China*, State Council, 13<sup>th</sup> March 2021, viewed 12<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592681.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm)>

<sup>17</sup> This calculation was made by collecting the data on national standards published on the SAC's National Public Service Platform for Standards Information. *National Public Service Platform for Standards Information*, SAC, viewed 19<sup>th</sup> April 2022 <<http://std.samr.gov.cn/gb/search/gbAdvancedSearch?type=std>>

<sup>18</sup> For more sector-specific information on the perspective of European business regarding adoption of and harmonisation with international standards, please see KR3 of the *Rail Working Group Position Paper 2022/2023*, p. 300, KR1 of the *Construction Working Group Position Paper 2022/2023*, p. 320, and KR1 and 3 of the *Information and Communication Technology Working Group 2022/2023*, p. 338 and p. 341 respectively.

## Recommendations

### Mandatory national standards

- Expand the standardisation reform to include exempted areas.
- Introduce reasonable transition periods for mandatory standards in a transparent manner and implement the European concept of transition periods in more industries.
- Accelerate the revision of traditional standards to match new technological developments.
- Avoid referring to recommended standards in mandatory standards.

### Recommended national standards

- Avoid implementing recommended standards as mandatory standards.
- Avoid referring to recommended standards in law enforcement and market surveillance.
- Follow the same notification procedure of mandatory standards and provide sufficient transition periods in cases where recommended standards must be implemented as mandatory.

### Social organisation standards

- Stick to the policy of independent development and free use of social organisation standards and strictly avoid the inclusion of such standards in administrative measures.
- Establish proper procedures to facilitate the transformation of social organisation standards into national and industry standards.
- Ensure there is transparency in processes related to social organisation standards, and that equal access is granted to all relevant players.
- Formulate in a timely manner an IP management system to disclose necessary patent-related information.
- Obtain the authorisation of copyright owners in cases where their standards are referenced, and clearly mention the referencing of such standards in the published document.

### Enterprise standards

- Clarify the definition of 'enterprise standards' in the context of self-declaration obligations.
- Clarify the disclosure or format requirements for enterprises, and limit the scope of the self-declaration mechanism to mandatory national standards adopted by enterprises.
- Improve the enterprise standards online service platform by making it more user-friendly.
- Allow enterprises to make self-declarations of





- enterprise standards on their own websites.
- Ensure the enterprise standards ‘top runner’ system is fair, open, transparent and follows a reliable scientific process.
- Protect the IPR of enterprise standards.

#### Industry standards

- Enhance coordination between industry standards and other standards to avoid overlaps.

#### International standards

- Continue participating in international standard-setting activities and increase the adoption rate of identical international standards.

## 5. Ensure Fair and Transparent Market Surveillance

### Concern

The current market surveillance process for many products has been extended in practice to voluntary requirements, which are not related to mandatory market access requirements, while not enough products—particularly on e-commerce platforms—are being checked for mandatory requirements.

### Assessment

While the working group recognises that product quality surveillance and inspection in China is becoming more standardised and systematic, it would like to highlight that some technical market surveillance requirements are not in line with mandatory market access requirements.

Market surveillance has been extended in practice to recommended and voluntary standards, which has resulted in the punishment of manufacturers whose products do not meet the requirements. This increases workloads for both manufacturers and the authorities, and prevents them from focussing on important tasks such as improving EHS and preventing deceptive practices. Additionally, in market surveillance processes, European business have been strongly encouraged to make extensive disclosures for enterprise standards. The working group therefore recommends aligning market surveillance and market entry requirements, and limiting market surveillance to compliance with national laws, regulations and mandatory standards.

On 2<sup>nd</sup> January 2019, the SAMR released the *Interim Provisions on Administrative Punishment Procedures*

for Market Supervision and Administration and on 2<sup>nd</sup> July 2021, the *Decision on Amending the ‘Interim Provisions on Administrative Punishment Procedures for Market Supervision and Administration’ and Two Other Regulations*, which regulate the penalties for non-compliance with market surveillance requirements.<sup>19&20</sup>

The working group recommends that such penalties only apply to violations of national laws, regulations and mandatory standards, and that non-mandatory requirements be subject to civil liability rather than administrative penalties.

Another issue encountered by European companies in certain sectors is that market surveillance of mandatory requirements in products is not sufficient. For example, out of more than 50 categories of lighting products, the SAMR generally only checks three, and they do so once a year. In addition, the quality of the products sold online is not properly monitored and supervised. Many e-commerce platforms currently do not ensure strict checking of mandatory requirements, such as the CCC and energy labelling, for the products sold on their platforms. For example, the working group has observed that many lighting products being sold on a major e-commerce platform, especially those produced in Zhongshan city in Guangdong Province—the largest manufacturing hub for lighting products globally—do not have CCC certificates. Checking standards that manufacturers claim they are compliant with is often overlooked. These standards can be either mandatory, recommended, social or enterprise standards. The working group therefore recommends that the relevant authorities implement proper checks to ascertain if these claimed standards are really being followed. In particular, when the standards are part of the ‘top runner’ system, it is important to check the compliance of products with said standards in order to support the fairness of the programme.

To ensure a sufficient level of surveillance, more resources are needed to perform compliance checks. In line with international best practices, more commercial organisations—like industry associations and testing laboratories—could be allowed to perform that type

<sup>19</sup> *Interim Provisions on Administrative Punishment Procedures for Market Supervision and Administration*, SAMR, 2<sup>nd</sup> January 2019, 12<sup>th</sup> April 2021, <[http://gkml.samr.gov.cn/nsjg/bgt/201901/t20190102\\_279555.html](http://gkml.samr.gov.cn/nsjg/bgt/201901/t20190102_279555.html)>

<sup>20</sup> *Decision on Amending the ‘Interim Provisions on Administrative Punishment Procedures for Market Supervision and Administration’ and Two Other Regulations*, SAMR, 2<sup>nd</sup> July 2021, viewed 20<sup>th</sup> April 2022 <[http://www.gov.cn/gongbao/content/2021/content\\_5639835.htm](http://www.gov.cn/gongbao/content/2021/content_5639835.htm)>



of work provided they meet relevant accreditation requirements. Meanwhile, the authorities could also consider developing diverse channels to identify more non-compliant products on the market. One avenue could be to develop a smartphone application, WeChat mini-programme or official website that allows consumers and other relevant stakeholders to report non-compliant products in the market. This practice has provided positive results in international markets like India.

Finally, the working group believes that, in order to avoid instances of the performance/safety features of products sold in the market differing from the samples sent for testing, the authorities should intensify their follow-up market checks, and develop processes and penalties that serve as effective deterrents.

#### Recommendations

- Align market surveillance and market access requirements.
- Limit administrative penalties in market surveillance to the violation of laws, regulations, mandatory standards and certification schemes, and make non-mandatory requirements in market surveillance subject only to civil liability.
- Increase the number of product categories to be checked in the market.
- Increase market surveillance efforts regarding e-commerce platforms and impose stricter verification requirements.
- Increase market surveillance in the case of certain enterprise standards.
- Allow commercial organisations that meet accreditation requirements to join market surveillance.
- Provide diverse channels for reporting non-compliance.
- Intensify follow-up market checks, and develop processes and penalties that serve as effective deterrents.
- Allow commercial organisations that meet accreditation requirements to join market surveillance.

## Abbreviations

14FYP	14 <sup>th</sup> Five-year Plan
ATEX	Equipment for Potentially Explosive Atmospheres
BCS	Business Confidence Survey
CCC	China Compulsory Certification
EHS	Environment, Health and Safety
EU	European Union
FIE	Foreign-invested Enterprise
IP	Intellectual Property
IPR	Intellectual Property Rights
KR	Key Recommendation
R&D	Research and Development
SAC	Standardisation Administration of China
SAMR	State Administration for Market Regulation
SCA	Standards and Conformity Assessment
TC	Technical Committee
WTO/TBT	Technical Barriers to Trade of the World Trade Organisation





## Quality and Safety Services Sub-working Group

### Introduction to the Sub-working Group

Established in 2012, the Quality and Safety Services (QSS) Sub-working Group is a sub-working group of the Standards and Conformity Assessment (SCA) Working Group. The QSS sector is made up of independent third-party agencies that provide manufacturers, trade-related parties and end users with testing, inspection and certification (TIC) services, and other conformity assessment services related to their products and management systems, with the aim of improving the safety and quality of products on the market. The members of the sub-working group are primarily European TIC industry leaders that have operated in China for over two decades, providing professional, reliable and high-quality services for Chinese manufacturers and other sectors.

These member companies have contributed significantly to both China's market-orientated reforms and the Belt and Road Initiative by sharing their expertise and advanced management experience with the State Administration for Market Regulation (SAMR) and the Certification and Accreditation Administration of China (CNCA). The sub-working group identifies industry concerns and makes constructive recommendations in order to create a more transparent and better-coordinated QSS system that improves market access for all players. The sub-working group is advocating for China to further open its TIC market and provide opportunities for cooperation between Europe and China in the area of quality and safety management.

### Recent Developments

Compared to other major economies, China imposes strict regulations on third-party TIC agencies, which come under the primary purview of the SAMR. China's regulatory agencies exert a tremendous amount of influence on quality and safety systems—as well as the development and enforcement systems for standards—by dictating the development of national quality infrastructure regulations.

State-owned enterprises and government-affiliated organisations have significant market share in China's

QSS sector, while foreign-invested TIC agencies account for only a small portion. Despite TIC services being included in the *Catalogue of Encouraged Industries for Foreign Investment*,<sup>1&2</sup> government-affiliated TIC agencies are still favoured in terms of developing national and industry standards, receiving important science and research projects, and being appointed or recommended as third-party organisations in government procurement. This puts foreign-invested QSS agencies at a competitive disadvantage in areas that are of crucial importance to the Chinese Government.<sup>3</sup>

### Market Developments in the TIC Industry

China's TIC industry continued to grow throughout 2021. According to the SAMR, there were 932 certification bodies in the country as of the end of 2021, representing 28 per cent year-on-year growth; a total of 3,020,000 verification certificates were issued by TIC agencies to 867,000 companies or organisations, an increase of 12 per cent and eight per cent respectively year-on-year; and 49,000 TIC agencies were accredited, representing 11 per cent growth year-on-year.<sup>4</sup>

### Developments in the Regulatory Environment

On 8<sup>th</sup> April 2021, the SAMR published the *Measures for the Regulation and Administration of Testing and Inspecting Institutions*,<sup>5</sup> with the aim of increasing accountability, improving overall management, and combatting dishonest and fraudulent practices among testing and inspection service providers, while regulating the overall development of the industry.

1 *Catalogue of Encouraged Industries for Foreign Investment (2019)*, National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM), 30<sup>th</sup> June 2019, viewed 23<sup>rd</sup> March 2022, <<http://www.mofcom.gov.cn/article/b/f/201906/20190602877005.shtml>>

2 *Catalogue of Encouraged Industries for Foreign Investment (2020)*, NDRC and MOFCOM, 27<sup>th</sup> December 2020, viewed 23<sup>rd</sup> March 2022, <<http://www.mofcom.gov.cn/article/zcfb/zcwgtz/202012/20201203026619.shtml>>

3 For more details about difficulties foreign-invested TIC agencies are facing, please refer to Key Recommendation 3 of the *Standards and Conformity Assessment Working Group Position Paper 2022/2023*.

4 *Report on the 2022 National Certification, Accreditation, Testing & Inspection Conference*, CNCA, 21<sup>st</sup> January 2022, viewed 10<sup>th</sup> April 2022, <[http://www.cnca.gov.cn/rdzt/gzhy/202201/t20220128\\_65967.shtml](http://www.cnca.gov.cn/rdzt/gzhy/202201/t20220128_65967.shtml)>

5 *Measures for the Regulation and Administration of Testing and Inspection Institutions*, SAMR, 8<sup>th</sup> April 2021, viewed 10<sup>th</sup> April 2022, <[https://gkml.samr.gov.cn/nsjg/fgs/202104/t20210423\\_328131.html](https://gkml.samr.gov.cn/nsjg/fgs/202104/t20210423_328131.html)>





On 22<sup>nd</sup> November 2021, the SAMR solicited public comments on the revised *Regulations of the People's Republic of China on Certification and Accreditation*,<sup>6</sup> with the sub-working group subsequently submitting comments collected from member companies. The sub-working group hopes that the SAMR will take these comments into consideration and adopt the most practical before publishing the revised regulations.

## Key Recommendations

### 1. Ensure Equal and Fair Treatment in Government Procurement Activities for Foreign-invested TIC Agencies

#### Concern

Certain unreasonable conditions set in government procurement activities constitute invisible barriers that exclude foreign-invested TIC agencies from obtaining equal and fair treatment during the process.

#### Assessment

China is committed to and has achieved notable results in establishing a government procurement system that provides equal and fair treatment for domestic enterprises and foreign-invested enterprises (FIEs).<sup>7</sup> On 26<sup>th</sup> October 2021, the Ministry of Finance (MOF) released the *Notice on the Implementation of Policies Relating to the Equal Treatment of Domestic and Foreign Enterprises in Government Procurement*,<sup>8</sup> a reform initiative to expand the scope of procurement. As a result, more third-party inspection agencies have been able to participate in government quality sampling and inspection activities.

However, since this reform involves multiple parties, overlapping responsibilities between different authorities have become a prominent issue. The imposition of unfair and unreasonable bidding requirements in government procurement that exclude or restrict market competition is another major hurdle encountered by FIEs.

Furthermore, in the process of promoting a market-orientated approach to public resource allocation, many current practices are found to conflict with current legislation, and are not in line with China's efforts to join the World Trade Organization's *Agreement on Government Procurement*. Public bidding and competitive negotiation are the two statutory methods of public procurement most commonly adopted by the Chinese authorities. Comparatively speaking, the process of competitive negotiation is less contentious, as it relies solely on prices to determine winning bids and the tender price will eventually be publicly announced. The public bidding process, on the other hand, involves a comprehensive scoring method with price accounting for only a portion of the score. Other factors, such as product quality, sales and after-sales services, are taken into consideration, which can leave the system at risk of manipulation. Specifically, bidding requirements could be established to impede bidders that are otherwise qualified but unable to meet unreasonable procurement rules set in the bidding document.

In July 2019, the MOF issued the *Notice on Promoting Fair Competition in Government Procurement and Optimising the Business Environment*,<sup>9</sup> requiring all relevant government authorities to eliminate any practices and regulations that hinder fair competition in the field of government procurement. It also requires the authorities to implement a fair competition review system in line with both the *Plan for Deepening the Reform of the Government Procurement Mechanism* and the *Notice by the State Council General Office on Focussing on Enterprises' Concerns and Further Promoting the Implementation of Policies to Optimise the Business Environment*.<sup>10&11</sup> Any public procurement tenders that have not undergone a fair competition review process cannot be published at all.

However, in practice, some local governments still adopt terms or conditions that could be considered to exclude

6 *Notice on Call for Public Consultation on Regulations of the People's Republic of China on Certification and Accreditation*, 22<sup>nd</sup> November 2021, viewed 28<sup>th</sup> April 2022, <[https://www.samr.gov.cn/hd/zjdc/202111/t20211122\\_337100.html](https://www.samr.gov.cn/hd/zjdc/202111/t20211122_337100.html)>

7 *State Council Policy Briefing on 29<sup>th</sup> October 2019*, State Council Information Office, 29<sup>th</sup> October 2019, viewed 10<sup>th</sup> April 2022, <<http://www.gov.cn/xinwen/2019zccfh/69/index.htm>>

8 *Notice on the Implementation of Policies Relating to the Equal Treatment of Domestic and Foreign Enterprises in Government Procurements*, MOF, 26<sup>th</sup> October 2021, viewed 23<sup>rd</sup> May 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-10/26/content\\_5644953.htm](http://www.gov.cn/zhengce/zhengceku/2021-10/26/content_5644953.htm)>

9 *Notice on Promoting Fair Competition in Government Procurement and Optimising the Business Environment*, MOF, 26<sup>th</sup> July 2019, viewed 10<sup>th</sup> April 2022, <[http://www.mof.gov.cn/gkml/caizhengwengao/wg201901/wg201908/201912/t20191230\\_3452065.htm](http://www.mof.gov.cn/gkml/caizhengwengao/wg201901/wg201908/201912/t20191230_3452065.htm)>

10 *Plan for Deepening the Reform of the Government Procurement Mechanism*, Central Committee for Deepening Overall Reform, 14<sup>th</sup> November 2018, viewed 10<sup>th</sup> April 2022, <<http://www.cgpnews.cn/articles/46544>>

11 *Notice of the State Council General Office on Focussing on Enterprises' Concerns and Further Promoting the Implementation of Policies to Optimise the Business Environment*, State Council General Office, 8<sup>th</sup> November 2018, viewed on 10<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2018-11/08/content\\_5338451.htm](http://www.gov.cn/zhengce/content/2018-11/08/content_5338451.htm)>





or restrict competition in their bidding processes. For instance, factors taken into consideration under the public bidding system include: 1) enterprises' experiences in sampling and inspection services carried out by administrations for market regulation at the national and provincial level; 2) experience in developing national or industrial standards; 3) recommendations or awards received; and 4) year-end performance reviews. However, government outsourcing of sampling and inspection services was only recently opened nationwide to the private sector, meaning that foreign-invested TIC agencies have not had enough time to accrue relevant sampling and inspection service experience.<sup>12</sup> Foreign-invested TIC agencies also have fewer opportunities to take part in Chinese standardisation technical committees or sub-committees, or to participate in the development of national or industry standards. Moreover, awards, commendations and performance assessments are only available for public agencies and do not directly relate to the capabilities of bid participants.

These inherent problems in the evaluation criteria for private inspection and testing agencies constitute unreasonable invisible barriers, particularly for foreign-invested agencies. They have resulted in foreign-invested TIC agencies receiving low scores in bidding and being practically excluded from market competition.

### Recommendations

- Regulate government procurement by establishing a fair, transparent, impartial and efficient management system.
- Remove all conditions that are not related to the capabilities necessary to perform the bid, and provide a platform for fair competition among testing and inspection service providers.

<sup>12</sup> Despite several local governments outsourcing third party inspection services since 2013, it was not until the introduction of the *Administrative Measures on Food Safety Sampling Inspection*, approved by the SAMR on 30<sup>th</sup> July 2019, and effective on 1<sup>st</sup> October 2019, that sampling and inspection services were officially opened to private inspection agencies. Article 11, Chapter 3 of these measures clearly state that market regulatory and administrative entities may independently perform sample tests or authorise a service provider to do so: *Administrative Measures on Food Safety Sampling Inspection, SAMR*, 1<sup>st</sup> October 2019, viewed 22<sup>nd</sup> June 2022, <[https://gkml.samr.gov.cn/nsjg/fgs/201908/t20190816\\_306080.html](https://gkml.samr.gov.cn/nsjg/fgs/201908/t20190816_306080.html)>

## 2. Accelerate Market-orientated Reforms of Government-affiliated TIC Agencies, and the Establishment of a Fair, Open TIC Market System

### Concern

The progress of market-orientated reforms of government-affiliated TIC agencies needs to be accelerated to further remove industry barriers.

### Assessment

TIC services play a vital role in promoting the sustainable development of entire industries, safeguarding the rights and interests of consumers, and facilitating trade, service market regulation and social governance. Having more world-leading foreign-invested players in the China market is beneficial to end-users and consumers, as the quality, safety and performance metrics of products will be better guaranteed. In addition, a market filled with more competent players helps to accelerate overall industry upgrading and replace lower-quality service providers with high-quality ones, which can provide an assessment basis for government and regulatory officers.

For the TIC industry to further facilitate economic and social progress, a more mature, market-orientated, transparent system needs to be developed, in which fair competition is promoted among all TIC agencies, whether state-owned, Chinese private or foreign-invested.

The *Modernisation of Market Regulation and Administration in the 14<sup>th</sup> Five-year Plan*, published by the State Council in December 2021, clearly states that the market-orientated reform should be maintained and reform of TIC agencies actively encouraged, along with the development of third-party testing and inspection service providers.<sup>13</sup> The sub-working group believes that a specific market-orientated reform initiative would foster a fair and open TIC market system, and accelerate growth of the TIC industry overall, which would serve economic and social development to the greatest extent.

The sub-working group also believes that further progress in market-orientated reforms of government-

<sup>13</sup> *The Modernisation of Market Regulation and Administration in the 14<sup>th</sup> Five-year Plan*, State Council, 14<sup>th</sup> December 2021, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2022-01/27/content\\_5670717.htm](http://www.gov.cn/zhengce/content/2022-01/27/content_5670717.htm)>



affiliated TIC agencies is needed. This was acknowledged in the *13<sup>th</sup> Five-year Plan for China's Testing, Inspection, Certification and Accreditation Development*,<sup>14</sup> issued in November 2016 by the then General Administration of Quality Supervision, Inspection and Quarantine and other government authorities.<sup>15</sup> However, the latest statistics released by the SAMR for the TIC industry show that, by the end of 2020, government-affiliated TIC agencies still accounted for 22.81 per cent of all 48,919 TIC agencies in the country.<sup>16</sup>

In addition, varying degrees of industry barriers remain, such as unreasonable and non-transparent market access conditions. These barriers are present predominantly in domains related to the inspection of industrial products that require administrative permits, such as special equipment and healthcare equipment. The relevant administrative authorities set high market entry thresholds and onerous documentation, such as requiring TIC agencies to provide total headcounts, as well as the titles and qualifications of their staff, which impedes fair competition. If such barriers are not removed, it will not be possible to introduce advanced technologies and experience to the Chinese market in a timely manner, and innovation and competitiveness will be restricted, thereby impeding overall development of the Chinese TIC industry.

#### Recommendations

- Continue accelerating market-orientated reform of government-affiliated TIC agencies.
- Reduce excessive and unclear market access barriers and adopt international norms for assessment.
- Provide true national treatment for foreign-invested TIC agencies.

### 3. Allow Foreign-invested TIC Agencies to Provide Container Inspection Services



#### Concern

According to certain government regulations, foreign-

<sup>14</sup> *The 13<sup>th</sup> Five-year Plan for China's Testing, Inspection, Certification and Accreditation Development*, CNCA, 3<sup>rd</sup> November 2016, viewed 11<sup>th</sup> May 2022, <[http://www.cnca.gov.cn/rdzt/2015/sswztl/zcdt/201612/t20161213\\_53010.shtml](http://www.cnca.gov.cn/rdzt/2015/sswztl/zcdt/201612/t20161213_53010.shtml)>

<sup>15</sup> Its functions are now assumed by the CNCA and the Standardisation Administration.

<sup>16</sup> *SAMR's Latest Data for Year 2020 on the Development of China's TIC Industry*, 9<sup>th</sup> June 2021, viewed 28<sup>th</sup> April 2022, <<http://epaper.cqn.com.cn/article/498931.html>>

invested TIC agencies are restricted from providing container inspection services.

#### Assessment

In China, containers are currently subject to statutory surveys managed by the Ministry of Transport and the China Maritime Safety Administration. The latter delegates the qualification of statutory surveys of containers solely to the China Classification Society (CCS)—a secondary public interest institution—which then subcontracts the work to its subsidiary company, the China Classification Society Certification Company, authorising it to carry out surveys of containers owned by both domestic and foreign enterprises. Pursuant to the *Regulations of the People's Republic of China Governing Inspection of Ships and Offshore Installations*,<sup>17</sup> the *Notice on Improving the Supervision and Management of Inspections Carried Out by Foreign Ship Inspection Agencies in China and the Vessel Inspection Administration Regulations*,<sup>18&19</sup> foreign-invested ship inspection agencies registered in China are only permitted to inspect containers owned by foreign businesses (i.e., foreign export containers). In other words, foreign-invested inspection and testing service providers registered in China are not permitted to conduct legal inspections on containers owned by domestic organisations subject to such requirements.

The sub-working group recommends that China open up the container inspection market to ship inspection agencies from all member states signatory to the *International Convention for Safe Containers (Convention)*,<sup>20</sup> and grant foreign-invested TIC agencies authorisation to provide inspection services for containers owned by Chinese businesses, for the following reasons:

#### 1) To meet the principle of reciprocity

The relevant authorities of European Union (EU) Member States neither restrict Chinese inspection

<sup>17</sup> *Regulations of the People's Republic of China Governing Survey of Ships and Offshore Installations*, State Council, 2<sup>nd</sup> March 2019, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2019/content\\_5468917.htm](http://www.gov.cn/gongbao/content/2019/content_5468917.htm)>

<sup>18</sup> *Notice on Improving the Supervision and Management of Inspections Carried Out by Foreign Ship Inspection Agencies in China*, pkulaw.cn, 2<sup>nd</sup> March 2009, viewed 10<sup>th</sup> April 2022, <[http://pkulaw.cn/fulltext\\_form.aspx?Db=chl&Gid=8492e9f098114d90bdfb](http://pkulaw.cn/fulltext_form.aspx?Db=chl&Gid=8492e9f098114d90bdfb)>

<sup>19</sup> *Vessel Inspection Administration Regulations*, MOT, 4<sup>th</sup> February 2016, viewed 10<sup>th</sup> April 2022, <[http://xxgk.mot.gov.cn/jigou/fgs/201602/t20160204\\_2973409.html](http://xxgk.mot.gov.cn/jigou/fgs/201602/t20160204_2973409.html)>

<sup>20</sup> *International Convention for Safe Containers*, International Maritime Organization, 6<sup>th</sup> September 1977, viewed 10<sup>th</sup> April 2022, <[https://www.imo.org/en/About/Conventions/Pages/International-Convention-for-Safe-Containers-\(CSC\).aspx](https://www.imo.org/en/About/Conventions/Pages/International-Convention-for-Safe-Containers-(CSC).aspx)>





agencies or their inspection companies established in EU countries to inspecting containers owned by non-EU governments, nor do they prohibit them from inspecting containers owned by businesses from EU countries. Therefore, it is recommended that the relevant authorities in China follow the principle of reciprocity. The sub-working group also suggests that China no longer restrict the licensed business scope of inspection agencies in China, which are invested in and established by European classification societies, based on the nationality of container owners.

## 2) To meet the principle of mutual recognition of the *Convention*

According to the *Convention*, once an inspection agency obtains the necessary qualification to survey containers from one contracting state, then all contracting states must accept the qualification of the agency in question, as well as the inspection process and results it provides. However, such mutual recognition is not observed in the Chinese market, with European enterprises restricted to inspecting only containers owned by foreign businesses. In so doing, China does not recognise the qualifications granted by the governments of the counterpart contracting states and, as such, violates the principle of mutual recognition under the *Convention*.

## 3) To conform to the 'pre-establishment national treatment plus negative list' administrative system

Article 4 of the Foreign Investment Law stipulates that China will apply the 'pre-establishment national treatment plus negative list' administrative system to foreign investments. This means there is an obligation to treat foreign investors in industries not included in the *Negative List for Foreign Investment (Negative List)*, jointly issued by the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM),<sup>21</sup> no less favourably than domestic investors at the initial stage of market access. In addition, Article 6 of the *Regulation on the Implementation of the Foreign Investment Law* stipulates that domestic enterprises and FIEs shall be treated equally by the authorities with respect to government funding arrangements, land supply, tax reductions, certification, standard setting, project

applications and human resource policies.<sup>22</sup>

## 4) To avoid monopolistic behaviour, in line with international practices

The statutory inspection of containers is a charged service provided by third parties. The service fees are adjusted in accordance with market prices, and supply and demand, as international practices dictate. In the majority of jurisdictions worldwide, enterprises are at liberty to choose inspection services from international classification societies that have the qualifications required by the *Convention* for statutory inspection services. When administrative measures specify only a single organisation can provide such services, a monopoly can easily result, as this results in a lack of competition and a price adjustment mechanism for inspection fees.

## 5) To promote the development of the industry and alleviate the burden on enterprises

The implementation of the *Vessel Inspection Administration Regulations* has been impeded by China's administrative policy that foreign ship inspection companies cannot carry out surveys of containers owned by Chinese enterprises.<sup>23</sup> For instance, if foreign ship inspection companies wish to conduct inspection services on Chinese hazardous cargo tank containers used for international shipping to Europe, when applying for a testing certificate with the CCS, they also need to apply separately for an additional certificate issued by a ship inspection company domiciled in an EU Member State and registered in China. This certificate is issued after the same tank containers are tested in accordance with the European Agreement Concerning the International Carriage of Dangerous Goods by Road. This certificate is required because China has yet to become a member of the European Agreement; consequently, without the authorisation of EU countries, the CCS cannot issue a corresponding certificate for these containers. Therefore, the policy prohibiting EU-domiciled ship inspection agencies in China from inspecting Chinese-owned containers prevents Chinese businesses from receiving the desired services. It also adversely affects China's international shipping business and impedes the advancement of the Belt and

<sup>21</sup> *China's Negative List for Foreign Investment Access (New Edition): English Version Available*, China Briefing, 28<sup>th</sup> December 2021, viewed 13<sup>th</sup> May 2022, <<https://www.china-briefing.com/news/chinas-foreign-investment-negative-list-2021-edition-english-version/>>

<sup>22</sup> *Regulation on the Implementation of the Foreign Investment Law*, State Council, 26<sup>th</sup> December 2019, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2019-12/31/content\\_5465449.htm](http://www.gov.cn/zhengce/content/2019-12/31/content_5465449.htm)>

<sup>23</sup> *Vessel Inspection Administration Regulations*, MOT, 4<sup>th</sup> February 2016, viewed 10<sup>th</sup> April 2022, <[http://xxgk.mot.gov.cn/jigou/fgs/201602/t20160204\\_2973409.html](http://xxgk.mot.gov.cn/jigou/fgs/201602/t20160204_2973409.html)>





Road Initiative. Moreover, the cost burden is doubled, as two inspection agencies must carry out a procedure that could otherwise have been completed by one.

#### Recommendation

- Allow foreign-invested TIC agencies to provide container inspection services.

## 4. Accelerate the Marketisation Process of Special Equipment Inspection Services



#### Concern

The rapid development of China's economy and society has exposed many issues in its TIC industry, including a lack of clarity in terms of accountability, insufficient supply, low productivity and corruption.

#### Assessment

'Special equipment'—a term used in China—is defined as equipment that could pose a significant risk to health and safety, such as boilers, pressure vessels (including gas cylinders), pressure pipes, elevators, lifting machinery, passenger ropeways, large-scale amusement facilities and special-purpose motor vehicles. There is no universal standard definition of this concept, with other countries enacting special laws for a certain group of devices that could pose a significant risk to human safety, providing provisions on safety supervision. The list of items for specialised supervision is similar to China's. Inspection and testing of special equipment refers to the supervision, regular inspection and type-testing of boilers, pressure vessels (including gas cylinders), pressure pipelines, elevators, hoisting machinery, passenger ropeways, large-scale amusement facilities, and non-destructive testing for the production, use and inspection of such equipment.

There was a large increase of special equipment recorded in China in 2021. As of the end of 2021, China had set up 5,075 supervisory agencies to test and inspect special equipment—one national-, 33 provincial-, 496 municipal-, 2,570 county- and 1,973 district-level—supported by 112,363 supervisory workers. The majority of testing and inspection agencies are government-affiliated institutions tasked with quality supervision, with non-public agencies making up only a

small proportion of the total,<sup>24</sup> which is a model unique to China.

Supervision, inspection and periodic inspection of special equipment tasks are allocated to inspection agencies within the market regulatory system by the SAMR, based on reasonable assignment of regional jurisdiction. Responsibility for inspection results and quality is also delegated to these agencies. Public TIC institutions are categorised as either state-funded, partially state-funded or self-funded, the latter two being the most dominant in the market. By that logic, testing and inspection fees are of a public administrative nature and are charged to organisations that manufacture, install and use special equipment at prices fixed by the price supervision authorities. The revenue from testing and inspection services for special equipment is a significant source of income for government inspection agencies, whose qualifications are granted by the SAMR.

The current model for the testing and inspection of special equipment in the Chinese market is problematic in the following ways:

#### 1) Unclear liabilities for different parties

According to Chinese law, special equipment must undergo testing and inspection before being put into use. Manufacturers and users assume primary liability, with government departments assuming supervisory liability and inspection agencies inspection liability. Currently, special equipment inspection and testing in China is conducted by inspection agencies under regulatory agencies and is an administrative practice. These agencies charge fees and issue inspection reports just like ordinary businesses, making it hard to distinguish between government authority and business operation responsibilities. This means that government inspection agencies play the role of both referee and player at the same time.

#### 2) Prone to corruption

Enterprises are not allowed to choose an inspection

<sup>24</sup> As of the end of 2021, special equipment across China amounted to 181,623,000 units, including: 347,100 boilers; 4,694,900 pressure vessels; 8,799,800 elevators; 2,730,200 units of heavy-lifting machinery; 1,114 passenger ropeways; 25,200 large-scale amusement facilities; 1,564,000 special-purpose motor vehicles. Additionally, there were 202,000,000 gas cylinders and 7,575,000 kilometres of pressure pipelines. See: *Notice on the Safety Status of Special Equipment in 2021 by the State Administration for Market Regulation*, SAMR, 19<sup>th</sup> April 2022, viewed 25<sup>th</sup> April 2022, <[https://gkml.samr.gov.cn/nsjg/tzsbj/202204/t20220419\\_341377.html](https://gkml.samr.gov.cn/nsjg/tzsbj/202204/t20220419_341377.html)>





agency due to the 'regional coverage' assignment of testing and inspection services for special equipment. This means that government authorities have absolute dominance in the industry. This has resulted in insufficient performance improvements for government inspection and testing agencies, a high degree of exclusiveness and ultimately poor service. Inadequate supervision can even lead to agencies leveraging their power to gain market share.

### 3) Inadequate supply of services

In recent years, the surge in the volume of special equipment in China has led to rapidly growing demand for testing and inspection services. In response, the authorities have integrated inspection agencies to combine their resources. Although some progress has been made, the primary role of the market in allocating resources is not being fully utilised, given that the authorities still decide which companies will be responsible for inspections. Restricted by the nature of China's public institution system, local government inspection agencies lack the staff required to cope with the burgeoning demand for special equipment. This leads to sub-par inspections and quality, which results in high accident rates.

The factors causing the above problems are as follows:

#### 1) Lack of competition

Fair competition is the most powerful driving force in upgrading service standards and quality. Given the monopolistic position held by public institutions and government-affiliated agencies in TIC, the absence of external pressure from competitive players in the field means there is little impetus for the improvement of efficiency and service quality.

#### 2) Lack of flexibility in public institutions' systems

Government-affiliated agencies are highly restricted by public institution management systems with regard to personnel, pricing, technical research and development, and equipment investment. As such, these agencies lack the discretion and liberty of deciding their own development path, making it difficult for them to grow as scientific and technical organisations. In addition, they face a contradiction – on one side they are labelled non-profit, public institutions, while on the other, revenue is one of the indicators for performance appraisal by the local supervision bodies. This dilemma can only be addressed in tandem with the state's reform of public

institutions to make the TIC industry market-orientated.

The importance of market-orientated reforms is as follows:

- 1) They help balance the shortfall in the supply of testing and inspection services for special equipment and the general public's safety needs. Making testing and inspection services market-orientated can effectively improve their volume, quality and efficiency, thereby addressing safety issues.
- 2) They accelerate changes to government functions and reform of public institutions. Developing special equipment testing and inspection services that are market-orientated would force public institutions to shift from a self-serving role to a consumer-orientated one.
- 3) They help stimulate social vitality and promote societal development. Progressing towards market-orientated testing and inspection services for special equipment allows the authorities to 'return' power to the market and society.

#### Recommendations

- Establish a market competition mechanism and allow enterprises to freely choose inspection agencies for statutory inspections.
- Enhance the diversity of inspection entities to provide both greater consumer choice and space for non-government-affiliated inspection agencies to grow.

### 5. Establish and Implement in a Timely Manner a System for Customs to Accept Inspection Results from Third-party Agencies for Imported Commodities, Including Imported Bulk Commodities



#### Concern

While demand for inspections is increasing, customs inspection talent is both in short supply and geographically imbalanced, which slows customs clearance processes for imported commodities and affects trade facilitation.

#### Assessment

As China's economy continues to develop, higher standards of customs supervision and services are required. While customs services have improved in recent years, customs clearance efficiency is



still lacking. Reforms are needed that can optimise clearance management, reduce both clearance costs and the time needed for import and export, and increase supervision efficiency.

China is stepping up reforms to simplify administration and delegate power, combine decentralisation and management, and optimise public services. In this context, third-party inspection agencies are starting to play an increasingly important role in the quality and safety supervision of imported and exported commodities. According to the *Opinions of the State Council on Improving the Quality Safety Risk Early Warning and Quick Response Regulation System for Imports and Exports and Effectively Protecting Consumer Rights and Interests*,<sup>25</sup> customs should improve the management system in order to accept inspection results from qualified third-party agencies and thereby encourage their participation in supervision work. The sub-working group believes that third-party inspection results will become the primary means to supervise the quality of imported and exported commodities. This practice will also apply to imported bulk resource-based commodities.

On 1<sup>st</sup> October 2020, in a significant shift in its inspection and supervision of imported crude oil, the customs authorities implemented the 'release before declaration modification', which allows cargo to be unloaded while samples are sent for inspection.<sup>26</sup> This model was introduced to further optimise the business environment at ports and significantly reduce the clearance time and costs for imported crude oil, thereby facilitating trade. Under the new policy, crude oil is subject to customs inspection and can only be sold or used by enterprises after being issued a certificate of quality. Although it reduces clearance time, inspection work is still necessary and a backlog may build up if the volume of bulk imports continues to increase. This would result in import and export enterprises having to queue up for their inspection results. An effective solution would be to allow third-party inspection agencies market access and accept their inspection results.

<sup>25</sup> *Opinions of the State Council on Improving the Quality Safety Risk Early Warning and Quick Response Regulation System for Imports and Exports and Effectively Protecting Consumer Rights and Interests*, State Council, 14<sup>th</sup> September 2017, viewed 20<sup>th</sup> June 2022, <[http://www.gov.cn/gongbao/content/2017/content\\_5232364.htm](http://www.gov.cn/gongbao/content/2017/content_5232364.htm)>

<sup>26</sup> 'Release before Declaration Modification' Regulation to Speed up Imported Crude Oil Inspection, GAC, 12<sup>th</sup> October 2020, viewed 25<sup>th</sup> April 2022, <<http://www.customs.gov.cn/customs/xwfb34/302425/3313452/index.html>>

The advantages of accepting third-party inspection results are as follows:

### 1) Greater relief in areas where law enforcement lacks staff and funding

Third-party agencies can make up for the lack of enforcement power due to shortages in human resources and funding among existing supervisory authorities.

### 2) Improved inspection processes

Reliable third-party agencies can be utilised to ensure imported commodities maintain the same quality and safety standards as in their country of origin by extending inspection services overseas. This can address complex problems that could arise with overseas law enforcement, for example, relating to the legality of jurisdiction and protection of domestic industries.

### 3) Increased versatility of law enforcement and supervision

The supervisory authorities tend to struggle to adjust law enforcement standards and procedures to meet the evolving needs of commodity quality and safety supervision. Third-party agencies are able to rapidly update their inspection criteria and methods, which could help mitigate authorities' enforcement limitations. As such, third-party agencies are better able to respond to emerging commodity quality and safety crises.

In October 2021, the General Administration of Customs (GAC) sought public opinions on the *Administrative Measures for Customs Import and Export Commodity Inspection and Credit Acceptance (Draft for Comments) (Administrative Measures)*.<sup>27</sup> The sub-working group welcomes the draft, which is aimed at improving both the trade supervision model and increasing the efficiency and volume of commodity import and export transactions. The sub-working group hopes that the GAC will issue the official version of the *Administrative Measures*, along with all necessary supporting documentation, and implement the inspection acceptance management system in a timely manner, taking into account the comments provided by all stakeholders, including testing and inspection agencies.

<sup>27</sup> GAC Notice on Call for Public Comments on the Administrative Measures for Customs Import and Export Commodity Inspection and Credit Acceptance (Draft for Comments), GAC, 8<sup>th</sup> October 2021, viewed 25<sup>th</sup> April 2022, <<http://www.customs.gov.cn/customs/302452/302329/zjz/3938404/index.html>>





### Recommendations

- Create and implement a system for customs to accept third-party inspection results for imported and exported commodities as soon as possible.
- Open up the market and accept evaluations by all inspection agencies, including foreign-invested, private and state-owned agencies, and grant equal treatment to foreign-invested inspection agencies.

### Abbreviations

CCS	China Classification Society
FIE	Certification and Accreditation Administration of China
EU	European Union
FIE	Foreign-invested Enterprise
GAC	General Administration of Customs
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
NDRC	National Development and Reform Commission
QSS	Quality and Safety Services
SAMR	State Administration for Market Regulation
TIC	Testing, Inspection and Certification



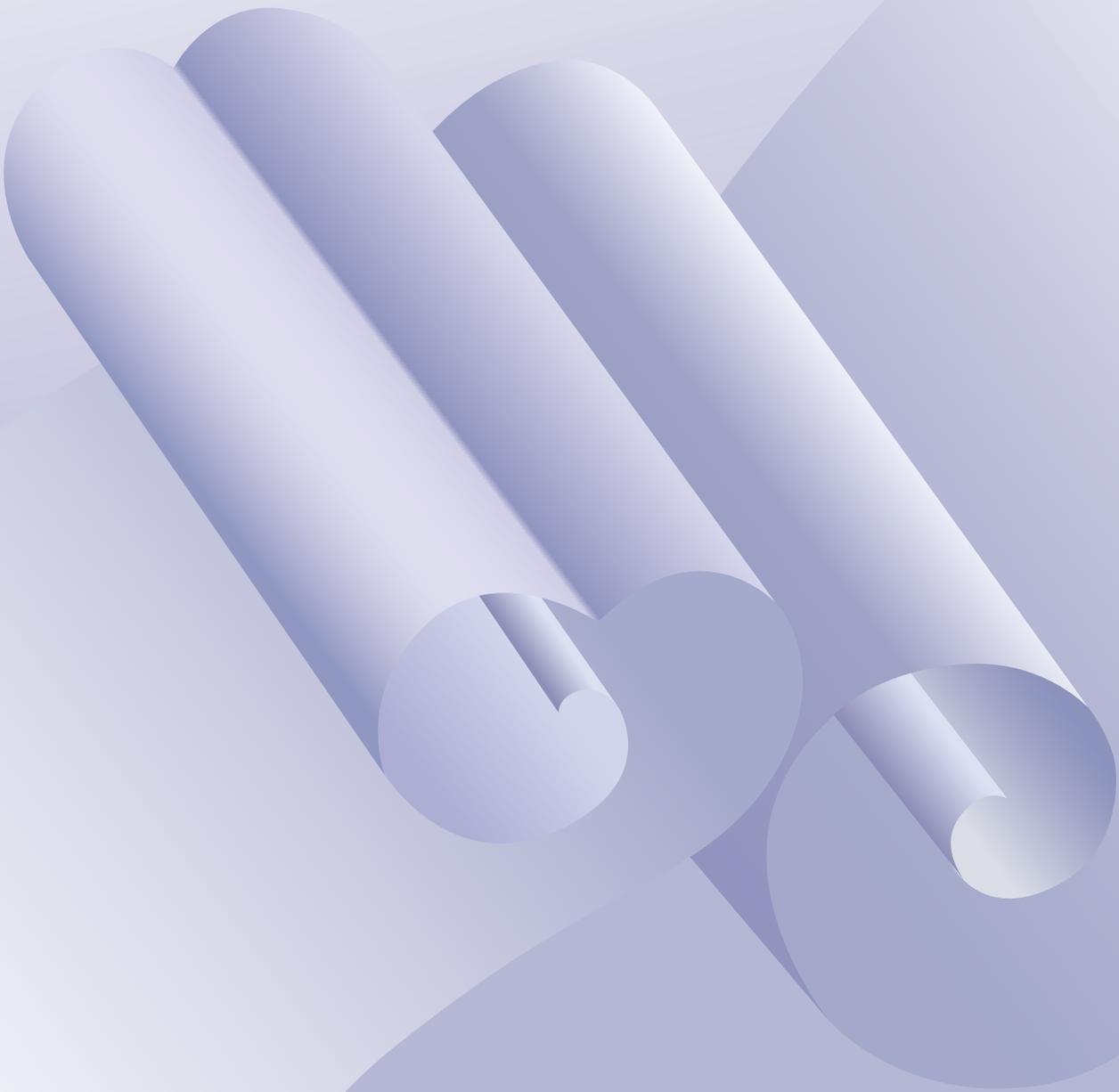
European Chamber  
中国欧盟商会

# 3

## Section Three

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Goods



## Goods

The Goods section of the *Position Paper* encompasses 11 European Chamber working groups and four sub-working groups:

- Agriculture, Food and Beverage
  - Paediatric Nutrition, and Food for Special Medical Purpose (two working groups)
  - Dairy Industry
- Automotive
- Automotive Components
- Cosmetics
- Energy
  - Carbon Market
- Fashion and Leather
- Healthcare Equipment
- Maritime Manufacturing and Industrial Services
- Petrochemicals, Chemicals and Refining
- Pharmaceutical
- Rail

Business became more difficult in 2021 for 54 per cent of respondents to the European Chamber's *Business Confidence Survey 2022* (BCS 2022) that manufacture goods. The main causes for this were ongoing COVID-19-related restrictions, China's complex and opaque regulatory environment, and the increased politicisation of business. Maritime manufacturing and services was an outlier in this regard, with a notable 90 per cent of respondents from the industry reporting that the business environment improved in 2021.<sup>1</sup> This is partly due to new International Maritime Organization (IMO) measures aimed at reducing carbon emissions,<sup>2</sup> alongside greater pressure to decarbonise shipping.<sup>3</sup> Shipowners need to now either invest in efficiency improvements or order new vessels to replace or upgrade part of their non-compliant fleet.

By contrast, not a single member from the healthcare equipment and pharmaceutical industries reported that doing business got easier in 2021.<sup>4</sup> This is in no small part due to China's staunch protection of its domestic firms, a concerning dynamic that has continued despite the ongoing pandemic.<sup>5</sup> For example, in the medical devices industry, the Chinese Government continues to provide local firms with direct financial support, tax benefits and research and development incentives, while maintaining opaque approval processes and its centralised volume-based procurement (VBP) directive, which disadvantages foreign companies.<sup>6</sup> A significant 72 per cent of BCS 2022 respondents

1 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 13<sup>th</sup> July 2022, <[https://www.eurochamber.com.cn/en/publications-archive/1020/Business\\_Confidence\\_Survey\\_2022](https://www.eurochamber.com.cn/en/publications-archive/1020/Business_Confidence_Survey_2022)>

2 Two IMO indexes—the Efficiency Existing Ship Index (EEXI) and the Carbon Intensity Indicator (CII)—have been established to provide shipowners with a reference point to reduce their greenhouse gas emissions levels: *Understanding New IMO Decarbonisation Measures EEXI And CII*, Bureau Veritas, 3<sup>rd</sup> May 2021, viewed 8<sup>th</sup> April 2022, <<https://www.bvsolutions-m-o.com/magazine/understanding-new-imo-decarbonization-measures-eexi-and-cii>>

3 See for example: *Sustainable maritime fuels - 'Fit for 55' package: the FuelEU Maritime proposal*, European Parliament, 11<sup>th</sup> April 2022, viewed 13<sup>th</sup> April, <[https://www.europarl.europa.eu/thinktank/en/document/EPRS\\_BRI\(2021\)698808](https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2021)698808)>

4 *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 13<sup>th</sup> July 2022, <[https://www.eurochamber.com.cn/en/publications-archive/1020/Business\\_Confidence\\_Survey\\_2022](https://www.eurochamber.com.cn/en/publications-archive/1020/Business_Confidence_Survey_2022)>

5 Protectionism in critical industries has existed for some time in China, but it is even more troubling at a time when the fight against the pandemic would be best served by deploying the best technologies and solutions, regardless of origin.

6 Erixon, Fredrik, Guildea, Anna, Guinea, Oscar & Lamprecht, Philip, *China's Public Procurement Protectionism and Europe's Response: The Case of Medical Technology*, European Centre for International Political Economy, December 2021, viewed 18<sup>th</sup> April 2022, <<https://ecipe.org/publications/chinas-public-procurement-protectionism/>>



from the healthcare equipment industry reported missing out on business opportunities due to market access restrictions or regulatory barriers, the highest among all industries represented in the survey. The second highest was the pharmaceutical industry, with 58 per cent reporting this to be the case, despite being granted nominal market access. China's VBP system,<sup>7</sup> as well as slower drug review and approval processes,<sup>8</sup> partly account for this and provide a good example of how some barriers that cause foreign firms to miss opportunities are hidden.

All goods manufacturers were negatively impacted by China's stringent COVID-19 policies throughout 2021. Local governments adopted *ad hoc* measures that led to long delays for and restrictions on lorries and other freight vehicles entering their territory, and ports suffered unprecedented levels of congestion.<sup>9</sup> The situation deteriorated rapidly in early 2022 following Omicron outbreaks, as local governments imposed full or partial lockdowns in at least 45 cities—accounting for 40 per cent of China's gross domestic product with a combined population of 370 million people—causing disruption on an unprecedented scale.<sup>10</sup> A flash survey conducted by the European Chamber in April 2022 revealed that these measures had a negative impact on 94 per cent of respondents overall, with 92 per cent reporting that both upstream and downstream supply chains suffered damage.<sup>11</sup>

The chemical industry was significantly impacted by supply chain disruptions and intermittent chemical park closures due to China's COVID-19 policy. Many chemical manufacturers faced logistics bottlenecks, including shortages of raw materials, interprovincial border restrictions and a general lack of transportation.<sup>12</sup> These challenges posed safety risks for hazardous chemicals, and severely disrupted production for crucial sectors such as semiconductors and healthcare, with repercussions for international supply chains, and both the domestic and global economies.

Another hurdle for goods manufacturers was China's energy crunch from September to October 2021, when severe power shortages occurred in at least 20 provinces.<sup>13</sup> Local governments instructed factories to limit power usage, curb output or even halt production until further notice, including those compliant with environmental protection measures. The Energy Working Group is advocating for local governments to avoid such one-size-fits-all approaches, as abrupt power shortages seriously jeopardise industrial operations, creating short-term safety risks—especially in the chemical and healthcare industries—and undermining business confidence in the medium to long-term. Significantly,

7 As a result of the VBP policy, a company that wins a bulk purchase bid on generic drugs secures a sizeable chunk of the Chinese pharmaceutical market and can reduce marketing outlays. However, the aggressive price-cutting required to win puts a huge strain on profits, and leads to a race to the bottom on pricing: *Foreign Drug Giants Undercut by up to 95% in China Bidding War*, *Bloomberg*, 20<sup>th</sup> August 2020, viewed 4<sup>th</sup> April 2022, <<https://www.bloomberg.com/news/articles/2020-08-20/foreign-drug-giants-undercut-by-up-to-95-in-china-bidding-war>>

8 In China, drug review and approvals processing for pharmaceuticals developed abroad is slower, which has resulted in foreign pharmaceutical companies missing business opportunities. In addition, localised testing requirements for biologics and the quality of imported ingredients, increase the costs of bringing drugs produced overseas to market, disproportionately hindering foreign firms: Atkinson, Robert, *The Impact of China's Policies on Global Biopharmaceutical Industry Innovation*, Information Technology and Innovation Foundation, 8<sup>th</sup> September 2020, viewed 4<sup>th</sup> April 2022, <<https://itif.org/publications/2020/09/08/impact-chinas-policies-global-biopharmaceutical-industry-innovation>>

9 Jiang, Yaling & Qu, Tracy, *China's COVID-19 Lockdowns Wreak Logistics Havoc and Slow Global Supply Chains*, *South China Morning Post*, 14<sup>th</sup> April 2022, viewed 20<sup>th</sup> April 2022, <<https://www.scmp.com/tech/policy/article/3174163/chinas-covid-19-lockdowns-wreak-logistics-havoc-and-slow-global-supply>>

10 Hancock, Tom, *Lockdown Financial Aid in China Leaves Households Behind*, *Bloomberg*, 14<sup>th</sup> April 2022, viewed 29<sup>th</sup> April 2022, <<https://www.bloomberg.com/news/articles/2022-04-13/lockdown-financial-aid-in-china-leaves-households-behind>>

11 Specifically, 85 per cent reported challenges sourcing raw materials or components needed for production; 89 per cent struggled to transport such raw materials or components; 87 per cent had difficulties delivering finished products within China; and 83 per cent had problems delivering them to the rest of the world. *Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China*, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 25<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/press-releases/3431>>

12 *Analysis: China's widening COVID curbs threaten global supply chain paralysis*, *Reuters*, 13<sup>th</sup> April 2022, viewed 15<sup>th</sup> April 2022, <<https://www.reuters.com/world/china/chinas-widening-covid-curbs-threaten-global-supply-chain-paralysis-2022-04-13>>

13 Tabahrili, Sam, *The global trickle down of China's energy supply shortage*, *Power Technology*, 30<sup>th</sup> November 2021, 13<sup>th</sup> July 2021, <<https://www.power-technology.com/analysis/china-energy-crisis/>>

since these power shortages, the central government has repeatedly emphasised the importance of ensuring energy security while balancing economic growth and climate goals. To achieve this, China will need to ensure European investment and technology has equal access to its renewable energy sector, while accelerating the coal-to-gas transition and developing new, high-quality power infrastructure and a green power market, among others.

An additional issue for European manufacturers in China is new and forthcoming supply chain legislation. The United States (US) Uyghur Forced Labor Prevention Act (UFLPA), effective from 21<sup>st</sup> June 2022,<sup>14</sup> restricts imports from Xinjiang and establishes a 'rebuttal presumption'. This puts the burden of proof on importers to show that goods being imported into the US have not been produced using forced labour. Also on 21<sup>st</sup> June 2022, the European Council and the European Parliament reached a political agreement on the Corporate Social Responsibility Directive (CSRD).<sup>15</sup> The CSRD introduces strict reporting requirements, obliging large public-interest companies to report on sustainability issues such as environmental, social and governance and human rights. Under the CSRD, companies' sustainability reports will have to be certified by independent, third-party certifiers/auditors, and published in company management reports. The provisional agreement is still subject to approval by the Council and the European Parliament.

These challenges are putting European companies' China operations in an increasingly precarious position. Many are considering further onshoring their supply chains into China to better service the domestic market. However, this may leave them highly exposed to global shocks. For example, just 19 per cent of BCS 2022 respondents in the manufacturing sector report they do not import any components or equipment into China that cannot be easily replaced in the event of a supply disruption. By contrast, one in two respondents note that while they can source alternatives for equipment/components, they will be either more expensive or lower quality and/or with compatibility issues. A further 31 per cent of manufacturers import critical components for which they cannot source alternatives at all.

Looking forward, manufacturers will continue to evaluate which parts of their supply chain they can shift into China to service the domestic market, while diversifying supply chains for the rest of the world to reduce overreliance on any one country. Companies will also increasingly investigate the options of reshoring, near-shoring and friend-shoring,<sup>16</sup> particularly for the production of critical goods. In short, while they recognise the need to maintain a strong presence in this crucial market, European companies look set to continue decoupling China and global operations in the areas where it makes most sense.

<sup>14</sup> Blinken, Anthony J., *Implementation of the Uyghur Forced Labor Prevention Act*, US Department of State, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.state.gov/implementation-of-the-uyghur-forced-labor-prevention-act/>>

<sup>15</sup> *New rules on corporate sustainability reporting: provisional political agreement between the Council and the European Parliament*, European Council, Council of the European Union, 21<sup>st</sup> June 2022, viewed 13<sup>th</sup> July 2022, <<https://www.consilium.europa.eu/en/press/press-releases/2022/06/21/new-rules-on-sustainability-disclosure-provisional-agreement-between-council-and-european-parliament/>>

<sup>16</sup> Reshoring is the act of bringing manufacturing from a remote location to the company's home country; near-shoring is the act of bringing manufacturing nearer to the point of use; friend-shoring is the act of relocating manufacturing to a country considered a trusted partner to the company's home country.



# Agriculture, Food and Beverage Working Group

## Key Recommendations

### 1. Implement the Measures for Registration of Overseas Manufacturers Reasonably, without Creating Either Excessive Constraints for Companies or Trade Disruption

- Take a reasonable approach to regulations on imported foods based on scientific assessment of the actual risks.
- Provide updated guidance on the General Administration of Customs website on frequently-asked-questions to avoid inconsistency between central and local customs.
- Set up an additional communication channel to deal with inquiries from overseas applicants on registration.
- Clarify the post-registration audit process, including relevant schemes and criteria, as well as timelines for recommencement of onsite inspections of overseas food producer facilities.

### 2. Distribute Responsibilities Proportionately Across the Supply Chain While Implementing the ‘Punishment Exemption’ Principle Where Appropriate, Reasonably Design the Major Punishment System and Establish a Unified National Traceability System 9

#### 2.1 Distinguish the Responsibilities of Food Producers and Food Business Operators, and Establish a Punishment System that is Reasonable and Based on Specific Principles

- Distinguish and enforce the responsibilities of food producers and food business operators separately.
- Take full account of the subjectivity of senior management of companies while penalising individuals responsible for legal violations.
- Implement the concept of presumption of innocence in China's criminal law throughout the law enforcement process in the food area, and transfer the burden of proof from companies to law enforcement departments.
- Abide strictly by the principle of ‘matching misbehaviour and penalties’ and improve the fairness and consistency of law enforcement in all regions.

#### 2.2 Establish a Unified National Food Traceability Platform, Legal Framework and Basic Standards to Promote Effective Tracing

- Unify the national platform, regulations and standards for food safety traceability.
- Ensure that tracing entities, products and information are bonded, technologies used are compatible and information gathered is reliable.

#### 2.3 Implement the ‘Punishment Exemption’ Principle on Agricultural Products and Imported Foods From Production to Circulation

- Distinguish product traceability information and product label information to ensure companies will not be penalised for inconsistencies.





### 3. Implement an Approval Process and Regulatory Standards to Encourage the Recycling of Food-grade Recycled Polyethylene Terephthalate (rPET) Materials

- Implement an assessment system and corresponding regulatory standards for rPET materials in food contact materials.
- Encourage the implementation of primary recycling of food-grade PET bottles to reduce the use of raw plastics.

### 4. Improve Effective Management and Consumer Education on Soon-to-expire Food and Reprocessed Raw Materials to Encourage Rational Consumption and Reduce Food Waste

- Encourage consumers to reasonably consume soon-to-expire food.
- Encourage companies to reasonably use reprocessed raw materials to reduce waste.

### 5. Further Relax Foreign Investment Negative List Restrictions in the Seed Industry and Level the Playing Field 2

- Relieve restrictions on genetically modified (GM) technology and GM seed production.
- Further relax restrictions on foreign investment in the selection, breeding and production of new crop varieties of wheat and maize.
- Allow foreign investment in rice and soybean breeding and production.

### 6. Accelerate the Approval Procedure for GM Microorganism (GMM) Food, Feed Additives and GM Agricultural Products 3

- Establish different approval procedures based on products' safety risk levels.
- Simplify the approval requirements and speed up the approval process for food nutritional fortification substances and additives produced with or from GMM without living GMMs and recombinant deoxyribonucleic acid (DNA).
- Refer to EU normal practice, whereby third-party test reports or independent culture collection organisations could be used instead of depositing GMM strains for feed enzyme production to the Ministry of Agriculture and Rural Affairs for submission to the institution.

### 7. Strengthen Communication with the Organisation for Economic Co-operation and Development (OECD) to Support the Advancement of China's Accession to the OECD Framework Agreement on the Pesticide Field 3

- Strengthen communication with the OECD and its members to support the advancement of China's accession to the OECD framework agreement on pesticide.

### 8. Optimise Implementation of the '14<sup>th</sup> Five-year' National Health Plan in Conjunction with the United Nations Sustainable Development Goals to Educate Consumers on Making Healthier Choices

#### 8.1 Continue to Encourage the 'Three Reductions and Three Health' Based on Scientific Assessment

- Implement the 14<sup>th</sup> Five-year' National Health Plan based on scientific data and current conditions, taking regional differences into account.





- Advance the implementation of educational programmes on healthy eating, appropriate portions and consumption frequency.
- Coordinate all stakeholders in adopting a more uniform front-of-package labelling framework and implement multiple measures to provide healthier food choices

### **8.2 Continue to Reduce Harmful Use of Alcohol by Cutting Excise Tax on Low-alcohol Products**

- Continue to raise public awareness on responsible drinking and dining to reduce harmful and excessive use of alcohol.
- Reduce the excise tax on low-alcohol products.

### **8.3 Improve the Plant-based Food Certification System, Develop Industry and National Standards Based on Existing Group Standards, Increase Marketing Activities and Boost Public Awareness**

- Create plant-based food standards and corresponding food production licence classifications.
- Improve public awareness and expand the sales channels for plant-based food.

## **Dairy Industry Sub-working Group**

### **1. Improve Dairy-related National Food Safety Standards**

- Better align the development and revision of dairy-related standards with international standards and practices, as well as the reality of domestic and international dairy markets and supply chains.
- Implement the Dairy Products Quality and Safety Improvement Action Plan and related industry policies by encouraging the introduction of group/industry standards instead of national standards.
- Optimise the development and revision of the national food safety standards to provide a more transparent and open channel to all industry players.

### **2. Optimise the Regulation of Cultures Applied in Dairy Production**

- Revise the labelling requirement in the relevant national food safety standard so that only the general name of the 'food culture' needs to be listed on the label instead of all individual cultures (except for probiotics), in order to align with international regulations.
- Exempt cultures that have a history of safe use in dairy production from the food culture positive list, and classify them as permitted ingredients in dairy production as soon as possible.

## **Food for Special Medical Purpose Sub-working Group and Paediatric Nutrition Sub-working Group**

### **1. Optimise the Registration System for Special Food**

#### **1.1 Enhance the Transparency and Consistency of Product Registration, and Ensure Administration is Based in Law**

- Improve the registration review and approval process, and inform the industry of any new requirements in a timely manner.





- Establish a communication mechanism between the State Administration for Market Regulation (SAMR), the Centre for Food Evaluation and industry to strengthen guidance on the research and development of food for special medical purpose (FSMP), and to enhance overall communication.
- Refrain from imposing new requirements for products that have already passed technical review, following the 'principle of non-retroactivity'.
- Ensure that future production conforms to the latest requirements by accepting a future guarantee statement from companies.
- Determine raw material standards to be applied during technical review according to the time the batches for registration are produced, and only require companies to comply with the new standards post-review during production or upon expiry of the interim standard period.

### **1.2 Continue to Explore Alternative Plans for Overseas Onsite Inspection to Address Challenges Faced by Overseas Manufactures in Infant Formula and FSMP Registration**

- Clarify both the 'actual needs' for conducting onsite inspections (i.e., specify the criteria to implement an on-site inspection) and the timeline for overseas onsite inspections.
- Explore alternatives to overseas onsite inspections, such as cooperating with overseas authorities, entrusting qualified third-party organisations or considering remote inspections, so that overseas onsite inspections will not continue to be delayed due to COVID-19.
- Ensure overseas onsite inspections are carried out in an orderly fashion under the newly revised national food safety standards related to infant formula.

### **1.3 Publish the Criteria for Differences in FSMP Formulas with Regard to Registration Review**

- Clarify the requirements for formula differentiation or formula upgrades of FSMP, and issue relevant guidelines as soon as possible.

### **1.4 Establish a 'Green Channel' for the Registration and Approval of FSMP Products for Rare Diseases**

- Revise the *Administrative Measures for the Registration of Food for Special Medical Purpose* to reflect the actual development of the sector, and conduct priority reviews and approvals of applications from such special channels for FSMP for subjects with rare diseases such as congenital metabolism defects.
- Strengthen communication among central and local governments, and the industry.
- Promote the implementation of pilot policies at the local level and allow conditional approvals of overseas marketed FSMP to be used by those with rare diseases.
- Develop documentation for approving and managing the donation of FSMP for use by those with rare diseases.
- Accelerate the review and approval of FSMP for rare diseases on the basis of ensuring the safety, effectiveness and quality control of the approved FSMP, so that patients can obtain reliable treatment as soon as possible.

## **2. Continue to Fine-tune National Food Safety Standards Related to FSMP to Ensure the Smooth Transition of Product Registration under New Standards**

- Accelerate the revision of new national standards and clarify the timeline for their introduction as soon as possible.



- Accelerate the revision of the *Administrative Measures for the Registration of Food for Special Medical Purposes*.
- Establish a sufficient transition period for new national standards for FSMP, taking into account the cycle from product development to product launch.
- Fine-tune old standards' indicators to form new standards based on the safe use of special medical products already registered and marketed.
- Investigate the necessity and feasibility of conducting clinical trials for the registration of FSMP products for specific diseases, and give clear guidance to companies.

### 3. Optimise the Requirements for Clinical Trials of FSMP 3

#### 3.1 Rationalise the Requirements Imposed on Trial Participants

- Waive clinical trials or conduct post-marketing clinical data collection for hypoallergenic formulas for toddlers over one year old.
- Provide relevant data, establish a method for exemption from conducting clinical trials, or allow a reduction in the use of clinical trial cases or conduct clinical research after marketing for populations under the age of 10 and subjects with rare diseases, to ensure the proper use of clinical trial resources and to satisfy the needs of special groups.
- Accept the normal diet as a control group, and either the 'before and after' comparison of one patient, or the comparison with standard normal growth, instead of mandating parallel controlled clinical trials.
- Establish a channel for consultations on clinical trial design prior to registration review, allowing companies to discuss experimental designs with review institutions before conducting clinical trials

#### 3.2 Adjust the Evaluation Indicators in Clinical Trials to Reflect the Features of FSMP Products

- Study the effects of renal-specific formulas by using before/after comparisons (i.e., single-arm) or by comparing with the renal-specific formulae marketed overseas.
- Consider the fact that FSMPs are only clinical nutritional support products, and design reasonable clinical observation indicators.
- Allow the sharing of clinical trials data on functional-equivalent (solid/liquid) formulas.

### 4. Encourage the Expansion of FSMP Market Access Channels, Standardise Post-market Supervision, and Improve Public FSMP Education 3

- Take comprehensive efforts to improve management, policy and regulation, and follow-up supervision, as well as to raise public awareness, to promote development of the FSMP industry in China.
- Include special medical products in the national medical charging system so as to provide more and better choices for nutritional support treatment for the majority of patients.

### 5. Establish an Appropriate Regulatory Framework to Supervise the Retail Marketing of 0–12-months Infant Formula and Provide a Detailed Plan to Effectively Encourage Breastfeeding 7

- Modify the *Administrative Measures for the Sale of Breast Milk Substitutes* in accordance





with existing nutritional and health conditions in China, and in a way consistent with the prohibitions on inappropriate promotion of 0–12-months infant formula as set out in China's Advertising Law.

- Establish appropriate norms and regulatory frameworks through the SAMR and provide detailed plans and enforcement programmes to prevent and detect inappropriate advertising and promotion of 0–12-months infant formula in retail channels to effectively protect breastfeeding.

## Introduction to Working Group

The Agriculture, Food and Beverage (AFB) Working Group represents a wide range of companies that include importers and exporters, manufacturers, distributors, retailers, catering service providers, specialised testing laboratories and consultants. Currently, the working group has over 150 member companies.

The working group is comprised of three sub-working groups – the Dairy Industry Desk, the Food for Special Medical Purposes Advisory Committee, and the Paediatric Nutrition Desk. The Dairy Industry Desk was originally established in 2014 as the Cheese Industry Desk to improve market access for European cheese and cheese products. Its members include ten prominent European cheese producers and industry associations. The Food for Special Medical Purposes Advisory Committee was established in 2016, and its members include four leading international manufacturers specialising in special nutrition. The Paediatric Nutrition Desk was established in 2009 and currently has nine international companies as members and four domestic manufacturers as local partners.

## Recent Developments

A number of major legislative changes that raised concerns for the industry took place in 2021. On 29<sup>th</sup> April 2021, the Anti-food Waste Law was amended, to immediate effect.<sup>1</sup> The law defines the concept and coverage of food waste at the legislative level, and plays an important role in preventing food waste and ensuring national food security. However, compliance requirements may pose burdensome financial and

administrative duties for food manufacturers and importers.

In January 2022, the *Regulations on the Administration of Registration of Overseas Food Manufacturing Enterprises (Decree 248)* came into effect.<sup>2</sup> Compared to its earlier version released in 2018 (*Decree 243*), *Decree 248* expands the scope of application to all food categories and imposes new requirements on overseas producers and operators involved in importing food into China. The working group highly appreciates the General Administration of Customs of China (GACC) engagement in dialogue with member companies and responses to industry inquiries regarding compliance and registration requirements ahead of the promulgation of *Decree 248*.

The National Health Commission issued the *National Food Safety Standard – Standard for Nutrition Labelling of Pre-packaged Foods (Draft for Comments)* in September 2021.<sup>3</sup> The proposed draft further clarifies the applicability of the standard, expands on terminology used, revises certain terms and definitions, and adds rules, such as mandatory labelling and warnings. However, the working group is still concerned about label updates, transition periods, and the conditions for positive and negative function claims, which could increase the burden on food producers' and importers' time and resources.

On 21<sup>st</sup> June 2022, the Agricultural Product Quality Safety Law (Revised Draft) was submitted to the

1 Anti-Food Waste Law of the People's Republic of China, National People's Congress (NPC), 25<sup>th</sup> May 2021, viewed 20<sup>th</sup> April 2022, <<http://www.yxltzw.gov.cn/html/2021/20210525898.shtml>>

2 *Registration and Administration of Overseas Manufacturers of Imported Food*, GACC, 12<sup>th</sup> November 2021, viewed 20<sup>th</sup> April 2022, <<http://jcksj.customs.gov.cn/spjzcfg18/bmgz91/3979122/index.html>>

3 *National Food Safety Standards - Standard for Nutrition Labelling of Prepackaged Foods (Draft for Opinions)*, NPC, 28<sup>th</sup> January 2022, viewed 20<sup>th</sup> April 2022, <<http://www.nhc.gov.cn/sps/s7887k/202109/5548757c9f1c415abb3c37456bbf4b9.shtml>>





Standing Committee of the National People's Congress (NPC) for review.<sup>4</sup> The proposed draft specifies the main responsibilities of producers, operators, and local governments, as well as the supervisory responsibilities of the competent authorities. Based on the draft, a traceability system for agricultural products will be implemented to improve quality and safety. The working group looks forward to the adoption of the revised law, and will continue to monitor relevant issues such as the primary responsibilities of food producers and operators, and implementation of the traceability system.

## Key Recommendations

### 1. Implement the Measures for Registration of Overseas Manufacturers Reasonably, Without Creating Either Excessive Constraints for Companies or Trade Disruption

#### Concern

Although the *Regulations on the Administration of Registration of Overseas Food Manufacturing Enterprises (Decree 248)* came into effect in January 2022, food importers still face difficulties in completing registration.

#### Assessment

Compared to its 2018 version, *Decree 248* expands the scope of registration to manufacturers of all types of food, introduces risk management principles and urges companies to establish effective food safety and hygiene management systems to ensure food exported to China meets requirements. Although *Decree 248* could enhance the supervision of imported food to ensure food safety, certain requirements also increase compliance pressures on food companies. For example, *Decree 248* requires a new registration every time the legal representatives of a company change, which is a disproportionate approach as executive rotation does not impact food product safety. This also imposes a significant administrative burden on companies, especially as the registration number must be displayed on the inner and outer packaging of a food product. The GACC should instead consider allowing companies to change the name of their legal representative through a simple amendment to an existing registration.

<sup>4</sup> Agricultural Product Quality Safety Law (Revised Draft), NPC, 29<sup>th</sup> June 2022, viewed 20<sup>th</sup> June 2022, <<http://www.npc.gov.cn/flcaw/flca/ff8081818180929401818f64bf55738f/attachment.pdf>>

In addition to the *Decree*, further clarification of the scheme, criteria and timelines for post-registration audit would similarly reduce the pressure on resources. For example, the GACC official website could provide further guidance on the scope and implementation of *Decree 248*, including frequently-asked-questions (FAQs) on registration through the China Import Food Enterprises Registration (CIFER) platform. For instance, several working group members report that when they contacted the official GACC dedicated email address concerning technical issues with their registration on CIFER, they only received a standard reply recommending them to follow the guidance provided in an attached CIFER manual. However, as the CIFER manual does not and cannot address all issues, an additional communication channel in English is needed.

#### Recommendations

- Take a reasonable approach to regulations on imported foods based on scientific assessment of the actual risks.
- Provide updated guidance on the GACC website on FAQs to avoid inconsistency between central and local customs.
- Set up an additional communication channel to deal with inquiries from overseas applicants on registration.
- Clarify the post-registration audit process, including relevant schemes and criteria, as well as timelines for recommencement of onsite inspections of overseas food producer facilities.

### 2. Distribute Responsibilities Proportionately Across the Supply Chain while Implementing the 'Punishment Exemption' Principle where Appropriate, Reasonably Design the Major Punishment System and Establish a Unified National Traceability System 9

#### 2.1 Distinguish the Responsibilities of Food Producers and Food Business Operators, and Establish a Punishment System that is Reasonable and Based on Specific Principles

#### Concern

Relevant laws and regulations do not clearly define the distinct responsibilities of food producers and food business operators, while implementation of policies and standards is inconsistent across different regions.





### Assessment

Food producers (including farming, manufacturing and processing) and food business operators bear different responsibilities in the value chain. However, in many cases, the Food Safety Law and its supporting regulations often regulate responsibilities and obligations by combining food producers and food business operators, resulting in operators often having penalties imposed on them that should be borne by producers.<sup>5</sup> With the implementation of policies and punishment standards also varying among different regions, these challenges become even more severe.

In addition, the senior management of chain retailers are normally not involved in the daily operations of each store. The existing systems of punishment, broad principles and inconsistent policies and enforcement among regions increase the potential compliance, reputational and financial risks for chain retailers and their senior management.

### Recommendations

- Distinguish and enforce the responsibilities of food producers and food business operators separately.
- Take full account of the subjectivity of senior management of companies while penalising individuals responsible for legal violations.
- Implement the concept of presumption of innocence in China's criminal law throughout the law enforcement process in the food area, and transfer the burden of proof from companies to law enforcement departments.
- Abide strictly by the principle of 'matching misbehaviour and penalties' and improve the fairness and consistency of law enforcement in all regions.

## 2.2 Establish a Unified National Food Traceability Platform, Legal Framework and Basic Standards to Promote Effective Tracing

### Concern

Different government agencies at all levels have set up various food traceability platforms with incompatible technologies and inconsistent standards.

### Assessment

Article 42 of the Food Safety Law stipulates that the state shall establish a whole-value-chain food safety

traceability system, and food producers and food business operators shall establish relevant policies and implementation practices. Yet government departments at all levels in different regions have established their own traceability platforms independently of each other. The tracing categories and technologies used are incompatible, which seriously hinders cross-departmental and cross-regional food safety traceability. Effective food safety traceability must integrate all links in the food value chain and requires a uniform platform, regulations and standards. Given the long and complex food safety value chain, it is necessary to ensure that the tracing entities, products and information are bonded, and that platforms are compatible with each other, in order to provide true and reliable information.

### Recommendations

- Unify the national platform, regulations and standards for food safety traceability.
- Ensure that tracing entities, products and information are bonded, technologies used are compatible and information gathered is reliable.

## 2.3 Implement the 'Punishment Exemption' Principle on Agricultural Products and Imported Foods From Production to Circulation

### Concern

Information in the food traceability system cannot be updated in a timely manner, causing consumers and anti-counterfeiting professionals to file incorrect complaints, which certain government agencies treat as 'mislabelling' and penalise the companies.

### Assessment

Article 136 of the Food Safety Law lays out the 'punishment exemption' principle, under which a food business operator that has fully implemented its compliance responsibilities can be exempted from punishment for mislabelling. The Food Safety Law also encourages companies to implement traceability systems to display product information for consumers via QR codes and other means.<sup>6</sup> Most companies upload traceability information manually to their system and generate their own labels. However, the level of digitalisation in the industry varies widely. Moreover, standards relating to food traceability systems are still in the preliminary

<sup>5</sup> Food Safety Law, National People's Congress, 7<sup>th</sup> January 2019, viewed 20<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/201901/c6d064de8295489288ec1383b33212ee.shtml>>

<sup>6</sup> Ibid.





stages, and requirements in terms of technology frameworks are not yet clear. As a result, companies might be penalised because of inconsistent and inaccurate tracing information. Additional clarification on requirements is needed so that product traceability information provided is not held to the same criteria as product label information. In addition, implementing the 'punishment exemption' principle in regard to agricultural products and imported foods will ensure that companies are not overly penalised due to immature technology.

#### Recommendation

- Distinguish product traceability information and product label information to ensure companies will not be penalised for inconsistencies.

### 3. Implement an Approval Process and Regulatory Standards to Encourage the Recycling of Food-grade Recycled Polyethylene Terephthalate (rPET) Materials

#### Concern

The lack of a properly developed system and standards for recycled food contact materials (FCM) in China means that all food-grade PET bottles are made using raw materials refined from petroleum, which consumes a huge number of resources.

#### Assessment

The 14<sup>th</sup> Five-year Plan Action Plan for Plastic Pollution Control clearly encourages homogenisation and high value-added utilisation of waste plastic.<sup>7</sup> However, the lack of clear industry standards in China makes it difficult for companies to take action, despite the availability of proven food-grade PET bottle primary recycling technology.

The food-grade PET bottle recycling rate in China is as high as 94 per cent. Fully implementing primary recycling of food-grade PET bottles could help China conserve tens of millions of tonnes of raw materials refined from petroleum and reduce greenhouse gas emissions by 63 per cent (including more than 50 million tonnes of carbon emissions), thereby reducing

7 14<sup>th</sup> Five-year Plan Action Plan for Plastic Pollution Control, NDRC, 9<sup>th</sup> August 2021, viewed 20<sup>th</sup> April 2022, <[https://www.ndrc.gov.cn/xxgk/zcfb/tz/202109/t20210915\\_1296580.html?state=123&code=&state=123](https://www.ndrc.gov.cn/xxgk/zcfb/tz/202109/t20210915_1296580.html?state=123&code=&state=123)>

energy consumption by 79 per cent.<sup>8</sup> Food-grade rPET materials are already widely used in European countries and the United States, but China is still in the process of conducting a risk assessment of such FCM materials. Government agencies should issue relevant policies, regulations and standards as soon as possible to encourage the use of rPET materials in FCM in order to facilitate achieving carbon neutrality in the food and beverage industry.

#### Recommendations

- Implement an assessment system and corresponding regulatory standards for rPET materials in FCM.
- Encourage the implementation of primary recycling of food-grade PET bottles to reduce the use of raw plastics.

### 4. Improve Management of and Consumer Education on Soon-to-expire Food and Reprocessed Raw Materials to Encourage Rational Consumption and Reduce Food Waste

#### Concern

Current regulations and national standards relating to soon-to-expire food and reprocessing food materials are not fully developed, and the public lacks proper understanding of soon-to-expire food, which leads to unnecessary waste.

#### Assessment

The release of the Anti-food Waste Law in 2021 demonstrates the importance the Chinese Government has placed on combatting food waste domestically and promoting green consumption by encouraging the public to consume food more rationally.<sup>9</sup> The National Development and Reform Commission (NDRC) in 2021 also issued the *Action Plan to Combat Food Waste*<sup>10</sup> and the *Green Consumption Implementation Plan*<sup>11</sup> to optimise the implementation of the law. The *Action Plan*

8 Dong, Ying & Sochi, Edward, *Research on Food Grade Recycled PET Bottles for Realizing China's 'Carbon Neutral' Goal*, Pepsi Asia R&D Centre, 15<sup>th</sup> July 2021, viewed 20<sup>th</sup> June 2022, <<https://kns.cnki.net/kcms/detail/detail.aspx?FileName=ZBZZ202107007&DbName=CJFQ2021>>

9 *Full text of the Anti-food Waste Law of the People's Republic of China*, NPC, 25<sup>th</sup> May 2021, viewed 20<sup>th</sup> April 2022, <<http://www.yxlzw.gov.cn/html/2021/20210525898.shtml>>

10 *Notice on the issuance of the Work Programme against Food Waste*, NDRC, 30<sup>th</sup> November 2021, viewed 20<sup>th</sup> April 2022, <[https://www.ndrc.gov.cn/xwd/tzgg/202112/t20211217\\_1308234.html?code=&state=123](https://www.ndrc.gov.cn/xwd/tzgg/202112/t20211217_1308234.html?code=&state=123)>

11 *The National Development and Reform Commission and seven other departments jointly issued the "Implementation Plan for Promoting Green Consumption"*, NDRC, 28<sup>th</sup> January 2022, viewed 20<sup>th</sup> April 2022, <[https://www.ndrc.gov.cn/fzggw/jgsj/zysj/dt/202201/t20220128\\_1313761.html?code=&state=123](https://www.ndrc.gov.cn/fzggw/jgsj/zysj/dt/202201/t20220128_1313761.html?code=&state=123)>





aims to improve approaches to the sale of food product and the food labelling system, by encouraging food producers to clearly indicate the 'best by' and expiration dates on food packaging, as well as to sell food close to the 'best by' date at discounted prices.

These initiatives have been effective in reducing food waste in China, but retailers and consumers still have concerns about the safety of soon-to-expire food. Government agencies should issue guidelines and increase public education efforts to develop a rational understanding among consumers of soon-to-expire food, and how it differs to expired food.

China should also improve regulations and national standards on raw food materials processing, such as the *National Food Safety Standard General Hygiene Practice for Food Production (GB 14881)*.<sup>12</sup> So long as food safety is not affected, food materials should be allowed to be reprocessed and used again. This can help the industry reduce raw material waste, and is also in line with the Anti-Food Waste Law and other supporting policies.

#### Recommendations

- Encourage consumers to reasonably consume soon-to-expire food.
- Encourage companies to reasonably use reprocessed raw materials to reduce waste.

## 5. Further Relax Foreign Investment Negative List Restrictions in the Seed Industry and Level the Playing Field

### Concern

The 2021 update of the *Special Administrative Measures for Foreign Investment (Negative List 2021)* relaxed some restrictions in the seed industry, but it still prohibits or restricts foreign investment in seed selection, breeding and production.

### Assessment

Although the *2018 Free Trade Zone Special Administrative Measures on Access to Foreign Investment (FTZ Negative List 2018)* increased foreign equity caps on wheat and maize breeding and seed production from 49 per cent to 66 per cent, neither the *Special*

*Administrative Measures for Access of Foreign Investments 2021* nor the *FTZ Negative List 2021* lifted restrictions with respect to crop breeding and seed production. The *Negative List 2021* and the *FTZ Negative List 2021* still prohibit foreign investment in "genetically modified (GM) varieties breeding and GM seed production." Prohibiting foreign investment in these areas not only limits competition and efficiency but is detrimental to China's goals for innovation and modernisation of the agricultural sector.

### Recommendations

- Relieve restrictions on GM technology and GM seed production.
- Further relax restrictions on foreign investment in the selection, breeding, and production of new crop varieties of wheat and maize.
- Allow foreign investment in rice and soybean breeding and production.

## 6. Accelerate the Approval Procedure for GM Microorganism (GMM) Food, Feed Additives and GM Agricultural Products



### Concern

The approval procedure for GMM feed additives and GM agricultural products is currently inefficient, and there is no pathway for the importation of agricultural microbial products.

### Assessment

According to the *Guidance for the Safety Assessment of GMM for Animal Use*,<sup>13</sup> products derived from the expression products of GMM (such as phytase, antimicrobial peptides) or metabolites, and from inactivated GMM, should pass an intermediate test and environmental release evaluation before they can apply for a safety certificate. However, feed products produced with a GMM but without living GMMs and recombinant deoxyribonucleic acid (DNA), which are excluded from the scope of the GM food and feed regulation in the European Union (EU), are still included in this category in China. They thus need to go through the aforementioned procedure, which is unnecessarily complex and time-consuming. In addition, a long approval procedure and uncertainties herein raised will

<sup>12</sup> *National Food Safety Standard General Hygiene Practice for Food Production (GB 14881)*, National Health Commission, 26<sup>th</sup> June 2013, viewed 20<sup>th</sup> April 2022, <<http://www.nhc.gov.cn/cms-search/xxgk/getManuscriptXxgk.htm?id=56f30af754ef49448705806d35af06a1>>

<sup>13</sup> *Guidance for the Safety Assessment of GMM for Animal Use*, Ministry of Agriculture, 3<sup>rd</sup> February 2012, viewed 20<sup>th</sup> April 2022, <[http://www.moa.gov.cn/ztl/zjyqwgz/sbzn/201202/t20120203\\_2474484.htm](http://www.moa.gov.cn/ztl/zjyqwgz/sbzn/201202/t20120203_2474484.htm)>





also slow down the development of new GMM feed additives. Differentiating non-GMM-containing products from GMM-containing products, and requiring only the intermediate test for the issuance of safety certificates for the former, would shorten the time from import to the market.

To apply for the safety certificate, agricultural GM biological samples and control samples, as well as testing materials and testing methods, to the Ministry of Agriculture and Rural Affairs (MARA) for safety assessment, according to *Administrative Measures for Safety Assessment of Agricultural Genetically Modified Organisms*.<sup>14</sup> The MARA then transfers the materials to the designated institution for verification. This may lead to inefficiencies in evaluation process, which will slow down industrial development and innovation. Adopting the current normal practice in EU, whereby third-party test reports or evaluation by independent culture collection organisation, instead of depositing the GMM strains for feed enzyme production to the MARA, which then sends them to the institution, would boost efficiency across the entire safety assessment process.

#### Recommendations

- Establish different approval procedures based on products' safety risk level.
- Simplify the approval requirements and speed up the approval process for food nutritional fortification substances and additives produced with or from GM microorganisms without living GMMs and recombinant DNA.
- Refer to EU normal practice, whereby third-party test reports or independent culture collection organisations are used for evaluation, instead of depositing GMM strains for feed enzyme production with the MARA for submission to the institution.

### 7. Strengthen Communication with the Organisation for Economic Co-operation and Development (OECD) to Support the Advancement of China's Accession to the OECD Framework Agreement on the Pesticide Field

#### Concern

As of 1<sup>st</sup> January 2021, the MARA has stopped accepting

<sup>14</sup> *Regulations on the Safety Management of Agricultural Genetically Modified Organisms*, MARA, 22<sup>nd</sup> December 2017, viewed 20<sup>th</sup> April 2022, <[http://www.moa.gov.cn/ztlz/zjyqwgz/zcfg/201007/20100717\\_1601306.htm](http://www.moa.gov.cn/ztlz/zjyqwgz/zcfg/201007/20100717_1601306.htm)>

overseas Good Laboratory Practice (GLP) data to support pesticide registration applications in China, and foreign products are required to carry out all registration tests in China, which has increased costs for foreign enterprises.

#### Assessment

On 1<sup>st</sup> June 2017, China's newly revised *Pesticide Management Regulations* went into effect,<sup>15</sup> with the *Pesticide Registration Administration Measures* released shortly afterwards. The industry is concerned, however, that the provisions related to the approval of overseas test data in Article 16 of the *Measures* is difficult to implement in practice because China has not signed a mutual recognition agreement with any country or international organization, such as the OECD framework agreement (or the OECD pesticides programme). China is in discussions but has yet to join the mutual acceptance of data (MAD) system of the OECD in the pesticide field.<sup>16</sup> Consequently, foreign enterprises must conduct registration tests with a China-based entity, at a cost of Chinese yuan (CNY) 20–30 million per registration, and face an additional procedure that can stretch out for three to four years. China is now one of the only countries in the world that will not accept data for pesticide registration under the MAD system and which requires all registration tests to be conducted within its territory.

#### Recommendation

- Strengthen communication with the OECD and its members to support the advancement of China's accession to the OECD framework agreement on pesticide.

### 8. Optimise Implementation of the 14<sup>th</sup> Five-year National Health Plan in Conjunction with the United Nations Sustainable Development Goals to Educate Consumers on Making Healthier Choices

#### 8.1 Continue to Encourage the 'Three Reductions and Three Health' Based on Scientific Assessment

#### Concern

Current health and wellness policies lack incentives,

<sup>15</sup> *Pesticide Management Regulation*, State Council, 1<sup>st</sup> April 2017, viewed May 22<sup>nd</sup> 2022, <[http://www.gov.cn/zhengce/content/2017-04/01/content\\_5182681.htm](http://www.gov.cn/zhengce/content/2017-04/01/content_5182681.htm)>

<sup>16</sup> *Mutual Acceptance of Data (MAD)*, OECD, 2020, viewed 21<sup>st</sup> April 2022, <<https://www.oecd.org/env/ehs/mutualacceptanceofdatamad.htm>>





making it is difficult for companies to create healthier products, invest in public education or actively engage in responsible marketing.

#### Assessment

The importance of improving public health in China has become more evident since the COVID-19 outbreak. In April 2022, the *14<sup>th</sup> Five-year National Health Plan* proposed to fully promote a national healthy lifestyle through the 'Three Reductions and Three Health'—salt reduction, oil reduction, sugar reduction, mouth health, weight health, bones health—and other special actions.<sup>17</sup>

Chinese food and beverage industry players expect clearer guidance from the authorities on the implementation of the Healthy China 2030 blueprint,<sup>18</sup> which recommends mandating labelling of sugars like sucrose, encouraging companies to advocate low sugar or sugar-free products, actively encouraging the use of front-of-package labelling (FOP) information to help consumers select healthy food quickly, and improving the supervision and management of pre-packaged food nutrition labels.

The China National Food Industry Association and the Chinese Nutrition Society each have their own FOP labelling system to indicate certain ingredients and their recommended daily intake to consumers, to encourage reduction of intake of salt, oil and sugar from food. However, the overlapping systems could confuse consumers and create difficulties for regulatory agencies. Many countries have their own FOP labelling systems. As such, China needs to develop a national FOP system that suits its unique national conditions while taking into account other countries' requirements to avoid possible trade barriers.

The food and beverage industry has conducted many useful studies and practices in product diversification and enhancing product nutritional and health values since the introduction of the Healthy China strategy, and has effectively implemented the key 'Three Reductions' initiative, through product innovation and diversification in order to raise nutritional and health awareness among consumers, and advocate for healthy lifestyles.

17 *14<sup>th</sup> Five-year National Health Plan*, State Council, 20<sup>th</sup> May 2022, viewed 20<sup>th</sup> June 2022, <[http://www.gov.cn/zhengce/zhengceku/2022-05/20/content\\_5691424.htm](http://www.gov.cn/zhengce/zhengceku/2022-05/20/content_5691424.htm)>

18 *Healthy China 2030 blueprint*, State Council, 2019, viewed 21<sup>st</sup> April 2022, <[http://www.gov.cn/xinwen/2019-07/15/content\\_5409694.htm](http://www.gov.cn/xinwen/2019-07/15/content_5409694.htm)>

It is hoped that the government can also provide guidance and encouragement for companies to further motivate them to produce healthier food and beverages.

#### Recommendations

- Implement the *14<sup>th</sup> Five-year National Health Plan* based on scientific data and current conditions, taking regional differences into account.
- Advance the promotion of educational programmes on healthy eating, appropriate portions and consumption frequency.
- Coordinate all stakeholders to adopt a more uniform FOP framework and implement multiple measures to provide healthier food choices.

## 8.2 Continue to Reduce Harmful Consumption of Alcohol by Cutting Excise Tax on Low-alcohol Products

#### Concern

The *14<sup>th</sup> Five-year National Health Plan* encourages reducing the harmful use of alcohol, but the path for implementation needs to be clarified and improved.

#### Assessment

The *14<sup>th</sup> Five-year National Health Plan* clearly specifies that health education on alcohol control should be strengthened to reduce the harmful use and overuse of alcohol.<sup>19</sup> On 8<sup>th</sup> June 2022, the Ministry of Industry and Information Technology and four other ministries jointly issued the *Guidelines to Promote the High-Quality Development Of Light Industry* to meet people's increasing desire for a better and healthier life, as well as the diverse needs of all generations.<sup>20</sup> Specifically, the *Guidelines* underline support for innovation and development in "low-alcohol baijiu, yellow wine and non-alcoholic beer (NAB)", to provide products tailored for different consumer groups.

Based on international experience and World Health Organization (WHO) studies, raising public awareness on responsible drinking, and increasing taxation on products, can reduce the harmful and over-

19 *14<sup>th</sup> Five-year National Health Plan*, State Council, 20<sup>th</sup> May 2022, viewed 20<sup>th</sup> June 2022, <[http://www.gov.cn/zhengce/zhengceku/2022-05/20/content\\_5691424.htm](http://www.gov.cn/zhengce/zhengceku/2022-05/20/content_5691424.htm)>

20 *Guidelines to Improve the High-quality Development of the Light Industry*, Ministry of Industry and Information Technology, Ministry of Ecology and Environment, Ministry of Human Resources and Social Security and SAMR, 8<sup>th</sup> June 2022, viewed 21<sup>st</sup> June 2022, <[http://www.gov.cn/zhengce/zhengceku/2022-06/19/content\\_5696665.htm](http://www.gov.cn/zhengce/zhengceku/2022-06/19/content_5696665.htm)>





consumption of alcohol.<sup>21</sup> For example, in most EU Member States, NAB is exempt from excise tax.<sup>22</sup> NAB refers to beer with alcohol content less than or equal to 0.5 per cent VOL (0.5 millilitres (ml) ethanol in 100 ml beer at 20 degrees Celsius (°C)).<sup>23</sup> In China, NAB is taxed at the same rate as normal beer, with excise tax amount accounting for seven to nine per cent of beer sales revenue, which the working group considers inappropriate. A lower excise tax rate for NAB would facilitate reducing the harmful use of alcohol, adopting to the ageing society and improving people's quality of life, while also increasing NAB competitiveness.

#### Recommendations

- Continue to raise public awareness on responsible drinking and dining to reduce harmful and excessive use of alcohol.
- Reduce the excise tax on low-alcohol products.

### 8.3 Improve the Plant-based Food Certification System, Develop Industry and National Standards Based on Existing Group Standards, Increase Marketing Activities, and Boost Public Awareness

#### Concern

The development of China's plant-based market is still at an early stage, and there is an urgent need for a well-developed certification system, standards, and effective promotion and education to guide consumers to make rational choices.

#### Assessment

Plant-based foods refer to foods made from plants or processed plants instead of animal materials to serve as the sole or main source of protein and fat. They are processed to have a flavour, texture and shape similar to animal-sourced foods. Current plant-based foods in the market include plant-based meat, dairy and eggs, with the main raw materials including beans, nuts and coconuts. However, the plant-based food market in China is still developing, and faces several issues in terms of standard setting, consumer awareness

21 Shield, Kevin D., Rylett, Margaret & Rehm, Jürgen, *Public health successes and missed opportunities: trends in alcohol consumption and attributable mortality in the WHO European Region, 1990–2014*, WHO, 29<sup>th</sup> October 2016, viewed 21<sup>st</sup> June 2022, <<https://apps.who.int/iris/handle/10665/329489>>

22 *Excise Duty Table*, European Commission, 9<sup>th</sup> January 2021, viewed 21<sup>st</sup> April 2022, <[https://taxation-customs.ec.europa.eu/system/files/2021-09/excise\\_duties-part\\_i\\_alcohol\\_en.pdf](https://taxation-customs.ec.europa.eu/system/files/2021-09/excise_duties-part_i_alcohol_en.pdf)>

23 *T/CBJ 3108 Non-alcoholic Beer*, China Alcoholic Drink Association, 14<sup>th</sup> October 2021, viewed 30<sup>th</sup> June, <[https://www.sohu.com/a/496245602\\_121124454](https://www.sohu.com/a/496245602_121124454)>

and purchasing channels, which greatly impede the industry's long-term development. The main issues include:

1. There are currently no industry standards for plant-based meat and egg products, or a specific food production licence classification.
2. Chinese consumers have many misconceptions about plant-based food, such as that plant-based food is different from vegetarian food, which could discourage them from purchasing products.
3. There are limited purchasing channels for plant-based meat and egg products.

#### Recommendations

- Create plant-based food standards and corresponding food production licence classification.
- Improve public awareness and expand the sales channels of plant-based food.

### Abbreviations

AFB	Agriculture, Food and Beverage
CIFER	China Import Food Enterprises Registration
CNY	Chinese Yuan
DNA	Deoxyribonucleic Acid
EU	European Union
FAQ	Frequently-asked-questions
FCM	Food Contact Materials
FOP	Front of Package
FTZ	Free Trade Zone
GACC	General Administration of Customs of China
GB	Guobiao
GM	Genetically Modified
GMM	Genetically Modified Microorganism
MARA	Ministry of Agriculture and Rural Affairs
MAD	Mutual Acceptance of Data
NAB	Non-alcoholic Beer
NDRC	National Development and Reform Commission
OECD	Organisation for Economic Cooperation and Development
R&D	Research and Development
rPET	Recycled Polyethylene Terephthalate
SAMR	State Administration for Market Regulation
WHO	World Health Organisation





## Dairy Industry Sub-working Group

### Introduction to the Sub-working Group

Dairy products are important sources of protein, iodine, calcium and several other vitamins. The consumption of these products in China continues to grow, and the industry is undergoing rapid development and modernisation. In 2021, the 27 European Union (EU) Member States and the United Kingdom combined were the second biggest dairy supplier for the Chinese market, accounting for almost half of all imports.<sup>1</sup>

The European Chamber's Dairy Industry Sub-working Group, originally the Cheese Industry Desk, was established in 2014, and has nine prominent European dairy producers and industry associations that are committed to bringing the best dairy products to the Chinese market. The sub-working group represents members' interests and promotes constructive dialogue between relevant stakeholders, including industry associations and regulators, to ensure a level playing field for all market participants.

### Recent Developments

Importers of dairy products continue to face severe challenges as a result of the global COVID-19 outbreak and China's subsequent introduction of strict epidemic prevention and control policies. Due to the special characteristics of some dairy products and raw materials—for example, the shelf life of most dairy products is between 12–18 months—the working group is concerned that COVID-19 tests and disinfection measures have affected clearance lead times and further impacted product quality/shelf life.

At the same time, China's dairy market experienced stable growth in 2021, including in raw milk production, dairy product processing and dairy consumption demand. The total dairy output increased by 9.4 per cent year-on-year, and dairy consumption by 10.6 per cent, with similar levels of growth expected to continue in 2022.<sup>2</sup> Part of this is a result of continuing

urbanisation advances and rising income levels. Although the price of raw milk generally remained high in 2021, the price gap ratio between domestic and international raw materials narrowed significantly due to increases in freight transportation costs. However, dairy farming returns trended downward throughout the year due to relatively faster growth in feed prices and production costs.<sup>3</sup>

Because China's demand for dairy products is growing while the production capacity of its domestic dairy industry remains limited, there is a great need for imported dairy products, particularly milk powder, cheese, butter, cream and whey powder. In 2021, China's total imports of dairy products reached 3.9 million tonnes, with a value of United States dollars (USD) 13.8 billion and representing a growth rate of 18.5 per cent year-on-year. Solid dairy products accounted for more than 67 per cent of imports, representing a year-on-year growth rate of 17.4 per cent.<sup>4</sup>

The EU-China Agreement on the Protection and Cooperation of Geographical Indications (GI) (EU-China GI Agreement) came into force on 1<sup>st</sup> March 2021.<sup>5</sup> Included among the first 200 GI products mutually recognised by China and Europe were 14 cheese products. Four years after its entry into force, an additional 175 GI names from each side will be covered by the scope of this agreement, with 19 more cheese products from Europe to become available to Chinese consumers.<sup>6</sup> This is extremely welcome news to the EU dairy industry, which expects the implementation of the agreement to provide fresh impetus for cooperation and exchange with the Chinese dairy industry.

In April 2021, the General Administration of Customs (GACC) published the modified *Regulations on*

<sup>1</sup> *Chinese Dairy Imports Update – Apr '22*, Atten Babler Commodities, 22<sup>nd</sup> April 2022, viewed 13<sup>th</sup> June 2022, <<https://www.attenbablercommodities.com/index.php/2022/04/21/chinese-dairy-imports-update-apr-22/>>

<sup>2</sup> *2022 will see continued rapid growth in dairy product consumption demand*, *Economic Daily*, 18<sup>th</sup> February 2022, viewed 11<sup>th</sup> April 2022, <<https://www.cfsn.cn/front/web/site.searchshow?pdid=132&id=73594>>

<sup>3</sup> Liu, Changquan, *2021 Review and 2022 Outlook of the China Dairy Industry*, *Chinese Journal of Animal Science*, 4<sup>th</sup> March 2022, viewed 11<sup>th</sup> April 2022, <<http://news.foodmate.net/2022/03/622076.html>>

<sup>4</sup> *China Dairy Trade Monthly Report of January 2022*, National Dairy Industry, Technology and Economy Research Office, 26<sup>th</sup> January 2022, viewed 12<sup>th</sup> April 2022, <<https://mp.weixin.qq.com/s/11sqXjq48YGJ2xxsPp3MoQ>>

<sup>5</sup> *EU-China Agreement on Geographical Indications to Take Effect in March*, *Xinhuanet*, 1<sup>st</sup> March 2021, viewed 13<sup>th</sup> June 2022, <[http://www.gov.cn/xinwen/2021-03/01/content\\_5589472.htm](http://www.gov.cn/xinwen/2021-03/01/content_5589472.htm)>

<sup>6</sup> *Agreement Between the Government of the People's Republic of China and the European Union on Cooperation on, and Protection of Geographical Indications*, Ministry of Commerce, 18<sup>th</sup> September 2020, viewed 20<sup>th</sup> April 2022, <<http://images.mofcom.gov.cn/tfs/202009/20200918163349821.pdf>>





the *Registration and Administration of Overseas Manufacturers of Imported Food (Decree 248)*,<sup>7</sup> which entered into force on 1<sup>st</sup> January 2022. The newly revised regulation updates the product scope, and includes additional details on registration methods, registration conditions and procedures, verification methods, the period of validity of the registration and labelling requirements. Manufacturers of dairy products are required to register their production facilities with the GACC and meet all requirements of *Decree 248* before exporting their products to China. Prior to *Decree 248* taking effect, the Dairy Industry Sub-working Group had actively participated in discussions with the GACC and submitted industry input on the legislation. In response to industry questions, the GACC released *Announcement 103* in December 2021,<sup>8</sup> which provides additional information on several issues regarding registration and the marking of registration numbers on product labelling and packaging. The response was much welcomed by the European dairy industry.

Several national food safety standards related to dairy products are under revision and have not been published at the time of writing. Between 2015 and 2017, the former National Health and Family Planning Commission (NHFPCC)—now the National Health Commission (NHC)—announced the initiation of revisions to a series of national food safety standards related to dairy products, including:

- *National Food Safety Standard Raw Milk (GB 19301-2010)*;<sup>9</sup>
- *National Food Safety Standard Pasteurised Milk (GB 19645-2010)*;<sup>10</sup>
- *National Food Safety Standard Sterilised Milk (GB 25190-2010)*;<sup>11</sup>

- *National Food Safety Standard Fermented Milk (GB 19302-2010)*;<sup>12</sup>
- *National Food Safety Standard Milk Powder (GB 19644-2010)*;<sup>13</sup>
- *National Food Safety Standard Cream, Butter and Anhydrous Cream (GB 19646-2010)*;<sup>14</sup>
- *National Food Safety Standard Whey Powder and Whey Protein Powder (GB 11674-2010)*;<sup>15</sup>
- *National Food Safety Standard Prepared Milk (GB 25191-2010)*;<sup>16</sup>
- *National Food Safety Standard Lactose (GB 25595-2010)*;<sup>17</sup> and
- *National Food Safety Standard Good Manufacturing Practice for Dairy Products (GB 12693-2010)*.<sup>18</sup>

In March and September 2021, the NHC and the State Administration for Market Regulation (SAMR) published the modified *National Food Safety Standard Cheese (GB 5420-2021)*<sup>19</sup> and the *National Food Safety Standard Limit of Pathogen in Pre-packaged Foods (GB 29921-2021)*<sup>20</sup> respectively, both of which became effective in November 2021. The standard *GB 5420-2021* not only enables more high-quality cheese varieties that have a long and safe consumption history in the European market to enter the Chinese market, but also fully guarantees the safety of cheese products on the Chinese market and promotes the development of the cheese industry in China; the standard *GB 29921-2021* contributes to the establishment of a

7 *Regulations on the Registration and Administration of Overseas Manufacturers of Imported Food*, GACC, 16<sup>th</sup> April 2021, viewed 20<sup>th</sup> April 2022, <<http://jckspj.customs.gov.cn/spj/zcfcg18/bmgz91/3625617/index.html>>

8 *Announcement on Matters Related to the Implementation of the Provisions on the Administration of the Registration of Overseas Production Enterprises of Imported Food and the Measures on the Administration of Food Safety in Import and Export*, GACC, 15<sup>th</sup> December 2021, viewed 20<sup>th</sup> April 2022, <<http://jckspj.customs.gov.cn/spj/zcfcg18/gfxwj65/4058583/index.html>>

9 *National Food Safety Standard Raw Milk (GB 19301-2010)*, NHFPC, 26<sup>th</sup> March 2010, viewed 16<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/6DEFF20C-AEBD-49D3-8C35-C9B086A0F44B.html>>

10 *National Food Safety Standard Pasteurised Milk (GB 19645-2010)*, NHFPC, 26<sup>th</sup> March 2010, viewed 16<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/BB832452-5017-4EA8-AD06-A6F1557A423D.html>>

11 *National Food Safety Standard Sterilised Milk (GB 25190-2010)*, NHFPC, 26<sup>th</sup> March 2010, viewed 16<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/69F95D12-21FC-46D0-BA60-0D8802593A1A.html>>

12 *National Food Safety Standard Fermented Milk (GB 19645-2010)*, NHFPC, 26<sup>th</sup> March 2010, viewed 16<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/849A1775-3D0A-4674-BCE4-3253BE5531CB.html>>

13 *National Food Safety Standard Milk Powder (GB 19644-2010)*, NHFPC, 26<sup>th</sup> March 2010, viewed 16<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/EF931D82-DF12-4CF5-B123-5D1B099D887E.html>>

14 *National Food Safety Standard Cream, Butter and Anhydrous Cream (GB 19646-2010)*, NHFPC, 26<sup>th</sup> March 2010, viewed 16<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/6818B3FF-4E2C-400B-AF62-D7BE3CF7FE3A.html>>

15 *National Food Safety Standard Whey Powder and Whey Protein Powder (GB 11674-2010)*, NHFPC, 26<sup>th</sup> March 2010, viewed 16<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/806A934C-35AA-44F6-8BE5-110A11B2B4D7.html>>

16 *National Food Safety Standard Prepared Milk (GB 25191-2010)*, NHFPC, 26<sup>th</sup> March 2010, viewed 16<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/EA77F1FA-3775-46D3-83C4-C845AD564355.html>>

17 *National Food Safety Standard Processed Lactose (GB 25595-2010)*, NHFPC, 21<sup>st</sup> December 2010, viewed 16<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/3885AFC7-00A0-40EC-98C1-38E88900BD6E.html>>

18 *National Food Safety Standard Good Manufacturing Practice for Dairy Products (GB 12693-2010)*, NHFPC, 26<sup>th</sup> March 2010, viewed 16<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/3A0055A3-DAFA-4D30-BC81-73DF14E8D029.html>>

19 *National Food Safety Standard Cheese (GB 5420-2021)*, NHC and SAMR, 22<sup>nd</sup> February 2021, viewed 20<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/db?type=1&guid=9D350D1F-E59B-4A08-9A3C-D111DB951743>>

20 *National Food Safety Standard Limit of Pathogen in Pre-packaged Foods (GB 29921-2021)*, NHC and SAMR, 7<sup>th</sup> September 2021, viewed 20<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/db?type=1&guid=B2CDB561-52B4-4A09-8E58-95596958CF04>>



more scientific and reasonable food safety supervision system in China.

On 28<sup>th</sup> July 2022, the NHC and the SAMR published the modified *National Food Safety Standard Processed Cheese and Cheese Products (GB 25192-2022)* and the *National Food Safety Standard Condensed Milk Products (GB 13102-2022)*, both of which will be effective from 30<sup>th</sup> December 2022.<sup>21</sup> There are only five months from the publication of the standard until implementation, and companies have to revise their labels accordingly during this short period. The grace period is too short and the industry faces challenges in not having enough time to revise the label and order packaging materials. This will lead to severe consequences for the industry.

At the time of writing, the other previously mentioned dairy standards are still in the process of revision, organised by the NHC's National Food Safety Standards Review Committee. The sub-working group has submitted comments on many of them and expects subsequent revisions to be based on existing scientific evidence. At the same time, the sub-working group hopes the barriers currently hindering the import of certain European dairy products and the development of China's domestic dairy industry can be further removed.

It is important for regulatory barriers to continue to be reduced and for the development of the dairy industry to be facilitated, in line with the Chinese Government's position on promoting trade liberalisation and economic globalisation. As dairy products are well-recognised as nutritional foods, the development of the industry would help to improve the overall health and nutrition status of the Chinese population, an aim that is laid down in the strategic plan *Healthy China 2030*,<sup>22</sup> and the *National Nutrition Plan 2017–2030*.<sup>23</sup>

The Chinese Government intends to enhance its technical competence with respect to dairy industry regulation in order to ensure the safety of dairy products in China. The Dairy Industry Sub-working

Group expects that the formulation and revision of the national food safety standards for dairy products will be compatible with related international standards and manufacturing conditions, while maintaining a high level of food safety. As market demand for dairy products continues to increase in China, sub-working group members continually seek opportunities to enhance communication with the regulatory authorities and present Chinese customers with a greater variety of nutritional products.

## Key Recommendations

### 1. Improve Dairy-related National Food Safety Standards

#### Concern

As current revisions to China's dairy-related standards sometimes do not take into account the reality of domestic and international markets and supply chains, many dairy products that have a long history of safe consumption in global markets are, and will continue to be, unable to meet the required Chinese standards, which may hinder innovation in China's dairy sector.

#### Assessment

According to the Food Safety Law, food safety standards are in place to protect public health, meaning the formulation of national food safety standards should be based on the results of risk assessments. The law states that relevant international standards and international food safety risk assessment results should be referenced, and the drafting of national food safety standards should be open to food producers, traders, consumers and relevant departments for public consultation.<sup>24</sup>

Most of the current national food safety standards related to dairy products were formulated and released in 2010. Over the past 12 years, innovation in technology for dairy production has increased, and product categories have become richer and more varied. Meanwhile, the Chinese dairy market has become more internationalised. The conflict that has arisen between the current national food safety standards for dairy products and the development status of the international and domestic dairy markets

<sup>21</sup> Notice on the Issuance of 36 National Food Safety Standards and 3 Amendments (2022, No. 3), 28<sup>th</sup> July 2022, viewed 1<sup>st</sup> August 2022, <<http://www.nhc.gov.cn/sps/s7891/202207/d30f4827b27148779c93f3090fc2afc3.shtml>>

<sup>22</sup> Outline of Healthy China 2030, State Council, 25<sup>th</sup> October 2016, viewed 20<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2016-10/25/content\\_5124174.htm](http://www.gov.cn/xinwen/2016-10/25/content_5124174.htm)>

<sup>23</sup> National Nutrition Plan (2017–2030), State Council, 30<sup>th</sup> June 2017, viewed 20<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2017-07/13/content\\_5210134.htm](http://www.gov.cn/zhengce/content/2017-07/13/content_5210134.htm)>

<sup>24</sup> Food Safety Law (Revised 2021), National People's Congress, 30<sup>th</sup> November 2021, viewed 20<sup>th</sup> April 2022, <[http://gxi.guizhou.gov.cn/zfxxgk/fdzdgknr/zdlyxxgk/xfpgygl/202111/t20211130\\_71841361.html](http://gxi.guizhou.gov.cn/zfxxgk/fdzdgknr/zdlyxxgk/xfpgygl/202111/t20211130_71841361.html)>



is a problem that needs to be urgently solved through revision of the relevant standards.

For example, the definition of 'processed cheese' and the testing methods for phosphates are the main industry concerns with regard to *GB 25192-2010*. In the modified *National Food Safety Standard Processed Cheese and Cheese Products (GB 25192-2022)*, the melting salt—which is required for production and features in the current standard—has been removed from the definition of 'processed cheese', bringing the definition better in line with international standards and products. However, in the new standard, the proportion of cheese used as the main raw material was adjusted from more than 15 per cent to more than 50 per cent, and a new category of 'cheese products' (in which the proportion of cheese used is less than 50 per cent and more than 15 per cent) was added. This classification does not conform to international standards and industry practices, or reflect the wide variety of processed cheese marketed worldwide. The move may result in some popular processed cheese products not being classified as 'processed cheese' but instead as 'cheese products', thus impeding product innovation. For instance, some spreadable processed cheeses that have a high water content, and have other raw materials added to enrich the texture and taste, may not meet the 50 per cent cheese content requirement. Moreover, there is no clear way to accurately gauge the cheese content in processed cheese products, which may lead to difficulties for both enterprises' implementation and the government's administration of the standard.

Additional problems with national food safety standards related to dairy products include the mixing of safety standards with quality standards, and the influence of industrial policies on the revision of mandatory standards.

For example, the industry learned that in the latest revision to the draft standard *GB 19644*, the definition of 'modified milk powder' was changed so that the main ingredient should contain no less than 70 per cent milk solids, and that 'main ingredients' must be limited to processed products produced from raw milk and/or whole milk (or skimmed or partially skimmed) derived from a single variety. This modification aims to improve the overall quality of milk powder products, but, at the same time, it will require large-scale adjustments to existing mixed milk powder products on the market that

will result in fluctuations of the raw material market. This deviates from the fundamental objective of the revision of national food safety standards, which is to ensure food safety and public health.

Due to China's limited cultivated areas for raising dairy cattle, inadequate feeding technology, climate conditions and other reasons, the domestic supply of high-quality milk is insufficient to meet demand, so imported dairy ingredients and products are necessary supplements. In order to meet the increasingly diversified demands of domestic consumers and to provide high-quality, reasonably priced products for domestic consumption, the Dairy Industry Sub-working Group recommends that the development status of the domestic and international dairy industries, and the objective situation of Chinese and global supply chains, should be fully taken into account when formulating policies and standards.

In terms of industrial policies related to improving the quality of dairy products and encouraging the use of fresh milk to produce dairy products, the sub-working group recommends encouraging the creation of industry standards and group standards to guide enterprises to develop higher quality products, rather than mandatory national food safety standards. It further recommends taking a holistic approach to promoting the sustainable development of China's dairy industry, based on the concept of globalisation.

#### Recommendations

- Better align the development and revision of dairy-related standards with international standards and practices, as well as the reality of domestic and international dairy markets and supply chains.
- Implement the Dairy Products Quality and Safety Improvement Action Plan and related industry policies by encouraging the introduction of group/industry standards instead of national standards.
- Optimise the development and revision of national food safety standards to provide a more transparent and open channel to all industry players.





## 2. Optimise the Regulation of Cultures Applied in Dairy Production

### Concern

Many cultures traditionally used in European dairy production processes are not included in the positive list that China uses to regulate the application of cultures in food production, which acts as a barrier to the Chinese market.

### Assessment

China's regulation of food cultures allows only a very limited number of microbial cultures to be used. In 2010, the then Ministry of Health issued the *List of Cultures Applied in Food (List)*.<sup>25</sup> It included a 'positive' list that recognised only a few microorganism types, mainly used for yoghurt manufacturing, with regulated cultures applied in food for infants and young children featuring in another list. This regulation exempts a number of cultures that are traditionally used for food manufacturing and processing. Although exempted cultures listed in the notice are not specified as those used in traditional Chinese cooking, the official interpretation and actual implementation does in fact apply only to cultures used in 'traditional Chinese food'; this includes vinegar, soy sauce and Chinese liquor, among others.

After seven additional notices on updates of the *List*, a total of 38 cultures are now listed, expanded from the original 21. This means that only 17 cultures have been added in 12 years. Cultures other than the 38 listed and those used in Chinese traditional foods are not permitted for use in food production until they are approved in a safety review conducted by the NHC. In October 2021, the National Food Safety Assessment Center issued a public consultation on a draft of a revised *List*.<sup>26</sup> New varieties of cultures were included and naming rules revised to reflect the latest international trends. However, most cultures that are traditionally used for cheese production are still not included in the *List*. Furthermore, the review process is made almost impossible for producers of cultures used

in dairy products, as it requires information that is very difficult to obtain—such as the toxicological assessment of a certain culture, which is very time- and resource-consuming—thereby hindering the development of the Chinese dairy industry, especially the cheese sector. In addition, the review process itself is labour-intensive, which is an unnecessary cost, as these cultures have a long history of safe usage in a wide variety of European dairy products.

Authoritative lists of microorganisms used by international organisations, or in countries other than China, include cultures that are generally recognised for their history of safe usage. Such lists include those published as a result of a joint project between the International Dairy Federation (IDF) and the European Food and Feed Cultures Association in 2002, and a Danish Veterinary and Food Administration (DVFA) list of notified microbial cultures that are used in food production. After being reviewed and updated in 2012 and 2018, the IDF inventory now lists approximately 300 microbial cultures covering a wide range of food matrices.<sup>27</sup> The Chinese Government and a number of research institutes are cooperating with the IDF to have the cultures used in manufacturing traditional Chinese food included in the inventory.

The DVFA list of notified microbial cultures is a record of all microbial cultures the organisation has been notified of, and can be expanded if culture manufacturers provide more information. Safety documentation is not precluded in the notification process: the DVFA does not approve microbial cultures before they are used, but safe-use history and safety risks are evaluated before a culture is included on the list. In European countries, cultures are considered ingredients and must satisfy legal safety requirements, with the responsibility for their safety lying with manufacturers. Related regulations state that manufacturers shall only use cultures that have a history of safe use.

The contributions certain microbes have made to cheese have been widely recognised, and pure microbial cultures are commonly used by dairy makers. In addition to lactic acid bacterial starter cultures, various species of bacteria and fungi are often added to

<sup>25</sup> Notice of Ministry of Health Office on Issuing the List of Cultures Applied in Food, NHC, 28<sup>th</sup> April 2010, viewed 20<sup>th</sup> April 2022, <[www.nhc.gov.cn/sps/s3593/201004/65839d2d57554dd29ae40a52dca92c74.shtml](http://www.nhc.gov.cn/sps/s3593/201004/65839d2d57554dd29ae40a52dca92c74.shtml)>

<sup>26</sup> Public Consultation on the List of Cultures Applied in Food and the List of Cultures Applied in Infant and Young Children Food, National Food Safety Assessment Center, 28<sup>th</sup> October 2021, viewed 13<sup>th</sup> June 2022, <<http://www.cfsa.net.cn:8033/UploadFiles/news/upload/2021/2021-10/23c78b5e-5a92-43a5-927b-ef15ada6bda9.pdf>>

<sup>27</sup> Bourdichon, F., Casaregola, S., Farrok, C., Frisvad, J.C., Gerds, M.L., Hammes, W.P., & Powell, I.B., *Food fermentations: microorganisms with technological beneficial use*, *International Journal of Food Microbiology*, vol.154, no.3, pp. 87–97, 15<sup>th</sup> March 2012, viewed 20<sup>th</sup> April 2022, <<https://www.sciencedirect.com/science/article/pii/S0168160511007586>>





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dairy products to give them very specific characteristics. For instance, blue-mould cheeses have always been fermented with *Penicillium roqueforti*; spores of the filamentous fungus *Penicillium camemberti* are inoculated into milk during the production of bloomy, rind cheeses such as Brie and Camembert; and the actinomycete bacterium *Brevibacterium linens* (*B. linens*) contributes to the reddish-orange colour found in the traditional cheese Epoisses. Dairy makers have learned over centuries how to consistently cultivate specific microbial colonies by controlling the conditions a dairy product is subjected to during the ageing process. Recognising the historical safe use of cultures applied in cheese will help promote the industry in China and allow Chinese customers to enjoy a wider variety of dairy products.

#### Recommendations

- Revise the labelling requirement in the relevant national food safety standard so that only the general name of the 'food culture' needs to be listed on the label instead of all individual cultures (except for probiotics), in order to align with international regulations.
- Exempt cultures that have a history of safe use in dairy production from the food culture positive list, and classify them as permitted ingredients in dairy production as soon as possible.

## Abbreviations

DVFA	Danish Veterinary and Food Administration
EU	European Union
GACC	General Administration of Customs of China
GI	Geographical Indication
IDF	International Dairy Federation
NHC	National Health Commission
NHFPC	National Health and Family Planning Commission
SAMR	State Administration for Market Regulation
USD	United States Dollar





# Food for Special Medical Purpose Sub-working Group and Paediatric Nutrition Sub-working Group

## Introduction to the Sub-working Groups

The European Chamber's Food for Special Medical Purpose (FSMP) Sub-working Group was established in 2016, and counts as members four leading international manufacturers that specialise in special nutrition. The European Chamber's Paediatric Nutrition Sub-working Group was established in 2009, and currently has nine international companies as members and four domestic manufacturers as local partners.

The Food for Special Medical Purposes Sub-working Group and the Paediatric Nutrition Sub-working Group fall under the European Chamber's Agriculture, Food and Beverage Working Group. All groups consider it crucial to regulate the special food sector with modern legislation and standards based on scientific evidence and input from both industry and the public at large.

## Recent Developments

In the past two years, European companies have faced unprecedented challenges and uncertainties resulting from China's COVID-19 containment measures, including lockdowns in cities, disrupted supply chains, and increasingly expensive and unstable logistics. According to a European Chamber flash survey published in May 2022, 75 per cent of respondents reported that the pandemic control measures have had a negative impact on their overall operations.<sup>1</sup> For the special food sector, the impact can be seen in the decrease of imports. For example, in 2021, the import volume of infant formula decreased by 21.8 per cent year-on-year to 272,700 metric tonnes, and its value was United States dollar (USD) 4.5 billion, a decrease of 14.6 per cent.<sup>2</sup> Infant formula manufacturers have also been impacted by rising business costs.<sup>3</sup> In addition, demographic changes in China have resulted

in slower growth of the domestic infant formula industry: there were 10.62 million births in 2021, a decrease of 11.5 per cent compared with 2020.<sup>4</sup>

Considering China's rapidly ageing population, as well as the increased focus on personal health awareness and the improvements in related policies, China's FSMP industry has huge potential.<sup>5</sup> For instance, in 2021, Shanghai and several other provinces and cities promulgated administrative measures for the operation and use of FSMP, which has incrementally improved the supervision system for the industry.<sup>6</sup>

As of 31<sup>st</sup> December 2021, 81 FSMP products and 1,392 modified infant milk powder formulas had been approved for recipe registration (with 48 modified infant milk powder formulas deregistered).<sup>7&8</sup> The registration rate of infant formula has dropped dramatically since 2018, while that of FSMP has stagnated over the same period, as can be seen in Table 1.

Table 1: Registration of FSMP and Infant Formulas<sup>9</sup>

Year	FSMP registrations	Infant formula registrations
2017	3	904
2018	18	243
2019	22	86
2020	14	70
2021	24	41

The *Administrative Measures for the Registration of Food for Special Medical Purposes*, which aim to safeguard FSMP quality and safety, and improve registration management, have been under revision

1 Flash Survey: COVID-19 and the War in Ukraine: The impact on European business in China, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 12<sup>th</sup> June 2022, <<https://www.eurochamber.com.cn/en/publications-flash-survey-2022>>

2 2021 Review and 2022 Outlook of China's Dairy Industry, China Dairy Industry Association, 8<sup>th</sup> April 2022, viewed 21<sup>st</sup> April 2022, <<https://news.foodmate.net/2022/04/625712.html>>

3 Liu, Changquan, 2021 Review and 2022 Outlook of China's Dairy Industry, Chinese Journal of Animal Science, 4<sup>th</sup> March 2022, viewed 24<sup>th</sup> April 2022, <<http://news.foodmate.net/2022/03/622076.html>>

4 Intensifying Competition: With 30 Per Cent of Mother and Baby Stores Closed, Milk Powder Industry is a Bit Cold, Sina Finance, 20<sup>th</sup> January 2022, viewed 24<sup>th</sup> April 2022, <<https://cj.sina.com.cn/articles/view/6745116791/1920a507701901c5mv>>

5 Liang, Yuan; Hu, Mengyao; Zhao, Yuanzhi & Zha, Tiantian, FSMP Market is Expected to Reach 10 Billion Yuan in 2021, People's Daily, 14<sup>th</sup> October 2021, viewed 24<sup>th</sup> April 2022, <<https://new.qq.com/rain/a/20211014A06ECN00>>

6 FSMP Industry's 2021 Top Ten Events, Guangming.com, 5<sup>th</sup> January 2022, viewed 24<sup>th</sup> April 2022, <[https://shipin.gmw.cn/2022-01/05/content\\_35428285.htm](https://shipin.gmw.cn/2022-01/05/content_35428285.htm)>

7 2021 Information on Registration and Approval of Formulas for Special Medical Purposes – Annual Check, Food Safety and Compliance Division, 18<sup>th</sup> January 2022, viewed 21<sup>st</sup> April 2022, <<http://news.foodmate.net/2022/01/618033.html>>

8 2021 Information on Registration and Approval of Infant Formulas for Special Medical Purposes – Annual Check, Food Safety and Compliance Division, 12<sup>th</sup> January 2022, viewed 21<sup>st</sup> April 2022, <<http://news.foodmate.net/2022/01/617507.html>>

9 These statistics are consolidated based on the public information published by the Centre for Food Evaluation (CFE) of the State Administration for Market Regulation (SAMR), <[http://www.cfe-samr.org.cn/sldt/sdxx/yypfrcpf\\_180/pjfb\\_181/](http://www.cfe-samr.org.cn/sldt/sdxx/yypfrcpf_180/pjfb_181/)>





by the State Administration for Market Regulation (SAMR) since 18<sup>th</sup> October 2021.<sup>10&11</sup> In addition, the *National Food Safety Standard – General Rules for Food for Special Medical Purposes (GB 29922-2013)*<sup>12</sup> and the *National Food Safety Standard – General Rules for Infant Formulas for Special Medical Purposes (GB 25596-2010)*,<sup>13</sup> are under revision as of July 2022. The Food for Special Medical Purpose Sub-working Group provided comments and suggestions on these measures and standards, and looks forward to subsequent revisions taking this feedback into account.

Other recent regulatory and standard changes that have had a significant impact on the operation and management of FSMP and the recipe registration of infant formula include the following:

- On 18<sup>th</sup> March 2021, the National Health Commission (NHC) and the SAMR issued the *National Food Safety Standard – Infant Formula (GB 10765-2021)*, *National Food Safety Standard – Older Infant Formula (GB 10766-2021)*, and *National Food Safety Standard – Young Children Formula (GB 10767-2021)*.<sup>14</sup> The standards will become effective on 22<sup>nd</sup> March 2023, and companies have already started registering their updated recipes according to the new standards.
- On 23<sup>rd</sup> March 2021, the SAMR issued the *Announcement on Matters Concerning the Formula Registration of Infants and Young Children Formula Milk Powder Product*.<sup>15</sup>
- On 12<sup>th</sup> April 2021, the SAMR's Centre for Food Evaluation (CFE) issued the *Technical Guiding Principles for Registration and Labelling Specifications*

10 *Administrative Measures for the Registration of Food for Special Medical Purposes*, former China Food and Drug Administration (CFDA), 7<sup>th</sup> March 2016, viewed 24<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2016/content\\_5076983.htm](http://www.gov.cn/gongbao/content/2016/content_5076983.htm)>

11 *SAMR's Notice on the Call for Comments on the Administrative Measures for the Registration of Food for Special Medical Purposes (Draft for Comments)*, SAMR, 18<sup>th</sup> October 2021, viewed 12<sup>th</sup> June 2022, <[https://www.samr.gov.cn/hd/zjdc/202110/t20211018\\_335729.html](https://www.samr.gov.cn/hd/zjdc/202110/t20211018_335729.html)>

12 *National Food Safety Standard - General Rules on Formula Foods for Special Medical Purposes (GB 29922-2013)*, former National Health and Family Planning Commission (NHFPC), 26<sup>th</sup> December 2013, viewed 24<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/StaticPages/EC073419-CC4C-463E-9BA2-8372D034396C.html>>

13 *National Food Safety Standard - General Rules for Infant Formulas for Special Medical Purposes (GB 25596-2010)*, former Ministry of Health (MOH), 21<sup>st</sup> December 2010, viewed 24<sup>th</sup> April 2022, <<http://www.nhc.gov.cn/sps/s7891/201012/2539e2314f74b402696c44e0906aa9ef1.shtml>>

14 *Notice on the Issuance of 50 National Food Safety Standards and 4 Amendments Including National Food Safety Standard - Cheese (GB 5420-2021)*, NHC, 18<sup>th</sup> March 2021, viewed 24<sup>th</sup> April 2022, <<http://www.nhc.gov.cn/sps/s7891/202103/0bd b6c4318724644b40e3f894aa88f.shtml>>

15 *Announcement on Matters Concerning the Formula Registration of Infants and Young Children Formula Milk Powder Product*, SAMR, 23<sup>rd</sup> March 2021, viewed 22<sup>nd</sup> April 2022, <[http://gkml.samr.gov.cn/nsjg/tssps/202103/t20210324\\_327214.html](http://gkml.samr.gov.cn/nsjg/tssps/202103/t20210324_327214.html)>

*of Modified Infant Milk Powder Formulas (Trial)*.<sup>16</sup>

- On 24<sup>th</sup> December 2021, the SAMR issued the *Announcement on Strengthening the Quality and Safety Supervision of Solid Beverages*.<sup>17</sup>
- On 24<sup>th</sup> December 2021, the SAMR's CFE issued the *Frequently Asked Questions and Answers for the Registration of Modified Infant Milk Powder Formulas*.<sup>18</sup>

The requirement to register recipes for infant and young children milk-based formula was introduced in 2016, and the first batch of registration applications were approved in August 2017. Companies were obliged to apply for a registration extension for these recipes in February 2022, six months prior to the expiration of the registration. However, due to strict COVID-19 control measures—including lockdowns—in certain parts of China then, many companies were not able to submit their documents in time, which raised a great deal of concern over their applications. Companies have also had to start preparing for the registration of recipes modified to comply with the new standards *GB 10765-2021*, *GB 10766-2021* and *GB 10767-2021*. On 26<sup>th</sup> April 2022, the SAMR's CFE held an online seminar to address both of these challenges.<sup>19</sup> The industry welcomed this opportunity and recommends more frequent communication among the CFE, the SAMR and industry to address such issues.

## Key Recommendations

### 1. Optimise the Registration System for Special Food

#### 1.1 Enhance the Transparency and Consistency of Product Registration and Ensure Administration is Based in Law

##### Concern

Frequent changes have been made to the administration of infant formulas and FSMP in recent years, and

16 *Technical Guiding Principles for Registration and Labelling Specifications of Modified Infant Milk Powder Formulas (Trial)*, SAMR CFE, 12<sup>th</sup> April 2021, viewed 22<sup>nd</sup> April 2022, <[https://www.cfe-samr.org.cn/zcfg/yyepfrfcpf\\_146/gfxwj\\_150/202104/t20210412\\_3095.html](https://www.cfe-samr.org.cn/zcfg/yyepfrfcpf_146/gfxwj_150/202104/t20210412_3095.html)>

17 *Announcement on Strengthening the Quality and Safety Supervision of Solid Beverages*, SAMR, 7<sup>th</sup> January 2022, viewed 21<sup>st</sup> April 2022, <[https://gkml.samr.gov.cn/nsjg/spscs/202201/t20220107\\_338958.html](https://gkml.samr.gov.cn/nsjg/spscs/202201/t20220107_338958.html)>

18 *Frequently Asked Questions and Answers for the Registration of Modified Infant Milk Powder Formulas*, SAMR CFE, 24<sup>th</sup> December 2021, viewed 24<sup>th</sup> April 2022, <[https://www.cfe-samr.org.cn/tzgg/202112/t20211224\\_4173.html](https://www.cfe-samr.org.cn/tzgg/202112/t20211224_4173.html)>

19 *The CFE Successfully Held an Online Communication Seminar on Recipe Registration of Infant and Young Children Milk-based Formula*, SAMR CFE, 9<sup>th</sup> May 2022, viewed 12<sup>th</sup> June 2022, <[http://www.cfe-samr.org.cn/zxdt/202205/t20220509\\_4275.html](http://www.cfe-samr.org.cn/zxdt/202205/t20220509_4275.html)>



the subsequent increased uncertainty over technical reviews and approval requirements now pose considerable challenges in terms of compliance and registration.

#### Assessment

Over the past five years, the requirements for both infant formula recipe registration and FSMP product registration have become increasingly strict and rigorous. For instance, some regulations were updated at the end of 2020 to include requirements relating to additives and control schemes for pollutants. However, the adjusted review and approval requirements have not been communicated to the industry in a timely and effective manner. Many enterprises only become aware of the new requirements when they commenced product registration review, which is the last critical step in new product development. Furthermore, enterprises may not be able to meet new requirements that come into effect while their applications are being reviewed, which will increase administrative burdens for companies and may even result in registration failures.

Prior to the preparation of product registration applications, enterprises need two to five years to conduct research and development (R&D), production testing and clinical trials, with investments running to tens of millions of Chinese yuan. Failure to publish new registration review and approval requirements in a timely manner will therefore not only result in huge challenges in the registration process for enterprises, but also waste time and resources.

In addition, innovative R&D processes may lead to issues arising that are not yet clarified in existing registration regulations. Adding an early communication mechanism among the SAMR, the CFE and industry stakeholders, so that the SAMR and the CFE can learn of R&D trends as soon as possible, would also facilitate targeted discussions on product registration issues, and help applicants to assess the feasibility of the development of innovative categories.

#### Recommendations

- Improve the registration review and approval process, and inform the industry of any new requirements in a timely manner.
- Establish a communication mechanism between the SAMR, the CFE and industry to strengthen

guidance on the R&D of FSMP, and to enhance overall communication.

- Refrain from imposing new requirements for products that have already passed technical review, following the 'principle of non-retroactivity'.
- Ensure that future production conforms to the latest requirements by accepting a future guarantee statement from companies.
- Determine raw material standards to be applied during technical review according to the time the batches for registration are produced, and only require companies to comply with the new standards post-review during production or upon expiry of the interim standard period.

### 1.2 Continue to Explore Alternative Plans for Overseas Onsite Inspection to Address Challenges Faced by Overseas Manufactures in Infant Formula and FSMP Registration

#### Concern

Manufacturers of infant and young children milk-based formula and FSMP are facing operational challenges due to both unclear regulations related to onsite inspections and the fact that the product registration process has been suspended indefinitely because onsite inspections are no longer taking place as a result of the COVID-19 pandemic.

#### Assessment

Article 13 of the *Management Measures on the Registration of Infant and Young Children Milk-based Powder Formula* states that the CFE shall conduct onsite inspections based on "actual needs".<sup>20</sup> A similar requirement for FSMP registration is prescribed in Article 11 of the 2016 *Administrative Measures for the Registration of Food for Special Medical Purpose*. Yet it remains unclear what "actual needs" means in both cases. At present, onsite inspections remain suspended due to the COVID-19 pandemic, and the authorities have neither made nor published plans for onsite inspections of overseas factories, so manufacturers cannot plan ahead. As a result, the process—from the submission of a registration to the final launch of a new product—is unpredictable. Enterprises are now at risk of failing to obtain the necessary approvals for registrations and ordinary business operations, while

<sup>20</sup> *Management Measures on the Registration of Infant and Young Children Milk-based Powder Formula*, former CFDA, 15<sup>th</sup> March 2016, viewed 20<sup>th</sup> April 2020, <[http://www.gov.cn/gongbao/content/2016/content\\_5145569.htm](http://www.gov.cn/gongbao/content/2016/content_5145569.htm)>





consumers and patients are unable to obtain the latest products in a timely manner.

Furthermore, the revised infant formula standards, including *GB 10765-2021*, *GB 10766-2021*, and *GB 10767-2021*, were released in March 2021, with a transition period of only two years. Certain FSMP standards (*General Rules for Infant Formulas for Special Medical Purposes (GB 25596-2010)* and *General Rules for Food for Special Medical Purposes (GB 29922-2013)*) are also under revision. According to industry feedback, review and approval of recipe registration of infant and young children milk-based formula and FSMP product registrations are more arduous than in previous years. Failure to restart overseas onsite inspections will have an immeasurable impact on EU infant milk-based formula and FSMP manufacturers that have been operating in China for many years, and will constitute a serious obstacle to the normal trading of infant formulas between China and Europe. It may even affect the development of EU-China relations. Consumers may also have the supply of products they love and trust being cut off.

#### Recommendations

- Clarify both the 'actual needs' for conducting onsite inspections (i.e., specify the criteria to implement an on-site inspection) and the timeline for overseas onsite inspections.
- Explore alternatives to overseas onsite inspections, such as cooperating with overseas authorities, entrusting qualified third-party organisations or considering remote inspections, so that overseas onsite inspections will not continue to be delayed due to COVID-19.
- Ensure overseas onsite inspections are carried out in an orderly fashion under the newly revised national food safety standards related to infant formula.

### 1.3 Publish the Criteria for Differences in FSMP Formulas with Regard to Registration Review

#### Concern

When a company submits registration applications for multiple FSMP products, it is often requested to provide evidence of significant difference among the product recipes, though the requirement on difference is not

specified in the registration regulation and the criteria for such differences are not published in any official guidelines, causing uncertainty among enterprises.

#### Assessment

FSMP are designed to meet the specific nutritional needs of people with dietary restrictions, digestion and absorption disorders, metabolic disorders or certain diseases. In clinical use, these products are already diversified based on individual patient needs and their different medical conditions. It is essential to introduce a greater variety of safe and high-quality FSMP into the Chinese market to meet the various needs of patients and clinicians. This would also contribute to the development of China's FSMP industry, paving the way for highly personalised products and services. However, the current review process for different recipes is unclear, which creates uncertainties, increases costs and discourages companies from providing a greater variety of FSMP products for Chinese patients. For enterprises to be able to develop their products and apply for registration with less uncertainty, the criteria for formula differentiation need to be clarified and published officially.

#### Recommendation

- Clarify the requirements for formula differentiation or formula upgrades of FSMP, and issue relevant guidelines as soon as possible.

### 1.4 Establish a 'Green Channel' for the Registration and Approval of FSMP Products for Rare Diseases

#### Concern

The rate at which FSMP products for rare diseases are registered and approved in China is very slow, which prevents patients from obtaining the latest products in a timely manner.

#### Assessment

##### 1) Registration challenges

For FSMP used for patients with rare diseases, such as congenital metabolism defects, the content of specific nutrients included is usually strictly controlled. Such products are also subject to strict restrictions regarding the use of shared production lines. However, due to the low yield of FSMP, it is expensive for companies to provide dedicated production facilities for such





products. For foreign companies, the output of one factory can usually meet the needs of many countries, and it is not conducive to the commercialisation of products if formulas must be developed according to the regulations of each country. In addition, Chinese registration regulations require trial production and stability testing of three commercial batches for each formula, the costs of which can be higher than the potential return on product sales in China.

Most Chinese enterprises are reluctant to register FSMP due to the high costs, and would rather produce and sell the goods as non-FSMP. This means that patients who rely on such foods for long-term treatment can only access those that are not strictly regulated. As such food products become subject to stricter regulation, many patients will struggle to obtain the products they rely on, which may cause a deterioration of their health.

Furthermore, in China, rare diseases, other than phenylketonuria, are not included in new-born screening, therefore treatment costs are non-reimbursable through the basic medical insurance, compounding the lack of incentive for companies to register related products as FSMP.

### 2) Slow local implementation of pilot policies

Some local governments allow the import of foreign FSMP that are not yet registered in China for urgent use by those with rare diseases. However, the implementation of such policies is slow and lacks transparency. In addition, insufficient communication between central and local governments results in local governments still being constrained by the current administrative measures on FSMP.

### 3) Unclear import procedures for donation

During the COVID-19 pandemic, FSMP was in short supply in China. European companies hoped that donations of products would solve this problem. However, due to the absence of written regulations on donations, there were many problems in the process and the products are still unable to enter the country, despite government support for such donations.

### Recommendations

- Revise the *Administrative Measures for the Registration of Food for Special Medical Purpose* to reflect the actual development of the sector, and conduct priority reviews and approvals of

applications from such special channels for FSMP for subjects with rare diseases such as congenital metabolism defects.

- Strengthen communication among central and local governments, and the industry.
- Promote the implementation of pilot policies at the local level and allow conditional approvals of overseas marketed FSMP to be used by those with rare diseases.
- Develop documentation for approving and managing the donation of FSMP for use by those with rare diseases.
- Accelerate the review and approval of FSMP for rare diseases on the basis of ensuring the safety, effectiveness and quality control of the approved FSMP, so that patients can obtain reliable treatment as soon as possible.

## 2. Continue to Fine-tune National Food Safety Standards Related to FSMP to Ensure the Smooth Transition of Product Registration under New Standards

### Concern

The current development and timeline for the revision of national food safety standards for FSMP are unclear, causing uncertainty among enterprises regarding registration renewals and the re-registration of products.

### Assessment

#### 1) Introduction of new standards and administrative measures

Both the *National Food Safety Standard – General Rules for Infant Formulas for Special Medical Purposes (GB 25596-2010)* released in 2010,<sup>21</sup> and the *National Food Safety Standard – General Rules for Food for Special Medical Purposes (GB 29922-2013)* released in 2013,<sup>22</sup> are currently under revision. The *Administrative Measures for the Registration of Food for Special Medical Purposes*, released in 2016,<sup>23</sup> is also under amendment.

21 *National Food Safety Standard – General Rules for Infant Formulas for Special Medical Purposes (GB 25596-2010)*, former MOH, 21<sup>st</sup> December 2010, viewed 20<sup>th</sup> April 2022, <<http://www.nhc.gov.cn/sps/s7891/201012/539e2314f74b402696c44e0906aa9ef1.shtml>>

22 *National Food Safety Standard – General Rules for Food for Special Medical Purposes (GB 29922-2013)*, former NHFPC, 26<sup>th</sup> December 2013, viewed 20<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/EC073419-CC4C-463E-9BA2-8372D034396C.html>>

23 *Administrative Measures for the Registration of Food for Special Medical Purposes*, former CFDA, 7<sup>th</sup> March 2016, viewed 24<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2016/content\\_5076983.htm](http://www.gov.cn/gongbao/content/2016/content_5076983.htm)>





It takes quite a long time for a company to develop FSMP products, which is exacerbated by China's lengthy registration process. To register a product in China, a company needs to provide sufficient medical evidence to prove that the formula is designed for certain special disease types, as well as to conduct clinical trials and facilitate onsite inspection of its production facilities in China or overseas. As onsite inspections are currently not taking place due to the pandemic, and the timeline for the introduction of new standards and further details of the revised administrative measures also remain unclear, companies face a great deal of uncertainty when developing and registering their products. As a result, products registered under new national standards will not be launched as scheduled, leading to a supply shortage.

On 5<sup>th</sup> August 2021, the SAMR's CFE released the *Frequently Asked Questions and Answers for Registration of Food Formulas for Special Medical Purposes (Q&A)*<sup>24</sup> to elaborate on the registration requirements for FSMP products. However, the Q&A includes additional requirements for general nutrient-complete products to those in the published registration regulations and secondary documents. On 18<sup>th</sup> October 2021, the SAMR issued the *Administrative Measures for Registration of Food Formulas for Special Medical Purposes (Draft for Public Comments) (Administrative Measures)*.<sup>25</sup> The draft, which aims to improve the process, included the additional requirements introduced in the Q&A. Due to the tightening of registration requirements and the time needed to develop new formulas in accordance with the new national standards, the *Administrative Measures* and its supporting secondary documents should be promulgated urgently.

## 2) FSMP designed for specific diseases

The *Administrative Measures* specify that applications for the registration of specific nutritional formulas should include clinical study reports. The measures apply to 13 disease-based FSMPs, yet only three relevant clinical study guidelines have been issued so far, with little practical information provided on the requirements or

process. Clinical trials are costly and time-consuming. In addition, the feasibility of clinical trials varies with each product and are therefore complicated in terms of trial design and selection of subjects. As registrations for disease-based FSMPs are still at a very early stage, enterprises are concerned that their clinical studies may not meet the registration requirements, which would result in a waste of resources and increased costs. Furthermore, as there are currently very few product registration applications for specific disease types, the amount of products that will be successfully registered is unlikely to meet the huge demand among patients in China.

Currently, *GB 29922-2013* is also in the process of being revised, with certain adjustments made to the original categorisation of specific diseases. This will inevitably lead to changes to requirements of relevant clinical trials.

The changes to both documents will have a significant impact on the registration review of products for specific diseases, which is causing concern among the industry.

### Recommendations

- Accelerate the revision of new national standards and clarify the timeline for their introduction as soon as possible.
- Accelerate the revision of the *Administrative Measures for the Registration of Food for Special Medical Purposes*.
- Establish a sufficient transition period for new national standards for FSMP, taking into account the cycle from product development to product launch.
- Fine-tune old standards' indicators to form new standards based on the safe use of special medical products already registered and marketed.
- Investigate the necessity and feasibility of conducting clinical trials for the registration of FSMP products for specific diseases, and give clear guidance to companies.

## 3. Optimise the Requirements for Clinical Trials of FSMP

### 3.1 Rationalise the Requirements Imposed on Trial Participants

#### Concern

Uniform clinical trial requirements are not suitable for

<sup>24</sup> *Frequently Asked Questions and Answers for Registration of Food Formulas for Special Medical Purposes*, SAMR CFE, 25<sup>th</sup> August 2021, viewed 18<sup>th</sup> May 2022, <[http://www.cfe-samr.org.cn/tzgg/202108/t20210825\\_3873.html](http://www.cfe-samr.org.cn/tzgg/202108/t20210825_3873.html)>

<sup>25</sup> *Administrative Measures for Registration of Food Formulas for Special Medical Purposes (Draft for Public Comments)*, SAMR, 18<sup>th</sup> October 2021, viewed 18<sup>th</sup> May 2022, <[https://www.samr.gov.cn/hd/zjdc/202110/t20211018\\_335729.html](https://www.samr.gov.cn/hd/zjdc/202110/t20211018_335729.html)>





diversified FSMP products, and therefore clinical trial regulations must be reassessed and revised.

#### Assessment

Due to ethical concerns over age and selection criteria, certain difficulties may arise when clinical trials involving paediatric patients are launched, especially large-scale trials. The *Announcement on the Technical Guiding Principles for Paediatric Populations in Drug Clinical Trials (No. 48 of 2016)* clearly stipulates that in designing clinical trials for drugs used in paediatric populations,<sup>26</sup> the principle of “smallest sample size, fewest specimens and least pain” shall be observed, while ensuring all evaluation needs are met. Based on these guiding principles, application channels need to be provided for exemption of clinical trials or reduction of the number of cases required for clinical trials in a paediatric population.

For instance, the specifications for the category ‘food protein intolerance’ of FSMP in the *National Food Safety Standard General Rules for Food for Special Medical Purposes (GB 29922-2013)* is similar to that of the category ‘FSMP for infants (0–12 months) with milk protein allergies’ in *National Food Safety Standard Infant Food for Special Medical Purposes (GB 25596-2010)*. As clinical studies are not required for the registration of infant FSMP, it should also not be required for the registration of hypoallergenic formulas for toddlers over a year old. Moreover, as infants aged from 6–12 months and young children over one year old have started eating other foods, FSMP clinical studies on this population are increasingly difficult to carry out due to increased diet diversity.

In order to obtain the necessary sample size for rare disease clinical trials, a relatively long clinical trial cycle is needed, due to low morbidity, the difficulties for patients to join such trials and the relatively high dropout rate. Furthermore, such disease-specific FSMP are always in demand by clinical patients and cannot be replaced by normal FSMP.

#### Recommendations

- Waive clinical trials or conduct post-marketing clinical data collection for hypoallergenic formulas

for toddlers over one year old.

- Provide relevant data, establish a method for exemption from conducting clinical trials, allow a reduction in the use of clinical trial cases or conduct clinical research after marketing for populations under the age of 10 and subjects with rare diseases, to ensure the proper use of clinical trial resources and to satisfy the needs of special groups.
- Accept the normal diet as a control group, and either the ‘before and after’ comparison of one patient, or the comparison with standard normal growth, instead of mandating parallel controlled clinical trials.
- Establish a channel for consultations on clinical trial design prior to registration review, allowing companies to discuss experimental designs with review institutions before conducting clinical trials

### 3.2 Adjust the Evaluation Indicators in Clinical Trials to Reflect the Features of FSMP Products

#### Concern

Requirements for clinical trials as the secondary documents of the 2016 *Administrative Measures for the Registration of Food for Special Medical Purposes* for 13 disease-specific FSMPs provide barely any scientific or objective reflections of the actual effectiveness of such products in nutritional therapy for patients.

#### Assessment

When establishing clinical regulations, it is important that scientific and clinical research are combined to design a reasonable evaluation plan that conforms to a patient’s usage habits, rather than simply adopting the clinical trial method used in medicine and non-inferiority of effectiveness indicators.

For example, for renal-specific formulas, ordinary nutrient-complete formula cannot be used as a control group in the clinical study process, as patients with kidney disease are required to avoid or reduce the intake of certain nutrients or ingredients, such as protein, potassium, calcium and phosphorus. Ordinary nutrient-complete formula is therefore not suitable for such patients to use long-term as it increases health risks, especially for outpatients for whom the daily dosage cannot be controlled.

<sup>26</sup> *Announcement of CFDA About the Release of Technical Guiding Principles for Paediatric Populations in Drug Clinical Test (No. 48 [2016])*, CFDA, 7<sup>th</sup> March 2016, viewed 14<sup>th</sup> July 2022, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20160307164401912.html>>





Most imported disease-based FSMPs currently on the China market have been sold in many other markets for several years and have been clinically observed during that time. The industry recommends recognising foreign clinical trial data for products that meet Chinese national food safety standards without requiring any adjustments, to avoid wasting resources by repeating clinical trials in China.

#### Recommendations

- Study the effects of renal-specific formulas by using before/after comparisons (i.e., single-arm) or by comparing with renal-specific formulae marketed overseas.
- Consider the fact that FSMPs are only clinical nutritional support products, and design reasonable clinical observation indicators.
- Allow the sharing of clinical trials data on functional-equivalent (solid/liquid) formulas.

#### 4. Encourage the Expansion of FSMP Market Access Channels, Standardise Post-market Supervision and Improve Public FSMP Education

##### Concern

Despite being an emerging food category, the development of the FSMP industry in China over the past decade has been slow, which is partly a result of strict regulations and restrictions on product standards, registration technical reviews, onsite inspections, and advertising and promotion.

##### Assessment

China's 'dual-track system' for the registration of FSMP has a serious impact on specific nutrient-complete products suitable for people with specific disease conditions.<sup>27</sup> Under the current regulations, it takes more than five years to complete the registration process. This factor, combined with product development costs, results in few specific nutrient-complete FSMP products being launched in the Chinese market. Those currently being sold are old products certified before 2009 as 'enteral nutrition preparations'. Therefore, very few hospitals are familiar with 'specific nutrient-complete

products', and most clinicians still consider such products as enteral nutrition preparations.

FSMP needs to be used under the guidance of doctors or clinical nutritionists, so should be marketed mainly through healthcare institutions and pharmacies, in line with international standards. However, FSMP products face significant challenges in circulation and application in healthcare facilities and clinical use in China. FSMP, health foods, functional beverages and general foods are all available in hospitals' nutrition department (canteen), yet, although companies invest a lot of resources in product registration, approved FSMP does not have an edge over other foods in hospitals. Moreover, healthcare professionals are unable to prescribe FSMP because it is not listed in the current healthcare prescription system, and pharmacies are unable to sell FSMP products due to business licensing restrictions and medical insurance compensation rules.

The *Interim Measures for the Administration of Advertisements on Drugs, Medical Devices, Dietary Supplements and FSMP* specify that the marketing and advertising of general nutrient-complete FSMP products must follow the same policy for over-the-counter drugs, and disease-specific FSMP must be regulated in the same way as prescription drugs.<sup>28</sup> Such strict limitations give consumers an overall impression that FSMP are closely related to drugs, which is compounded by the presence of similar products in the market, such as health foods, functional drinks and protein drinks. The variety of product categories makes it more difficult for consumers to decide which product to use.

Promotion and advertising restrictions also affect product distribution. According to related regulations, general nutrient-complete FSMP products are permitted to be sold in regular supermarkets. However, the lack of public awareness of such products leads to low consumer demand, while distribution costs are high, which hinders supermarket sales. Failure to market in busy supermarkets impacts the ability to raise awareness of such products. In the long run, this endless loop results in poor market development of such products.

<sup>27</sup> Before the category of FSMP was officially introduced in China in 2013, and the registration system established in 2016, certain FSMP products were registered as drugs. In China's current health system, certain products are still registered and regulated as drugs, while others are registered as FSMP.

<sup>28</sup> *Interim Measures for the Administration of Advertisements on Drugs, Medical Devices, Dietary Supplements and FSMP*, SAMR, 24<sup>th</sup> December 2019, viewed 20<sup>th</sup> April 2022, < [https://gkml.samr.gov.cn/nsjg/fgs/201912/t20191227\\_309564.html](https://gkml.samr.gov.cn/nsjg/fgs/201912/t20191227_309564.html)>





### Recommendations

- Take comprehensive efforts to improve management, policy and regulation, and follow-up supervision, as well as to raise public awareness, to promote development of the FSMP industry in China.
- Include special medical products in the national medical charging system so as to provide more and better choices for nutritional support treatment for the majority of patients.

## 5. Establish an Appropriate Regulatory Framework to Supervise the Retail Marketing of 0–12-months Infant Formula and Provide a Detailed Plan to Effectively Encourage Breastfeeding

### Concern

The lack of a framework to standardise and regulate the marketing of formulae for infants aged 0–12 months in retail channels may have an adverse influence on the protection and promotion of breastfeeding.

### Assessment

On 15<sup>th</sup> November 2021, the NHC released the *Breastfeeding Promotion Action Plan (2021–2025)*,<sup>29</sup> which requires that, by 2025, the national breastfeeding rate for infants aged 0–6 months should exceed 50 per cent. To achieve this goal, the NHC plans to enforce two tasks, "improving the policy system to build a breastfeeding support environment; and strengthening industry supervision and effectively cracking down on violations of laws and regulations that endanger breastfeeding."

Improper advertising and promotion of infant formulas may mislead mothers to give up breastfeeding prematurely, adversely affecting the breastfeeding rate. China lacks a framework and specific implementation plan to regulate and standardise the marketing of 0–12 months infant formulas in retail channels. Relying only on the self-discipline of companies is not enough to prevent inappropriate or illegal behaviour in the market, such as providing pregnant women with free infant formula samples and promoting infant formulas to parents through stores.

### Recommendations

- Modify the *Administrative Measures for the Sale of Breast Milk Substitutes* in accordance with existing nutritional and health conditions in China, and in a way consistent with the prohibitions on inappropriate promotion of 0–12-months infant formula as set out in China's Advertising Law.
- Establish appropriate norms and regulatory frameworks through the SAMR and provide detailed plans and enforcement programmes to prevent and detect inappropriate advertising and promotion of 0–12-months infant formula in retail channels to effectively protect breastfeeding.

## Abbreviations

CFDA	China Food and Drug Administration
CFE	Centre for Food Evaluation
FSMP	Food for Special Medical Purpose
GACC	General Administration of Customs of China
MOH	Ministry of Health
NHC	National Health Commission
NHFPCC	National Health and Family Planning Commission
R&D	Research and Development
SAMR	State Administration for Market Regulation

<sup>29</sup> Notice on Printing and Distributing the *Breastfeeding Promotion Action Plan (2021–2025)*, NHC, 15<sup>th</sup> November 2021, viewed 15<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-11/24/content\\_5653169.htm](http://www.gov.cn/zhengce/zhengceku/2021-11/24/content_5653169.htm)>





# Automotive Working Group

## Key Recommendations

### 1. Unify Policies Related to Vehicle Data Security Administration and Permit Cross-border Transfer of Data for Research Purposes

- Ensure implementation of the upcoming automotive data security management system is fully coordinated among the Cyberspace Administration of China (CAC), the Ministry of Industry and Information Technology and other government agencies, to avoid regulatory overlaps.
- Ensure that the automotive data security management system is developed with a global perspective in line with the international development of the automotive industry.
- Improve legislation related to cross-border data transfer and enable secure, adequate and steady cross-border transfers under the premise of ensuring data security.
- Give opportunities to foreign automotive companies to assist the CAC and other agencies in developing policies related to automotive data and information security.

### 2. Create a Predictable, Non-discriminative and Balanced Legislative Environment that is Conducive to the Sustainable Development of New Energy Vehicles (NEVs)

#### Policy transparency and predictability

- Ensure international automotive manufacturers can participate in the drafting and revision of new policies and regulations.
- Provide lead time of at least four to five years for automotive manufacturers to plan and react to released policies and planning documents.

#### Equal treatment

- Provide the same incentives and equal rights for imported and locally produced NEVs.
- Ensure technology neutrality without distinction between electric vehicle classes, as well as equal access to registration plates at the regional level.

#### Decarbonisation

- Provide ample lead time when designing the decarbonisation roadmap for the automotive industry.
- Calculate separately the emissions of upstream and downstream suppliers to provide additional incentives to decarbonise.
- Allow reimbursement or other incentives for proven decarbonisation initiatives.
- Enable utility companies to offer private renewable energy charging solutions.
- Develop whole-life-cycle carbon emission regulations that highlight the individual development status of each phase in the lifecycle.

#### Incentives (national level)

- Extend the 2020–2022 NEV subsidies and purchase tax exemption (PTE) to 2025.
- Maintain existing technical requirements and the current policy in order to mitigate the impact on the NEV market.
- Ensure models that have been approved and listed in the tax exemption list are still eligible for PTE even after new taxation policies have been released.



**Licence plate quotas and restrictions (local level)**

- Prohibit local governments from issuing fragmented implementation measures and unique requirements that restrict the purchase of NEVs.
- Enhance local incentive measures, for example by lifting licence plate quota.

**Charging infrastructure**

- Enhance standards related to charging infrastructure to keep pace with NEV development.
- Harmonise standards with in-use pillars and new generation pillars.
- Coordinate charging infrastructure development with green energy, power grids and vehicles.
- Harmonise the standards of high-power charging, including fast-charging.
- Encourage private wall-box installations in residential compounds.

**NEV credits**

- Consult with the industry in advance to avoid setting policy goals or management measures related to dual credits for 2024 and 2025 that are too aggressive, and give enterprises enough lead time to make plans.
- Release the plan for dual credits and carbon emissions as early as possible so that enterprises have enough time to prepare for compliance.

**3. Establish a Consistent, Transparent and Friendly Legislative and Policy Environment to Promote Intelligent and Connected Vehicle (ICV) Development**

- Improve the legal and standards system and gradually abolish institutional obstacles for the development of ICVs.
- Ensure consistency, non-discrimination and appropriateness of market access laws, regulatory systems and technical requirements related to ICVs.
- Clearly define the responsibilities of government agencies in charge of regulating ICVs, to avoid over-burdening companies due to regulatory overlaps.
- Optimise the policy environment to ensure that foreign-invested enterprises (FIEs) can fully participate in the legislative process.
- Allow FIEs the same access, including voting rights, as domestic automotive brands in standards and technical committees related to ICVs.
- Amend the high-definition mapping regulations.
- Reasonably liberalise the cross-border flow of automotive data and support enterprises to improve intelligent connectivity technologies with global research and development capabilities.
- Provide enough lead time for automotive manufacturers to implement ICV regulations.

**4. Commercial Vehicles****4.1 Recognise Optimised Vehicle Specifications in the Regulations of Commercial Vehicles (CVs) **

- Involve the automotive industry early in the process of drafting and updating regulations for CVs.
- Implement only one national standard covering CVs.
- Publish recommended standards (GB/T) and industry standards under the World Trade Organization/Technical Barriers to Trade publication system as mandatory standards.
- Grant sufficient lead time for manufacturers to adapt to new regulations.
- Unify market access requirements and implementation procedures.
- Simplify the registration process for the issuance of transport licences.





#### 4.2 Minimise the Carbon Footprint of CVs by Harmonising Fuel Consumption and Emissions Regulations Among Ministries and by Measuring Fuel Consumption in Relation to Payload

- Use *GB 1589-2016* to optimise transport units in cities and to strive for long vehicle combinations.
- Implement proper road classification and allow for different lengths and gross combination weight, depending on road and bridge conditions.
- Amend standard *GB 1589-2016* to allow for more than six axles.
- Calculate the carbon footprint of vehicles as carbon dioxide (CO<sub>2</sub>) emissions (energy consumption) per tonne per kilometre.
- Include in government plans and roadmaps the use of biofuel by CVs to reduce CO<sub>2</sub> emissions.

#### 4.3 Allow Longer Vehicle Combinations to Increase Transport Efficiency

- Complete the development of the long vehicle combination standard as soon as possible.

### 5. Motorcycles

#### 5.1 Rescind the 13-year ‘Shelf Life’ Limitation for Motorcycles in China

- Lift the mandatory scrapping requirement for motorcycles, and adopt annual inspections of motorcycles used for 13 years, so as to extend their service life.

#### 5.2 Open to Motorcycles All Roads that Permit Four-wheeled Vehicles, Including Highways

- Further refine the limitations and restriction areas for motorcycles, open highways to motorcycles over 250 cubic centimetres (cc), and effectively enforce national laws regarding roads and highways.
- Perform category-based administration of motorcycle plate number and driver's licence examination according to motorcycle displacement range, with electric motorcycles corresponding to the levels per motor output power.
- Encourage the development of motorcyclist retraining institutions to educate users on safety and environmental protection after they obtain a driver's licence.

## Introduction to the Working Group

The Automotive Working Group is composed of European manufacturers and importers of passenger vehicles, commercial vehicles (CVs), motorcycles, automotive components including tyres, special vehicles and automation systems. The Automotive Working Group has more than 100 members and works closely with the Auto Components Working Group, which consists of more than 80 European companies involved in the manufacture of automotive components, machine tools to produce automotive components and automotive assembly lines. The core members of the Automotive Working Group are also members of the Automobile Associations of the European Union (EU) and individual EU Member States.

The working group actively maintains communication with government authorities on topics of market access, creation of technical standards, unified regulatory benchmarks, fair competition and improving the business environment.

## Recent Developments

On 22<sup>nd</sup> July 2021, the State Administration for Market Regulation (SAMR) promulgated the *Provisions on Liabilities for the Repair, Replacement and Return of Household Automotive Products*,<sup>1</sup> which took effect on 1<sup>st</sup> January 2022. The provisions put forward more stringent requirements relating to operators' three warranty services ('3Rs-warranty policy'), expanding the

<sup>1</sup> *Provisions on Liabilities for the Repair, Replacement and Return of Household Automotive Products*, SAMR, 22<sup>nd</sup> July 2021, viewed 15<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-07/27/content\\_5627788.htm](http://www.gov.cn/zhengce/zhengceku/2021-07/27/content_5627788.htm)>





warranty scope to include new energy vehicles (NEVs), and further improving the overall regulatory system.

On 16<sup>th</sup> August 2021, the Cyberspace Administration of China (CAC), together with the National Development and Reform Commission (NDRC), the Ministry of Industry and Information Technology (MIIT), the Ministry of Public Security (MPS) and the Ministry of Transport (MOT), jointly issued the *Several Provisions on the Management of Automobile Data Security (Trial Provisions)*,<sup>2</sup> laying down rules for regulating the processing of automotive data, protecting the legitimate rights and interests of individuals and organisations, safeguarding national security and social public interests, and promoting the reasonable development and utilisation of automotive data. To support the implementation of the *Trial Provisions*, the National Information Security Standardisation Technical Committee (TC260) issued a technical document, *TC260-001 Security Guidelines for Processing Vehicle Collected Data* on 8<sup>th</sup> October 2021,<sup>3</sup> refining the requirements of the *Trial Provisions* regarding the transmission, storage and cross-border transfer of automotive data, and providing guidelines for implementing certain *Trial Provisions* principles.

On 27<sup>th</sup> December 2021, the NDRC and the Ministry of Commerce (MOFCOM) jointly released the *Special Administrative Measures for Foreign Investment Access (Negative List) (2021 Edition)*,<sup>4</sup> and the *Special Administrative Measures for Foreign Investment Access in Pilot Free Trade Zones (Negative List) (2021 Edition)*.<sup>5</sup> Following the removal of ownership restrictions as well as restrictions on the number of joint ventures foreign entities can enter into, foreign automotive manufacturers will now be able to work with their Chinese partners to formulate appropriate investment and development strategies, integrate global resources and enhance the efficiency of their operations.

2 *Several Provisions on the Management of Automobile Data Security (Trial)*, CAC, NDRC, MIIT, MPS & MOT, 16<sup>th</sup> August 2021, viewed 15<sup>th</sup> April 2022, <[http://www.cac.gov.cn/2021-08/20/c\\_1631049984897667.htm](http://www.cac.gov.cn/2021-08/20/c_1631049984897667.htm)>

3 *TC260-001 Security Guidelines for Processing Vehicle Collected Data*, NISSTC, 8<sup>th</sup> October 2021, viewed 15<sup>th</sup> April 2022, <<https://www.tc260.org.cn/front/cbw.html?start=0&length=4&type=6>>

4 *Special Administrative Measures for Foreign Investment Access (Negative List) (2021 Edition)*, NDRC and MOFCOM, 27<sup>th</sup> December 2021, viewed 15<sup>th</sup> April 2022, <[https://www.ndrc.gov.cn/xxgk/zcfb/fzggw/202112/t20211227\\_1310020.html?code=&state=123](https://www.ndrc.gov.cn/xxgk/zcfb/fzggw/202112/t20211227_1310020.html?code=&state=123)>

5 *Special Administrative Measures for Foreign Investment Access in Pilot Free Trade Zones (Negative List) (2021 Edition)*, NDRC and MOFCOM, 27<sup>th</sup> December 2021, viewed 15<sup>th</sup> April 2022, <[https://www.ndrc.gov.cn/xxgk/zcfb/fzggw/202112/t20211227\\_1310019.html?code=&state=123](https://www.ndrc.gov.cn/xxgk/zcfb/fzggw/202112/t20211227_1310019.html?code=&state=123)>

The *2022 Notice on the Financial Subsidies Policy for Promoting New Energy Vehicles* was jointly issued on 31<sup>st</sup> December 2021 by the Ministry of Finance (MOF), the MIIT, the Ministry of Science and Technology (MOST) and the NDRC.<sup>6</sup> The *Notice* states that the previous subsidy policy on purchases of NEVs will expire on 31<sup>st</sup> December 2022, after which no subsidies will be provided. This is welcomed by the working group, as it means that new imported NEVs will be able to compete on a more level footing with domestic NEVs.

On 10<sup>th</sup> January 2022, the NDRC and other government departments issued the *Implementation Opinions on Further Enhancing the Service Guarantee Capability of Electric Vehicle Charging Infrastructure*.<sup>7</sup> According to the *Opinions*, by the end of the 14<sup>th</sup> Five-year Plan period, China aims to build an electric vehicle charging infrastructure network capable of meeting the demands of over 20 million such vehicles, in order to support the development of the NEV industry and to realise the country's carbon peak and neutrality goals.

Equipment Industry Division I of the MIIT issued the *2022 Work Guidelines on Automotive Industry Standards* on 18<sup>th</sup> March 2022.<sup>8</sup> The document provides detailed plans for setting standards in nine fields, including NEVs, intelligent and connected vehicles (ICVs), automotive chips, carbon emissions, traditional vehicles and vehicle parts, among others. The working group hopes that Chinese and European standards organisations and automobile manufacturers can enter into deeper collaboration on cutting-edge automotive technologies, especially the areas of intelligent connectivity, and energy saving and carbon neutrality.

## Key Recommendations

### 1. Unify Policies Related to Vehicle Data Security Administration and Permit Cross-border Transfer of Data for Research Purposes

#### Concern

Various pieces of legislation relating to vehicle data

6 *2022 Notice on The Financial Subsidies Policy for Promoting New Energy Vehicles*, MOF, MIIT, MOST and NDRC, 31<sup>st</sup> December 2021, viewed 15<sup>th</sup> April 2022, <[http://jjs.mof.gov.cn/zhengcefaqu/202112/t20211231\\_3780322.htm](http://jjs.mof.gov.cn/zhengcefaqu/202112/t20211231_3780322.htm)>

7 *Implementation Opinions on Further Enhancing the Service Guarantee Capability of Electric Vehicle Charging Infrastructure*, NDRC, 10<sup>th</sup> January 2022, viewed 15<sup>th</sup> April 2022, <[http://jjs.mof.gov.cn/zhengcefaqu/202112/t20211231\\_3780322.htm](http://jjs.mof.gov.cn/zhengcefaqu/202112/t20211231_3780322.htm)>

8 *2022 Work Guidelines on Automotive Industry Standards*, MIIT, 18<sup>th</sup> March 2022, viewed 15<sup>th</sup> April 2022, <[https://www.miit.gov.cn/jgsj/zby/qcgy/art/2022/art\\_b703341da41a49c682a7c878c868dccb.html](https://www.miit.gov.cn/jgsj/zby/qcgy/art/2022/art_b703341da41a49c682a7c878c868dccb.html)>





security have been imposed by different regulators without a full understanding of the industry, resulting in official policy interpretations that are too vague to properly guide the industry towards compliance.

### Assessment

The three highest-level data laws pertaining to data security in China, the Cybersecurity Law, the Data Security Law and the Personal Information Protection Law, have already come into effect.<sup>9,10&11</sup> The *Several Provisions on the Management of Automobile Data Security (Trial) (Provisions)* on the management of automotive data security has also been released and implemented. Although companies involved in automobile production, sales, operations and maintenance need precise guidance on the specific information to be reported, as well as related procedures, the CAC has not yet published standardised report templates and procedures for the annual automotive data security management required by the *Provisions*. In practice, there have been circumstances where local authorities in different regions are unable to specify report requirements, or where two authorities in the same area—for example, the CAC in Shanghai and Shanghai Communications Administration—have different requirements for annual report submissions.

Because data flow is the basis of a data economy, it is essential that authorities consider the balance between regulatory needs and innovation when formulating data regulations for the automotive industry. Data needed for automobile research and development (R&D), as well as personal information and vehicle data that does not contain sensitive information, should be allowed to flow freely, as long as they do not endanger national security and has been anonymised. Immediate remote assistance from engineers outside the country is often required to analyse and solve problems under emergency circumstances, such as car accidents; therefore, a special process should be allowed where data that needs to be sent overseas in order to ensure vehicle and user safety is exported first and approved later.

9 Cybersecurity Law, Standing Committee of the National People's Congress (NPCSC), 7<sup>th</sup> November 2016, viewed 15<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2016-11/07/content\\_5129723.htm](http://www.gov.cn/xinwen/2016-11/07/content_5129723.htm)>

10 Data Security Law, NPCSC, 10<sup>th</sup> June 2021, viewed 15<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-06/11/content\\_5616919.htm](http://www.gov.cn/xinwen/2021-06/11/content_5616919.htm)>

11 Personal Information Protection Law, NPCSC, 20<sup>th</sup> August 2021, viewed 15<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-08/20/content\\_5632486.htm](http://www.gov.cn/xinwen/2021-08/20/content_5632486.htm)>

The relevant Chinese authorities should also actively communicate and coordinate with industry players, including international automotive companies, when formulating related policies, to ensure they are complete, scientific and appropriate when implemented.

### Key Recommendations

- Ensure implementation of the upcoming automotive data security management system is fully coordinated among the CAC, the MIIT and other government agencies to avoid regulatory overlaps.
- Ensure that the automotive data security management system is developed with a global perspective, in line with the international development of the automotive industry.
- Improve legislation related to cross-border data transfer and enable secure, adequate and steady cross-border transfers under the premise of ensuring data security.
- Give opportunities to foreign automotive companies to assist the CAC and other agencies in developing policies related to automotive data and information security.

## 2. Create a Predictable, Non-discriminative and Balanced Legislative Environment that is Conducive to the Sustainable Development of NEVs

### Concern

The lack of transparency and equal treatment in policy implementation, combined with stricter requirements on the supply side and the lack of clarity on the demand side, creates uncertainty for NEV developers.

### Assessment

#### Policy transparency and predictability

As product decisions need to be made several years ahead of the launch of new NEV models, it is important that the government ensures policy transparency and early industry involvement before introducing new policies. Manufacturers need long-term policies that are clearly communicated, so, in the absence of a predictable way to determine whether a NEV product will be able to fulfil new regulatory requirements, original equipment manufacturers (OEMs) will remain cautious about investing in and developing new models.

### Equal treatment

There is a trend towards abandoning 'technology





neutrality', as the government is only promoting electric cars. For example, some provinces and municipalities have introduced different licence plate policies for battery electric vehicles (BEVs) and plug-in hybrid electric vehicles (PHEVs). Both BEVs and PHEVs play vital roles in electrification of the automotive industry and should be treated equally. NEV policies should therefore be consistently implemented nationwide without special local requirements.

### Decarbonisation

China's 14<sup>th</sup> Five-year Plan provides some general guidance towards achieving peak carbon by 2030,<sup>12</sup> but lacks the level of specificity required by the automobile industry. Similarly, China's '1+N' policy framework for achieving peak carbon and carbon neutrality is of great significance to automotive manufacturers,<sup>13&14</sup> but a clear roadmap with concrete solutions for achieving the 2030 goals is yet to be developed. Adding to the challenge of developing practical solutions, policymakers often have a limited understanding of company operations (for more on this issue, please refer to the *Carbon Neutrality* report published by the European Chamber).<sup>15</sup> To achieve carbon neutrality in the automotive industry, synergies with upstream and downstream suppliers are necessary for developing a policy for zero-emission cars.

For both public and private charging in China, it is currently unclear how to access renewable energy (RE) and how to trace its use for emissions calculation purposes. Most provinces lack a policy that allows utility companies to directly sell RE to charging station operators. In terms of life-cycle assessments, attempts to draft regulations on whole-life-cycle carbon emissions are delayed due to a lack of alignment among relevant Chinese authorities.

### Incentives (national level)

According to the *Announcement on the Policy of*

12 *Outline of the 14<sup>th</sup> Five-year Plan for National Economic and Social Development of the People's Republic of China and the Long-term Vision for 2035*, State Council, 13<sup>th</sup> March 2021, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592681.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm)>

13 *Opinions of the Central Committee of the Communist Party of China and the State Council on the Complete and Accurate Implementation of the New Development Concept and Good Performance of Carbon Peak and Carbon Neutral Work*, CPC and State Council, 22<sup>nd</sup> September 2021, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/2021-10/24/content\\_5644613.htm](http://www.gov.cn/zhengce/2021-10/24/content_5644613.htm)>

14 *What is the '1' in the '1+N' policy system of carbon neutrality and carbon peaking?*, QQ.com, 26<sup>th</sup> October 2021, viewed 10<sup>th</sup> April 2022, <<https://new.qq.com/omn/20211026/20211026A095MJ00.html>>

15 *Carbon Neutrality: The Role of European Business in China's Race to 2060*, European Union Chamber of Commerce in China, 25<sup>th</sup> May 2022, viewed 10<sup>th</sup> June 2022, <<https://www.eurochamber.com.cn/en/publications-archive/974>>

*Exemption From Vehicle Purchase Tax for NEVs*, purchase tax exemption (PTE) incentives will end at the end of 2022.<sup>16</sup> The adoption of NEVs by the consumers is important for China to achieve its decarbonisation targets. The withdrawal of tax exemptions and other incentive policies for consumers risks undermining the NEV market. Therefore, to support development of the NEV industry, the working group recommends extending PTE until 2025. In addition, the working group recommends changing the method for deciding and announcing thresholds for granting PTE. Currently, the MIIT releases technical requirements for NEVs to be eligible for PTE without prior notice nor sufficient lead time. This disrupts manufacturers' production schedules for launching new NEV products, which—due to the time needed to develop new products—are decided well in advance.

### Licence plate quotas and restrictions (local level)

To promote NEV sales, many local governments lifted restrictions on NEV licence plate quotas. However, there are exemptions. For example, in Beijing, there is still an annual quota in place, which substantially restricts purchases. There are other instances of fragmented policy implementation and differing requirements at the local level with regard to automotive manufacturers' access to free licence plates, which will further hinder NEV consumption.

### Charging Infrastructure

The *NEV Industrial Development Plan 2021–2035* included a 20 per cent NEV market share target for 2025.<sup>17</sup> As the number of NEVs on the road increases, emerging challenges to the development and rolling out of charging infrastructure—such as harmonisation of standards of in-use and new generation pillars,<sup>18</sup> and coordination among power grids, vehicles and the infrastructure itself—need to be dealt with.

Although private wall boxes are crucial for the daily use of BEVs, their installation in residential compounds is difficult for several reasons, despite policy support for residential charging. Challenges include limited power

16 *Announcement on the Policy of Exemption from Vehicle Purchase Tax for NEVs*, MOF, State Taxation Administration and MIIT, 16<sup>th</sup> April 2020, viewed 20<sup>th</sup> May 2022, <[http://www.gov.cn/zhengce/zhengceku/2020-04/22/content\\_5505188.htm](http://www.gov.cn/zhengce/zhengceku/2020-04/22/content_5505188.htm)>

17 *NEV Development Plan 2021–2035*, State Council, 20<sup>th</sup> October 2020, viewed 15<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2020-11/02/content\\_5556716.htm](http://www.gov.cn/zhengce/content/2020-11/02/content_5556716.htm)>

18 There are three generations of pillars in the market now, but due to lack of harmonisation between them, old cars can't use the new-generation charging pillars, and vice-versa; which is a waste of resources and causes great inconvenience for NEV users.





in city centre infrastructure and insufficient shared car parks, among others.

Another issue hindering the development of charging infrastructure is that there is a lack of cooperation between vehicle manufacturers and charging station providers. While there are many charging station providers and BEV OEMs, the development and promotion of convenient charging services (such as plug and charging) relies heavily on communication and data exchange platforms between vehicles and charging stations (especially next-generation fast-charging interfaces), as well as supporting policies and regulations.

### NEV credits

Rules for dual credits after 2024 have not yet been released,<sup>19</sup> which may impact healthy development of the automotive industry, which relies on a stable and predictable regulatory environment to plan production schedules. Before setting up the rules, full consultation with the industry is necessary to avoid making over-aggressive goals or impractical transition periods. While the *NEV Development Plan 2021–2035* outlines a proposal to connect the *Dual Credits Measures* and China's emissions trading scheme, details on how these two systems will be integrated are not yet in place. It is important to clarify the integration details as early as possible to give manufacturers the lead time they need to achieve compliance.

### Recommendations

#### Policy transparency and predictability

- Ensure international automotive manufacturers can participate in the drafting and revision of new policies and regulations.
- Provide lead time of at least four to five years for automotive manufacturers to plan and react to released policies and planning documents.

#### Equal treatment

- Provide the same incentives and equal rights for imported and locally produced NEVs.
- Ensure technology neutrality without distinction between EV classes, as well as equal access to registration plates at the regional level.

### Decarbonisation

- Provide ample lead time when designing the decarbonisation roadmap for the automotive industry.
- Calculate the emissions of upstream and downstream suppliers separately to provide additional incentives to decarbonise.
- Allow reimbursement or other incentives for proven decarbonisation initiatives.
- Enable utility companies to offer private RE charging solutions.
- Develop whole-life-cycle carbon emission regulations that highlight the individual development status of each phase in the lifecycle.

#### Incentives (national level)

- Extend the 2020–2022 NEV subsidies and PTE to 2025.
- Maintain existing technical requirements and the current policy in order to mitigate the impact on the NEV market.
- Ensure models that have been approved and listed in the tax exemption list are still eligible for PTE even after new taxation policies have been released.

#### Licence plate quotas and restrictions (local level)

- Prohibit local governments from issuing fragmented implementation measures and unique requirements that restrict the purchase of NEVs.
- Enhance local incentive measures, for example, by lifting licence plate quotas.

#### Charging infrastructure

- Enhance standards related to charging infrastructure to keep pace with NEV development.
- Harmonise standards among in-use pillars and new generation pillars.
- Coordinate charging infrastructure development with green energy, power grids and vehicles.
- Harmonise standards for high-power charging, including fast-charging.
- Encourage private wall-box installations in residential compounds.

#### NEV credits

- Consult with the industry in advance to avoid setting policy goals or management measures related to dual credit targets for 2024 and 2025 that are too aggressive, and give enterprises enough lead time to make plans.
- Release the plan for dual credits and carbon emissions as early as possible so that enterprises have enough time to prepare for compliance.

<sup>19</sup> The *Decision to Amend the Parallel Management Measures for Corporate Average Fuel Consumption of Passenger Vehicle and New Energy Vehicle Credits* states that "the accounting requirements for 2024 and subsequent years shall be separately announced by the MIIT, MOF, MOFCOM, General Administration of Customs, and SAMR, 15<sup>th</sup> June 2020, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2020-06/22/content\\_5521144.htm](http://www.gov.cn/zhengce/zhengceku/2020-06/22/content_5521144.htm)>





### 3. Establish a Consistent, Transparent and Friendly Legislative and Policy Environment to Promote Intelligent and Connected Vehicle (ICV) Development

#### Concern

The lack of consistency and transparency in ICV legislation, as well as poorly defined responsibilities among different authorities, creates unnecessary confusion and challenges for automotive companies.

#### Assessment

Chinese authorities have issued several laws to support and standardise the development of the ICV industry in recent years.<sup>20</sup> However, the way policy has been formulated and implemented raises issues of consistency and transparency.

The legislation process remains opaque, despite active efforts by Chinese authorities to improve policy drafting and implementation in recent years, and foreign-invested enterprises (FIEs) still have less chances to participate in drafting compared to major domestic companies. There is also a lack of representatives from FIEs in Chinese ICV standards committees, such as the National Technical Committee of Auto Standardisation (SAC/TC114/SC34) and the TC260. In addition, drafts or final regulations need to be published in a timely fashion to enable automotive manufacturers to be compliant. This is particularly important for FIEs, because they generally need to devote global R&D resources to meet new Chinese compliance requirements. It would help significantly in this regard to involve both domestic enterprises and FIEs in policy and standards drafting from the very beginning. This would also facilitate building a global standards system for ICVs, which in turn would help to promote the export of Chinese vehicles.<sup>21</sup>

With the development of electric vehicles and artificial intelligence, there are an increasing number of new technologies from other industries, such as information technology and electronics, being integrated into the automotive industry, bringing new challenges to the existing regulatory system. Strengthened collaboration

among regulatory agencies is therefore crucial to ensure drafting efficiency and the effectiveness of policies regulating ICVs, and to avoid regulatory overlap, thereby reducing the burden on companies that develop ICVs and enable new technologies to thrive.

Vehicle intelligence cannot be improved without high-definition maps. Although there is currently no dedicated law on maps for ICVs in China, the *Basic Requirements of Security Processing Technology for Navigable Electronic Maps* provide that, "navigable electronic maps must be encrypted using spatial location technology ('encryption and deflection') prior to publication, sale, dissemination, display, and use."<sup>22</sup> Furthermore, elevation information (such as the height of a car driven on a flyover) is prohibited from being shown on navigation maps. Deflected positions and a lack of elevation information affect both the accuracy and reliability of automatic navigation, which seriously compromises the safety of automatic driving.

Automotive companies have been heavily influenced by the globalisation of the automobile market and its supply chains, under which independent enterprises, joint ventures and FIEs must all exchange data across borders while conducting R&D on ICVs for such purposes as iterating algorithms and upgrading self-driving systems based on traffic data. The R&D, production, sales and services of ICV companies, especially for imported automotive products, would be greatly restricted if there is no scientific management system to facilitate appropriate and effective cross-border exchanges of automotive data.

#### Key Recommendations

- Improve the legal and standards system and gradually abolish institutional obstacles for the development of ICVs.
- Ensure consistency, non-discrimination and appropriateness of market access laws, regulatory systems and technical requirements related to ICVs.
- Clearly define the responsibilities of government agencies in charge of regulating ICVs, to avoid regulatory overlaps over-burdening companies.
- Optimise the policy environment to ensure that FIEs can fully participate in the legislative process.
- Allow FIEs the same access, including voting rights, as

<sup>20</sup> China has issued several laws relevant to the automotive industry, including the Cybersecurity Law, the PIPL, the DSL and the Road Traffic Safety Law (Revised Draft).

<sup>21</sup> Please see the *Standardisation and Conformity Assessment Position Paper 2022/2023* for more information regarding equal access issues in standardisation in China.

<sup>22</sup> GB 20263-2006 *Navigable Electronic Map - Basic Requirements of Security Processing Technology*, Standardisation Administration of China (SAC), 15<sup>th</sup> March 2006, viewed 10<sup>th</sup> April 2022, <<http://openstd.samr.gov.cn/bzgk/gb/newGblinfo?hcn=517545EC0EE59615E0CA8D7EA56B153B>>





domestic automotive brands in standards and technical committees related to ICVs.

- Amend the high-definition mapping regulations.
- Reasonably liberalise the cross-border flow of automotive data and support enterprises to improve intelligent connectivity technologies with global R&D capabilities.
- Provide enough lead time for automotive manufacturers to implement ICV regulations.

## 4. Commercial Vehicles

### 4.1 Recognise Optimised Vehicle Specifications in the Regulations of Commercial Vehicles (CVs)

#### Concern

Regulators fail to recognise the specific nature of CVs, which hampers industry development.

#### Assessment

Although CVs have wheels and an engine, and are often used on public roads, they are not the same as passenger vehicles. While the sales volume of heavy-duty CVs is less than five per cent of that of passenger vehicles, the way CVs are regulated has more far-reaching implications for society as a whole. This is mostly because CVs are essential for efficient transportation – they are used by companies to transport goods and people, and to provide other vital services. Such companies are often highly specialised, and need very specific, tailor-made vehicles to provide optimal services, as well as to maximise their revenue in the process.

Specialist vehicles play an important role in upholding critical functions in our increasingly modernised society: they consist of a chassis that carries a specialised superstructure to provide dedicated services. Examples include refuse collectors, fire engines, construction wreckers, vacuum tanks, bridge inspection vehicles, sky lifts, cranes and snow ploughs. As a consequence, CVs comprise a much wider variety of models and variants per vehicle type compared to passenger vehicles, yet China's vehicle homologation and registration system makes no distinction between them. The system is also overly complicated, slow and costly, which holds back the time to market for vehicles that could provide crucial services to society. In addition, the introduction of new technologies gets delayed and stock management of

CVs becomes impossible when new regulations are introduced too quickly. It is furthermore superfluous to have an additional testing system to qualify for transport licences, as all necessary testing should only be done in the China Compulsory Certificate system.

By continuing to regulate CVs in the same way as passenger vehicles, without taking into account the vast differences between these distinct categories, overall development will be held back and the profitability of the Chinese transportation industry as a whole will suffer. The homologation and certification system must be designed in such a way that time to market for CVs is kept to a minimum. Only then can the transport industry develop the most optimised transport solutions.

As a member of the World Trade Organization (WTO), China is obligated to invite other WTO member states' comments on new national 'mandatory' standards (*guobiao*, or GB) that have the binding force of technical regulations. The category of technical standards thus made public under the Technical Barriers to Trade (TBT) publication procedure should be extended to cover 'recommended' standards (GB/T) as well as industry standards, because they often become mandatory in practice by executive order.

Companies should be given 24 months to prepare for the implementation of new rules and regulations, as short implementation times result in immense costs and complications, for example, as happened with introduction of the China V, China VIa and China VIb.<sup>23&24</sup>

#### Recommendations

- Involve the automotive industry early in the process of drafting and updating regulations for CVs.
- Implement only one integrated national standard covering CVs.
- Publish recommended standards (GB/T) and industry standards under the WTO/TBT publication system as mandatory standards.
- Grant sufficient lead time for manufacturers to adapt to new regulations.
- Unify market access requirements and implementation procedures.

<sup>23</sup> *China Light Duty Emissions*, TransportPolicy.net, 20<sup>th</sup> April 2020, viewed 15<sup>th</sup> April 2022, <<https://www.transportpolicy.net/standard/china-light-duty-emissions/>>

<sup>24</sup> *Sales Transition Period of National IV Emission Vehicle Extended Leads to Parallel Imports Price Up, Dealers Look Forward to Rules*, QQ.com, 15<sup>th</sup> May 2020, viewed 26<sup>th</sup> June 2022, <<https://new.qq.com/rain/a/20200515A0OQJU00>>





- Simplify the registration process for the issuance of transport licences.

## 4.2 Minimise the Carbon Footprint of CVs by Harmonising Fuel Consumption and Emissions Regulations Among Ministries and by Measuring Fuel Consumption in Relation to Payload

### Concern

While the EU has one harmonised carbon dioxide (CO<sub>2</sub>) regulation,<sup>25</sup> China has several regulations for fuel consumption and CO<sub>2</sub> emissions for CVs, which are not harmonised among different ministries, while an unscientific measurement is applied for fuel consumption.

### Assessment

Although modern society cannot survive without transportation, there is a serious need to minimise its impact on our environment and the world's finite resources. Regulators, OEMs, operators and consumers therefore need to work together to reduce the negative impact of transportation: this must become an integral part of corporate social responsibility.

The lowest-hanging fruit when it comes to reducing the carbon footprint is to use larger transport units, i.e., fewer engines to transport more goods. Regardless of whether transport is moving on highways or through cities, the transport unit should always be as large as possible, while adhering to all relevant standards.

The standard *GB 1589-2016* allows the in-city use of vehicles with a total weight of 31 tonnes, that have up to four 12-metre-long axles.<sup>26</sup> Within the limits of permitted outer dimensions and axle loads, society and industry should always seek optimised transport solutions in and outside of cities. In many countries, up to 12 axles and over 100 tonnes gross combination weight (GCW) are allowed on certain routes, providing even greater

opportunities to carry more goods with fewer engines.<sup>27</sup>

Biogas is a renewable fuel, the combustion of which does not contribute to a net increase of CO<sub>2</sub> in the atmosphere, as opposed to natural gas, a fossil fuel that does. A biogas system is part of a circular economy industrial chain,<sup>28</sup> and the use of biogas and other forms of biofuels are proven technologies in the CV and transport sectors in Europe. The use of biofuels in CVs is a good alternative to electrified vehicles as long as the energy mix contains a high share of fossil energy. Furthermore, the use of biofuels made from waste, such as sludge, food waste and other organic waste, is a reliable and well-proven way to affect an immediate reduction in CO<sub>2</sub> emissions from CVs.

### Recommendations

- Use *GB 1589-2016* to optimise transport units in cities and to strive for long vehicle combinations.
- Implement proper road classification and allow for different lengths and GCW, depending on road and bridge conditions.
- Amend standard *GB 1589-2016* to allow for more than six axles.
- Calculate the carbon footprint of vehicles as CO<sub>2</sub> emissions (energy consumption) per tonne per kilometre.
- Include in the government plans and roadmaps the use of biofuel by CVs to reduce CO<sub>2</sub> emissions.

## 4.3 Allow Longer Vehicle Combinations to Increase Transport Efficiency

### Concern

Current standards and regulations limit the types of vehicle and trailer combinations that can be used, which has resulted in overcapacity of inefficient vehicles.

### Assessment

The current standards *GB1589-2016* and *GB7258-2017* limit the use of long vehicle and trailer combinations that are common in many countries around the world.<sup>29</sup>

<sup>25</sup> *The EU Emissions Trading Scheme (ETS) and its reform in brief*, European Parliament, 9<sup>th</sup> March 2021, reviewed 12<sup>th</sup> April 2022, <<https://www.europarl.europa.eu/news/en/headlines/society/20170213STO62208/the-eu-emissions-trading-scheme-ets-and-its-reform-in-brief>>

<sup>26</sup> *GB 1589-2016 Limits of Dimensions, Axle Load and Masses for Motor Vehicles, Trailers and Combination Vehicles*, General Administration of Quality Supervision, Inspection and Quarantine, and SAC, 26<sup>th</sup> July 2016, viewed 15<sup>th</sup> April 2022, <<http://c.gb688.cn/bzgk/gb/showGb?type=online&hcno=4D4FEB86F718FA6C4E2F8A0BB0EC9AC2>>

<sup>27</sup> Enough empirical studies show that this has no negative impact on road safety – rather the opposite; *High Capacity Transport, Towards Efficient, Safe and Sustainable Road Freight*, Organisation for Economic Co-operation and Development, 2<sup>nd</sup> May 2019, viewed 15<sup>th</sup> April 2022, <<https://www.itf-oecd.org/sites/default/files/docs/high-capacity-transport.pdf>>

<sup>28</sup> Biogas from municipal wastewater that is purified and upgraded to contain a high proportion of methane can be used as a vehicle fuel and is an example of a circular economy industrial chain, <<https://smartcitysweden.com/focus-areas/climate-energy-environment/biogas/>>

<sup>29</sup> *GB 7258-2017 Technical Specifications for Safety of Power-driven Vehicles Operating on Roads*, SAMR and SAC, 29<sup>th</sup> September 2017, viewed 10<sup>th</sup> April, <<http://openstd.samr.gov.cn/bzgk/gb/newGbInfo?hcno=06A0C376A0CA7B14E93106194C99730F>>





Using so-called road trains is the single most effective way to reduce transportation carbon emissions and freight costs. It is encouraging that China is now piloting long vehicle combinations, and that relevant standards and regulations are about to be revised. The working group believes such revisions will facilitate the early introduction of road trains on Chinese highways.

#### Recommendation

- Complete the development of the long vehicle combination standard as soon as possible.

## 5. Motorcycles

### 5.1 Rescind the 13-year ‘Shelf Life’ Limitation for Motorcycles in China

#### Concern

The mandatory imposition of a 13-year shelf life on high-quality motorcycles does not reflect the potential lifetime of vehicles manufactured to a high standard, and hinders foreign companies from further investment, as well as undermining the development of a circular economy.

#### Assessment

In most provinces in China, the service life period of newly bought motorcycles is limited to 13 years from the day of registration. In East China’s Jiangsu Province, the limitation is 11 years. Both imported and locally produced motorcycles must abide by the regulation without distinction of engine cylinder categories.

The output volume of motorcycles imported to China are generally above 150 cubic centimetres (cc), and with an average market price of more than Chinese yuan (CNY) 30,000. These products are in line with both China’s type certification standards and foreign technical regulations, including those of the EU. At present, China’s product type certification experiments include emissions durability projects that follow the world’s most stringent standards of pollutant control; electronic fuel injection technology, as well as the same emissions after-treatment equipment used in cars, are also applied to all imported and domestic motorcycles. This is a technological leap of several generations compared to that available and consumer purchase cost

of motorcycles when the 13-year mandatory scrapping rule was first established in 2012.<sup>30</sup>

Given that motorcycles have become for many consumers a lifestyle more than a transportation solution, it will benefit domestic manufacturers and consumers, as well as boosting domestic motorcycle consumption growth, if the 13-year mandatory shelf-life limitation is lifted. Also, mandatory scrapping of motorcycles after 13 years, even those in good shape, is not only hard for owners to accept, but also has a significant negative impact on the environment due to the waste produced. Mandatory scrapping of working motorcycles is also not conducive to the development of the circular economy advocated by the Chinese Government.

Safety concerns are a likely reason for the government imposing a uniform 13-year limit on motorcycles. To address this issue, the working group recommends introducing inspections similar to those mandated for automobiles, through which motorcycles, after being used for 13 years, will be required to undergo an annual inspection (or multiple times per year, to be justified) to ensure that they meet safe driving conditions.

#### Recommendation

- Lift the mandatory scrapping requirement for motorcycles, and adopt annual inspections of motorcycles used for 13 years, so as to extend their service life.

### 5.2 Open to Motorcycles All Roads that Permit Four-wheeled Vehicles, Including Highways

#### Concern

Banning motorcycles from highways or other areas designated by local governments hinders both the consumption and mobility of motorcycles.

#### Assessment

Even though motorcycles are permitted on highways under national law, some provinces have implemented local restrictions due to safety concerns. Today, the construction quality and maintenance of both highways and general roads are at a good level. Signage, protection measures, surveillance cameras and rapid police responses are already in place. Meanwhile,

<sup>30</sup> *Regulations for Motor Vehicle Mandatory Scrapping Standard*, MOFCOM, NDRC, MPS and Ministry of Environmental Protection, 27<sup>th</sup> December 2012, viewed 26<sup>th</sup> June 2022, <<http://www.mofcom.gov.cn/article/swfg/swfgbh/201303/20130300062947.shtml>>





providing retraining for motorcyclists after they receive their licence would also help to address safety concerns and educate them on environmental protection.

About 200 cities in China currently have local restrictions on motorcycles,<sup>31</sup> including bans on motorcycle licensing, and riding in urban centre areas and defined neighbourhoods. Such measures are based on the simplicity of early motorcycles in China, their poor performance, and high levels of both carbon and noise emissions, as well as early motorcycle riders' poor awareness of laws and regulations.

Now that improved technologies are being applied in motorcycle production—with large-displacement models of 250cc output volume and above that are equipped with antilock braking system gradually becoming the mainstream—these restrictions are no longer appropriate. Administration requirements should correspond to different displacement ranges. Another reason to review and abolish restrictions on motorcycle use is the shift in consumption patterns from commuting purposes to lifestyle purposes, such as sport and travel. Removing restrictions will boost consumption of motorcycles and associated equipment, and help growth in such service industries as fitness and tourism. For example, domestic tourism, including the type of remote area exploration popular among motorcyclists, will eventually return to pre-pandemic levels. The vast majority of motorcycle riders are responsible consumers of tourism and deserve attention and service in all provinces. Allowing motorcycles on regular highways not only demonstrates a spirit of fairness but also helps boost tourism development.

### Recommendations

- Refine further the limitations and restriction areas for motorcycles, open highways to motorcycles over 250cc, and effectively enforce national laws regarding roads and highways.
- Perform category-based administration of motorcycle plate number and driver's licence examination according to motorcycle displacement range, with electric motorcycles corresponding to the levels per motor output power.
- Encourage the development of motorcyclist retraining institutions to educate users on safety and

environmental protection after they obtain a driver's licence.

## Abbreviations

BEV	Battery Electric Vehicle
CAC	Cyberspace Administration of China
cc	Cubic Centimetre
CCC	China Compulsory Certificate
CNY	Chinese Yuan
CO <sub>2</sub>	Carbon Dioxide
CV	Commercial Vehicle
EU	European Union
FIE	Foreign-invested Enterprise
GB	<i>Guobiao</i>
GCW	Gross Combination Weight
ICV	Intelligent and Connected Vehicle
MIIT	Ministry of Industry and Information Technology
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOST	Ministry of Science and Technology
MOT	Ministry of Transport
MPS	Ministry of Public Security
NDRC	National Development and Reform Commission
NPCSC	Standing Committee of the National People's Congress
OECD	Organisation for Economic Co-operation and Development
OEM	Original Equipment Manufacturer
PHEV	Plug-in Hybrid Electric Vehicle
PTE	Purchase Tax Exemption
R&D	Research and Development
RE	Renewable Energy
SAC	Standardisation Administration of China
SAMR	State Administration of Market Regulation
TBT	Technical Barriers to Trade
TC260	National Information Security Standardisation Technical Committee
WTO	World Trade Organization

<sup>31</sup> *Motorcycle ban spreads to 200 cities, will be released in controversy after 37 years?*, QQ News, 11<sup>th</sup> February 2022, viewed 10<sup>th</sup> April 2022, <<https://new.qq.com/omn/20220211/20220211A0AAQG00.html>>





## Auto Components Working Group

### Key Recommendations

- 1. Mandate Snow Tyre Usage During the Cold Season of Low-temperature Areas to Improve Road Safety and Reduce Societal Costs of Accidents**  
  - Promulgate in a timely manner China's national standards for snow tyres to regulate snow tyre products and their use in the Chinese market.
  - Formulate snow tyre legislation to mandate the usage in China's low-temperature areas to improve road safety and reduce the negative impact on society.
- 2. Improve the Development of the Intelligent Connected Vehicles (ICV) Industry, Implement Appropriate Data Standards, and Increase Industry-wide Data Collaboration and Sharing**
  - Improve legislation on data circulation, sharing and utilisation, particularly relating to use of automotive and ICV market data.
  - Accelerate the standardisation of automotive data, and organise the Standardisation Administration of China, the China Association of Automobile Manufacturers, and all relevant industry stakeholders to actively discuss and create specifications to systematically optimise automotive data standards.
- 3. Allow the Import of Rejected Auto Parts from Overseas Markets for Quality Assessment by Analysis Centres Based in China**  
  - Release annual quotas for companies with relevant qualifications to import rejected auto components from overseas markets to conduct quality inspection and analysis.
  - Allow the components of returned parts to be shipped to a lower-level supplier for in-depth analysis, both domestically and internationally.

### Introduction to the Working Group

The Auto Components Working Group was created in 2000, the year the European Chamber was established. It consists of around 80 international companies involved in the manufacturing of auto components, machine tools for producing auto components and automotive assembly lines. Members also import and distribute auto components and provide after-sales services in China. This working group has fostered ties with various organisations and governmental bodies in Europe and China.

### Recent Developments

#### Market Development

China's auto production in 2021 increased by 3.4 per cent, with 26.1 million vehicles produced, though sales decreased by 1.6 per cent, to 26.3 million units year-on-year.<sup>1</sup> The auto sector can be broken down into two sub-sectors: passenger vehicles and commercial vehicles. In 2021, passenger vehicle production and sales volumes increased by 8.4 per cent and 2.0 per cent year-on-year, reaching 21.4 million and 21.5 million units respectively.

<sup>1</sup> 2021 Automotive Industry Development Conditions, China Association of Automobile Manufacturers, 21<sup>st</sup> January 2022, viewed on 14<sup>th</sup> April 2022, <[http://www.caam.org.cn/search/con\\_5235337.html](http://www.caam.org.cn/search/con_5235337.html)>





The passenger vehicle market showed substantial growth in the first quarter (Q1) of 2021 on the low base of Q4 2020. However, the impact of COVID-19 and low global production capacity of semi-conductor chips led to a decline in passenger vehicle sales and production in Q2 and Q3 of 2021, though the passenger vehicle market stabilised in Q4 as chip shortages gradually eased. Moreover, as the per capita disposable income of urban residents increased, sales of high-end passenger vehicles also grew significantly.

The NEV sector was one of the largest contributors to the increase in sales of passenger vehicles in 2021, a 42 per cent year-on-year increase. NEV production and sales keep rising annually, with nearly 80 per cent purchased by individuals.

Commercial vehicle production and sales volumes decreased 20 per cent and 18.7 per cent respectively, falling to 4.7 million and 4.8 million units respectively in 2021. Market performance was significantly better in the first half of 2021 than in the second half. Similar to passenger vehicles, production and sales of commercial vehicles showed substantial increases in Q1 2021 from the low base of the previous year. In Q2 2021, the sales volume began to decline year-on-year, and the downward trend continued in the second half of the year.<sup>2</sup>

Several factors caused the mixed results for the industry throughout the year. The recovery from the low market base of 2020 saw positive growth in Q1, which was stifled by the impact of shortages in chips and raw materials, while the continuous implementation of China's carbon emission reduction strategy and related incentives boosted NEV production and sales. Last but not least, the *14<sup>th</sup> Five-year Plan for National Economic and Social Development and the Long-range Objectives Through the Year 2035* reiterated the goal of common prosperity, which drove up consumption levels, including in the automobile industry.<sup>3</sup>

### Carbon Neutrality for the Auto Industry

The State Council issued the *Action Plan for Carbon Dioxide Peaking before 2030* in October 2021,<sup>4</sup> which

<sup>2</sup> Ibid.

<sup>3</sup> *14<sup>th</sup> Five-year Plan for National Economic and Social Development and the Long-range Objectives Through the Year 2035*, State Council, 13<sup>th</sup> March 2021, viewed 21<sup>st</sup> April 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592681.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm)>

<sup>4</sup> *Action Plan for Carbon Dioxide Peaking Before 2030*, State Council, 26<sup>th</sup> October 2021, viewed 16<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2021-10/26/content\\_5644984.htm](http://www.gov.cn/zhengce/content/2021-10/26/content_5644984.htm)>

aims to expand the application of clean energy sources such as electricity, hydrogen energy, natural gas and advanced liquid biofuels in the transportation field. This plan requires vigorously promoting NEVs, gradually reducing the proportion of traditional fuel vehicles in new vehicle production, sales and car ownership, and further replacing urban public service vehicles with EVs. The *Action Plan* also encourages adoption of electric, hydrogen and liquid biofuel-powered heavy-duty freight vehicles. It recommends recycling waste in emerging industries such as retired power batteries, and promoting the high-quality development of remanufacturing industries such as automotive components. It also aims to provide macro guidelines for China's automotive industry to achieve carbon neutrality.

### Policy Environment

#### Intelligent and Connected Vehicles (ICVs)

The Ministry of Industry and Information Technology (MIIT), Ministry of Public Security (MPS) and Ministry of Transport (MOT) jointly issued the *Management Specification for Road Testings and Demonstrative Application of Intelligent and Connected Vehicles (Trial Version)*, which went into effect in September 2021.<sup>5</sup> The specification supports further development of highway testing and demonstrative applications of ICV transport of people and goods, and comprehensive assessments of test demonstration areas, as well as encouraging data sharing and mutual recognition of test results. Implementation of the specification will standardise the ICV testing system, and further promote the collaborative development of the whole industry chain. The working group welcomes policy development in this field, as it was a key recommendation in the *Auto Components Working Group Position Paper 2021/2022*.

### Key Recommendations

#### 1. Mandate Snow Tyre Usage During the Cold Season of Low-temperature Areas to Improve Road Safety and Reduce Societal Costs of Accidents

##### Concern

There are no regulations to mandate the usage of snow tyres in complex road conditions of snow and slush in

<sup>5</sup> *Management Specification for Road Testing and Demonstrative Application of Intelligent and Connected Vehicles (Trial Version)*, State Council, 27<sup>th</sup> July 2021, viewed 14<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-08/03/content\\_5629199.htm](http://www.gov.cn/zhengce/zhengceku/2021-08/03/content_5629199.htm)>





China's low-temperature regions,<sup>6</sup> which significantly increases tyre-related crashes and fatalities.

### Assessment

Complex snowy and icy road conditions are common in the cold regions of China. The tread compound of normal tyres tends to stiffen and lose traction and grip in low temperatures, which makes accelerating, cornering and braking less reliable and riskier on snowy and icy roads. Therefore, the promotion of snow tyres and the formulation of legislation and standards to mandate snow tyre usage is essential to ensure driving safety under snowy road conditions.

Snow tyres are specially developed for use during winter, with a soft rubber compound and tread pattern designed to deliver excellent grip and driving performances in complex winter road conditions such as snow and ice, with significantly improved braking distance. Their use is crucial to avoid sideslip and ensure driving safety. According to a survey by the China In-depth Accident Study of the China Automotive Technology and Research Centre, snow tyre usage led to a significant decline in car accidents (occurring twice as less) and fatalities (nearly three times less).<sup>7</sup>

Road Condition	Tyre Category	Number of Accidents	Accident Ratio
Snow/ice	Snow tyre	36	1 (benchmark)
	Normal tyre	55	2

Road Condition	Tyre Category	Fatal Accidents	Fatal Ratio
Snow/ice	Snow tyre	6	1 (benchmark)
	Normal tyre	14	3.055

Currently, snow tyres are already mandatory<sup>8</sup> during winter in many European countries (including Austria, Finland, Sweden and Norway) to ensure driving safety. The working group recommends that China introduce a similar policy in the affected areas of its northern region.

### Recommendations

- Promulgate in a timely manner China's national

<sup>6</sup> China's low-temperature areas refer to Heilongjiang, Jilin and Liaoning provinces, the northern part of Xinjiang and Inner Mongolia Autonomous Region, among others.

<sup>7</sup> This data was supplied by a member company.

<sup>8</sup> The 'mandatory' notice can vary, depending on the country involved, and the map is updated regularly.

standards for snow tyres to regulate snow tyre products and their use in the Chinese market.

- Formulate snow tyre legislation to mandate the usage in China's low-temperature areas to improve road safety and reduce the negative impact on society.

## 2. Improve the Development of the ICV Industry, Implement Appropriate Data Standards, and Increase Industry-wide Data Collaboration and Sharing

### Concern

Current data-related policies and standards of relevance to the ICV market in China are not yet clear, making it difficult for data service providers, automotive components manufacturers and after-sales maintenance companies to effectively obtain vehicle operation data.

### Assessment

Developing ICVs has become the main trend in the automotive industry in China, which in turn has had a huge impact on the auto components industry. As increasing numbers of ICVs enter the market, approximately 10 terabytes of data per vehicle per day will be generated.<sup>9</sup> Management of this data will have a significant impact on the future development of transportation and the whole industry value chain:

1. Data exchange and collaboration between the intelligent traffic system, road systems and ICVs will improve automated driving capabilities, road access efficiency and passenger safety.
2. Automotive and automotive components manufacturers can analyse data to provide optimised services and better user experiences.
3. Third-party service providers can use the data to provide maintenance services.

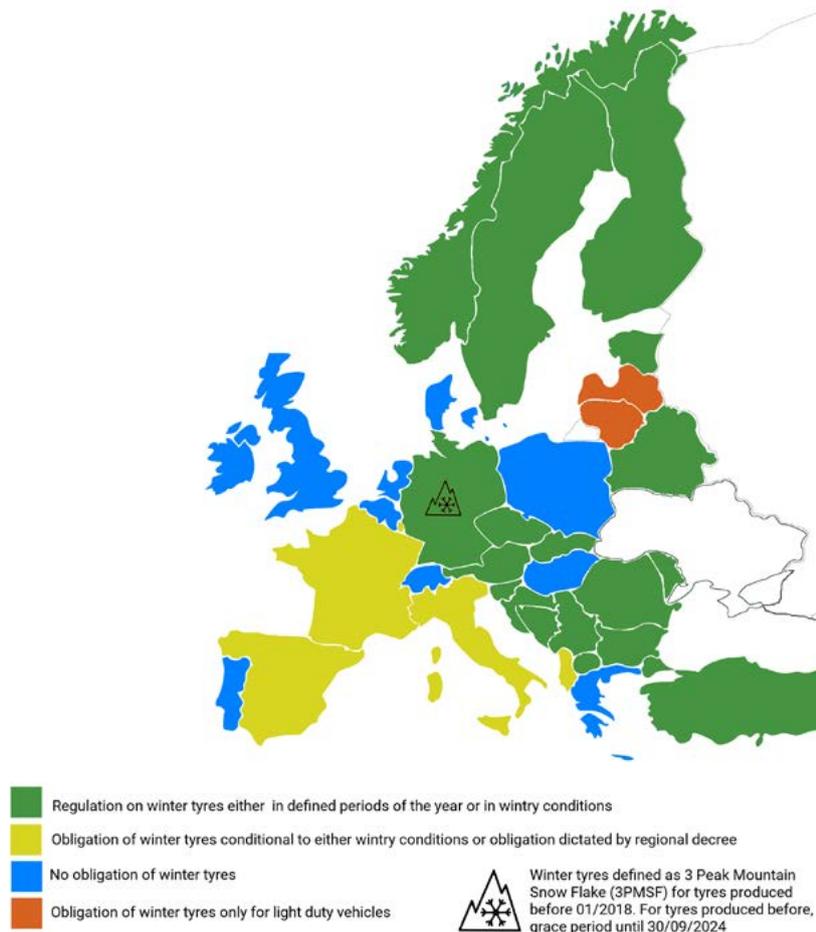
Therefore, it is crucial to ensure the automotive data is standardised and transferable to allow automotive manufacturers, auto component manufacturers and third-party maintenance companies to develop and provide differentiated services, which will in turn encourage healthy industry development and fair competition. Furthermore, standardised data

<sup>9</sup> *Research Report on Data Security of Intelligent and Connected Vehicles*, CERT, 20<sup>th</sup> June 2021, viewed on 10<sup>th</sup> March 2022, <[https://www.sohu.com/a/473091463\\_118021](https://www.sohu.com/a/473091463_118021)>





### SNOW TYRE OBLIGATIONS ACROSS EUROPE<sup>30</sup>



will prevent data barriers and monopolies, improve consumer experiences and protect user rights.

While China has enacted several data protection-related legislation, there is limited progress in data flow, sharing, utilisation and standardisation, especially in the automotive sector. A balance between guaranteeing data security and improving data flow is needed if the industry is to develop.

Data sharing is essential for both upstream and downstream automotive companies. The working group recommends the Chinese Government design principles and frameworks based on data type for open data-sharing between organisations, focussing on elements such as data transparency, joint value creation, mutual respect, and fair and healthy competition. The government should also promote the creation of technology and platforms that can facilitate

data-sharing. Specifically, China should develop a well-structured legal framework for automotive data, comprising data exchange platforms, an independent third-party certification system, and an accessible data standard and data classification system, to ensure data security. Furthermore, China should also promote the circulation, analysis and use of data, to facilitate the development of the ICV industry as well as a future intelligent transportation system.

The European Union (EU) is gradually establishing a data regulatory system for the automotive industry, with the relevant policies and practices listed below.

#### EU Data Act

The EU passed the Data Act in April 2022,<sup>10</sup> which contains important provisions concerning the right to use and share data, including:

<sup>10</sup> *European Union Data Act*, European Commission, 22<sup>nd</sup> March 2022, viewed 14<sup>th</sup> April 2022, <<https://digital-strategy.ec.europa.eu/en/policies/data-act>>



1. Users and third parties have the right to access and utilise data, that is, product (such as automotive) users have the right to access, use or share their product usage data with third parties.
2. Unfair data sharing contracts are prohibited.

### EU Regulation on the Free Flow of Non-personal Data

The EU introduced the *Regulation on the Free Flow of Non-personal Data* in November 2018 to ensure the free flow of non-personal data in business.<sup>11</sup> The main objectives are to (1) increase the cross-border free flow of non-personal data in the Single Market; (2) ensure that competent authorities' power to request access to data for regulatory purposes is not compromised; and (3) ensure that professional data storage users or other data processing services are able to easily change service providers and migrate data without overburdening service providers or distorting the market.

### EU Directive on Open Data and the Re-use of Public Sector Information

The EU passed the *Directive on Open Data and the Re-use of Public Sector Information* in 2019,<sup>12</sup> which aims to remove major barriers to data re-use, and promote the re-use of public sector data across the bloc and the development of data-intensive technologies.

The working group recommends that the Chinese Government issue similar policies and regulations to promote collaborative data-sharing across the automotive industry chain.

### Recommendations

- Improve legislation on data circulation, sharing and utilisation, particularly relating to use of automotive and ICV market data.
- Accelerate the standardisation of automotive data, and organise the Standardisation Administration of China, China Association of Automobile Manufacturers, and all relevant industry stakeholders to actively discuss and create specifications to systematically optimise automotive data standards.

<sup>11</sup> *Regulation (EU) 2018/1807 of the European Parliament and of the Council of 14 November 2018 on a framework for the free flow of non-personal data in the European Union*, European Commission, 14<sup>th</sup> November 2018, viewed 14<sup>th</sup> April 2022, <<https://eur-lex.europa.eu/eli/reg/2018/1807/oj>>

<sup>12</sup> *Directive (EU) 2019/1024 of the European Parliament and of the Council*, European Commission, 20<sup>th</sup> June 2019, viewed 14<sup>th</sup> April 2022, <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019L1024&qid=1649934357210>>

## 3. Allow the Import of Rejected Auto Parts from Overseas Markets for Quality Assessment by Analysis Centres Based in China

### Concern

According to China's current laws and regulations,<sup>13</sup> rejected auto parts from overseas markets are regarded as 'electromechanical waste products' and cannot be imported for dismantling and analysis.

### Assessment

The automobile industry is an essential pillar of China's economy, with the newly developed sections playing an important role in the entire industrial chain. Considering China's influence on neighbouring economies, some large multinational auto parts companies that intend to set up regional analysis centres in China are likely to upgrade these centres to regional headquarters. This in turn gives their business the potential to affect the entirety of Asia and beyond. Though the direct economic revenue generated by analysis centres is limited, the indirect return is significant. The main duty of the analysis centres is to conduct technical analysis on returned auto parts to determine the reasons for the failure of the returned parts. Such analysis not only can help a company improve its product quality and technical capabilities but can also assist in the establishment of a quality management system in China for domestic auto parts. In addition, analysing rejected parts from overseas markets can help Chinese subsidiaries enhance their understanding of product application and environments in other regions. It will also allow these China-based centres to bring their research and development (R&D) capabilities closer to the technical level of the corporate headquarters. Therefore, analysis of rejected auto parts from overseas markets is key to the industrial advancement and market development of Chinese companies.

Moreover, in recent years, China Customs has consistently emphasised the need to improve customs clearance efficiency to optimise the import/export business environment. R&D is a priority for many auto components companies; therefore, the facilitation of the import and export of R&D materials and analysis of

<sup>13</sup> *Customs Law of the People's Republic of China (Amended in 2021)*, Shantou Customs District, 23<sup>rd</sup> August 2021, viewed 10<sup>th</sup> July 2022, <[http://lasa.customs.gov.cn/shantou\\_customs/zfxgk39/3008252/3008377/2659888/2660195/index.html](http://lasa.customs.gov.cn/shantou_customs/zfxgk39/3008252/3008377/2659888/2660195/index.html)>





parts can play a decisive role in boosting the economy.

Through innovative systems and mechanisms, strengthened coordination and interconnection, improved legal guarantees, and benchmarking against advanced international standards, China can create a stable, fair, transparent, and predictable environment for various entities to invest in and start businesses.

Rejected auto components are divided into three types:

1. Those produced in China and supplied to domestic automobile manufacturers;
2. Those produced in China and supplied to overseas automobile manufacturers;
3. Those produced overseas and supplied to an overseas manufacturer.

In China, types 2 and 3 are regarded as ‘electromechanical waste products’ and forbidden for import, meaning that Chinese auto component companies cannot analyse rejected parts from overseas markets. According to the *Administrative Procedures on Goods of Temporary Entry and Exit (Administrative Procedures)*,<sup>14</sup> if the parts enter China through temporary import and export, they must be re-exported within a specified time, and the inbound and outbound status of goods should remain the same. However, in-depth analysis of the rejected parts will require disassembly. If component issues are involved, the components (the percentage of which can be as high as 60 per cent of the part) also need to be disassembled and sent to downstream suppliers—which may be located overseas as well as in China—for a more in-depth analysis, but the *Administrative Procedures* do not allow components to be disassembled from the main body and shipped separately.

Under the *Regulation on Repair, Replacement and Refund of Private Cars (3R Regulations)*, manufacturers are liable for the repair, replacement and return of components in relation to certain quality issues.<sup>15</sup> Auto components sold abroad also need to comply with overseas regulations. However, as the *Administrative Procedures* do not currently allow for the importation or disassembly of rejected parts for analysis, not only are

the operations of individual companies affected but also the development of international business is impeded. As domestic auto component enterprises continue to expand their overseas markets, they will also face the same dilemma when attempting to return parts to China for quality analysis.

### Recommendations

- Release annual quotas for companies with relevant qualifications to import rejected auto components from overseas markets to conduct quality inspection and analysis.
- Allow the components of returned parts to be shipped to a lower-level supplier for in-depth analysis, both domestically and internationally.

### Abbreviations

EU	European Union
EV	Electric Vehicle
ICV	Intelligent Connected Vehicle
MIIT	Ministry of Industry and Information Technology
MOT	Ministry of Transport
MPS	Ministry of Public Security
NEV	New Energy Vehicle
OE	Original Equipment
R&D	Research and Development

<sup>14</sup> *Administrative Procedures on Goods of Temporary Entry and Exit (Administrative Procedures)*, GACC, 7<sup>th</sup> December 2017, viewed 10<sup>th</sup> March 2022, <[http://www.gov.cn/gongbao/content/2018/content\\_5260801.html](http://www.gov.cn/gongbao/content/2018/content_5260801.html)>

<sup>15</sup> *Regulation on Repair, Replacement and Refund of Private Cars (3R Regulations)*, State Administration of Market Regulation, 27<sup>th</sup> July 2021, viewed 10<sup>th</sup> March 2022, <[http://www.gov.cn/xinwen/2021-07/27/content\\_5627785.htm](http://www.gov.cn/xinwen/2021-07/27/content_5627785.htm)>





# Cosmetics Working Group

## Key Recommendations

### 1. Ensure a Smooth Transition Period with Clear Implementing Guidelines for the Cosmetics Supervision and Administration Regulation (CSAR) Supplementary Legislation 4

- Implement streamlining and delegation in supplementary legislation to establish an efficient supervision system based on risk management, with companies bearing the responsibility for product quality and safety.
- Provide sufficient transition periods for changes that will have a significant influence on the industry and prepare flexible policies for grace periods on a case-by-case basis, to ensure a smooth and stable transition.
- Collect issues raised during the implementation of new regulations and launch necessary policy interpretations that are pertinent to the implementation and release of the regulations.

### 2. Encourage Safety Supervision in a Scientific Way to Boost Innovation in the Cosmetics Industry

#### 2.1 Raw Material Safety Information Submission

- Accept new product registration applications when the reporting code for raw material safety information or safety information annex is missing, provided this information can be submitted later.
- Allow an entity's registrant or notifier to fill in raw material safety information, using their own signatures or seals as verification, instead of those of raw material suppliers.
- Regard the raw material safety information submitted by suppliers as being subject to in-market product risk monitoring and traceability.
- Cancel the requirement of product re-registration and notification for those registered or notified before 1<sup>st</sup> January 2023 with formula changes in raw material components and content provided by suppliers, if the amount of raw material added in the formula, raw material manufacturer and trade name remain the same (except in cases where name changes are not for quality and safety reasons).
- Develop standardised guidelines for the registration of raw material composition and to identify the proportion of impurities to ensure a consistent raw material reporting standard is used by raw material suppliers and cosmetics companies.

#### 2.2 Modern Risk Management System 16

- Promote alternatives to animal testing, and formulate detailed implementation rules for innovative, non-test assessment methods such as Threshold of Toxicological Concern (TTC) and read-across.
- Phase out the requirement to submit animal test data for registration of cosmetics in special cases where such data is still needed.

#### 2.3 Scientific and Sound Adverse Effects Monitoring Rules 2

- Take into consideration the sales quantity, adverse reaction types, and cause and effects when





determining product safety.

## 2.4 Feasible Regulatory Supervision Model and Pathway for Innovative Cosmetics Products 3

- Establish management and surveillance mechanisms for personalised cosmetics that include administrative provisions on registration and notification, production and sales, in order to allow market access and promote the development of and meet the demand for personalised cosmetics in China.
- Provide clear definition and scope of "cosmetics that must used in conjunction with devices" and refine the related detailed management requirements.
- Develop administrative standards with reference to different circumstances and risk control points related to product quality and safety.

## 3. Ensure the Smooth Implementation of the Provisions on the Management of Cosmetics Registration and Notification Dossiers

### 3.1 Transparent and Unified Evaluation Standards and Guidelines 2

- Formulate detailed, transparent and consistent criteria for the evaluation of cosmetics, as well as guidelines to allow manufacturers to compile registration dossiers.
- Conduct investigations and surveys prior to introducing new or controversial evaluation requirements and then publicly notify companies before such review requirements are implemented.

### 3.2 Capacity Training for Evaluators and Manufacturers and Improving Communication Between Different Stakeholders 2

- Increase different forms of training by authoritative individuals, such as formal in-person training sessions, online interpretations and question-and-answer (Q&A) sessions, to provide an official interpretation of the regulations and consistent answers to specific questions.
- Establish an open consultation and communication mechanism for different stakeholders, in support of the evaluation and registration of cosmetics.
- Establish a Q&A section on the National Medical Product Administration's website, sharing regularly updated information on common challenges experienced during the registration process and providing an authoritative interpretation of regulations and provisions.

## 4. Improve the Management of Efficacy Claims and Labelling

### 4.1 Administration of Efficacy Claim Evaluation 2

- Extend the application scope of the guiding principle of equivalent evaluations to all product efficacies, not only multi-colour cosmetics products.
- Accept an applicant's rationale as to why minor differences in formulas do not affect efficacy, and allow for slight adjustments of pigments, essences and antiseptics in formulas.

### 4.2 Administration of Labelling 2

- Issue implementation guidelines for the *Administrative Measures of Cosmetics Labelling* as soon as possible.
- Issue a series of supporting policies, such as the use of electronic labels, to resolve the difficulties of labelling for small-sized products.
- Allow the Chinese label to reflect selected efficacy claims within the scope of the *Classification Catalogue of Efficacy Claims*, and allow any information required by the laws and regulations of the region of origin to be either noted on, or covered by, the Chinese label.





## Introduction to the Working Group

In this paper, ‘cosmetics’ refers to daily-use chemical products intended to be applied externally to parts of the human body—such as skin, hair, nails and lips—by rubbing, spraying or other similar ways for the purposes of cleansing, protecting, beautifying or grooming.<sup>1</sup> They are used by individuals to improve both appearance and well-being. Although once thought of as luxury products, most people now consider cosmetics daily necessities. Thus, creating a sustainable cosmetics industry will help to improve people’s quality of living.

The Cosmetics Working Group consists of more than 70 members, including a large number of internationally well-known cosmetics brands, with a diverse range of business models. The majority of members are industry leaders and have established research and development (R&D) as well as production facilities in China. Their expertise has been widely recognised by consumers and they have contributed significantly to cosmetics development in China. The cosmetics industry has also acted as a catalyst for other related industries, such as fine chemicals, packaging, logistics and advertising.

The purpose of the Cosmetics Working Group is to:

- present the interests of European cosmetics companies and facilitate information exchange among members, professional associations and regulatory bodies;
- promote the healthy and sustainable development of China’s cosmetics industry and contribute to the formation of an efficient, fair and transparent regulatory environment; and
- ensure consumer safety.

European cosmetics companies possess cutting-edge technologies and extensive experience in quality management and safety assessment. A fully-opened market that allows both competition and cooperation between Chinese and European cosmetics companies will ensure that the domestic market becomes stronger, and provide Chinese consumers access to a variety of new and advanced products.

## Recent Developments

According to China’s National Bureau of Statistics

1 *Cosmetics Supervision and Administration Regulation (CSAR)*, State Council, 29<sup>th</sup> June 2020, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2020-06/29/content\\_5522593.htm](http://www.gov.cn/zhengce/content/2020-06/29/content_5522593.htm)>

(NBS), overall retail sales of consumer goods in 2021 increased 12.5 per cent year-on-year, exceeding Chinese yuan (CNY) 44 trillion. Annual retail sales of cosmetics by companies above the ‘designated size’—defined as those whose main annual business income exceeds CNY 20 million—grew by 14 per cent.<sup>2</sup> According to the General Administration of Customs (GACC), the quantity and value of imported beauty cosmetics and toiletries in China continued to rise from January to December 2021, with a cumulative increase of 23.1 per cent and valued at approximately CNY 150 billion.<sup>3</sup> China’s cosmetics industry was relatively resilient and maintained steady growth in 2021, bolstered by the rapid emergence of live streaming e-commerce as companies adapted their business models to cope with pandemic-related restrictions.

However, most cosmetics industry players were significantly impacted by COVID-19 containment measures implemented by China in March 2022, which saw the city of Shanghai placed under lockdown. Factories and R&D centres based in the city were shut, and supply chains and operations grounded to a standstill. According to the results of a flash survey conducted by the European Chamber in May 2022, as result of these stringent restrictions, 80 per cent of respondents from the cosmetics industry decreased their 2022 revenue projections; 20 per cent are now considered downsizing operations; and 40 per cent were considering shifting current or future investments to other markets.<sup>4</sup>

The interruption to operations also presented cosmetics manufacturers with difficulties in meeting the 1<sup>st</sup> May 2022 deadline for completion of the supplementary documentation required for previously registered and notified cosmetics, and to submit the summary of product efficacy claims. Failure to meet this deadline would have negatively impacted manufacturing and product launches. In response to industry concerns, the National Medical Product Administration (NMPA)

2 *Statistical Communiqué of the People’s Republic of China on National Economic and Social Development in 2021*, NBS, 28<sup>th</sup> February 2022, viewed 18<sup>th</sup> April 2022 <[http://www.stats.gov.cn/tjsj/zxfb/202202/t20220227\\_1827960.html](http://www.stats.gov.cn/tjsj/zxfb/202202/t20220227_1827960.html)>

3 *China’s Total Export & Import Values, December 2021 (in USD)*, GACC, 14<sup>th</sup> January 2022, viewed 18<sup>th</sup> April 2022, <<http://www.customs.gov.cn//customs/302249/zfxgk/2799825/302274/302275/4122074/index.html>>

4 Unpublished statistics from *Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China*, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 6<sup>th</sup> June 2022, <[https://european-chamber.com/Upload/documents/documents/Flash\\_Survey\\_COVID\\_19\\_and\\_the\\_War\\_in\\_Ukraine\\_The\\_impact\\_on\\_European\\_business\\_in\\_China\\_FINAL\[973\].pdf](https://european-chamber.com/Upload/documents/documents/Flash_Survey_COVID_19_and_the_War_in_Ukraine_The_impact_on_European_business_in_China_FINAL[973].pdf)>





released measures allowing “vacancy management”<sup>5</sup> and extended the deadline by eight months for companies to submit the required information. This helped to ensure a smooth transition to the new regulations and enable enterprises to resume operations with minimal impact.<sup>6</sup>

These new regulations are part of several recently issued by China while stepping up its oversight and administration of cosmetics. Since 2021, the NMPA has published more than ten supporting regulations and explanations concerning the registration and notification of cosmetics, oversight of manufacturing and operations, safety evaluation and adverse reaction monitoring, classification and efficacy claim verification, label administration, and the administration of children’s cosmetics. The implementation of these regulations is aimed at improving companies’ quality management systems, encouraging increased investments in R&D and enhancing the overall level of quality and safety assurance in China’s cosmetics industry.

The *Provisions for the Management of Cosmetics Registration and Notification Dossiers* were promulgated on 1<sup>st</sup> May 2021, which conditionally waived the requirement for animal testing of non-special cosmetics imported into China.<sup>7</sup> This reflects a breakthrough in the application of equal treatment by the Chinese Government in terms of registration and notification requirements for domestically produced and imported products.

The Cosmetics Working Group will continue to support the formulation and revision of provisions and standards by the regulatory authorities, offer expert know-how for the formulation and implementation of supporting regulations, and actively cooperate with the authorities to smoothly implement the new regulations. The Cosmetics Working Group expects the regulatory authorities to continue with an inclusive approach to the legislative process, fully heed the opinions of the industry, strengthen field visits and investigations, and objectively assess the actual impact of new

requirements on the whole process of R&D, production and operations. It is recommended that—in line with the best practices of mature, international markets—the Chinese regulatory authorities should, during the extremely intensive promulgation of regulations, minimise the impact of such regulations on the launch of new products. This can help to ensure high-quality development of the cosmetics industry while promoting smooth implementation of new regulations.

## Key Recommendations

### 1. Ensure a Smooth Transition Period with Clear Implementing Guidelines for the Cosmetics Supervision and Administration Regulation (CSAR) Supplementary Legislation 4

#### Concern

The CSAR supplementary regulations contain new and unique requirements, many of which have a short lead-time for enforcement, which will pose many challenges for cosmetics manufacturers.

#### Assessment

The promulgation of the CSAR marks significant progress in promoting administrative streamlining and decentralisation of authority.<sup>8</sup> It also implements a risk-based classification management system, which is conducive to innovation and upgrading R&D operations. Furthermore, the CSAR also encompasses a registrant and notifier system, which improves the compliance level for the entry threshold of cosmetics manufacturing and operations as a whole. However, detailed supporting regulations are needed if all of these systems are to be effectively implemented.

The CSAR significantly alters the definition and scope of cosmetics, the oversight and administration of products with special efficacies and ingredients, and labelling requirements. These alterations will entail changes to the supervisory framework, which in turn will have a long-term impact on the industry. Full consideration should therefore be given to the potential effects that these new regulations may have, and the principle differences between the respective laws and regulations of China and Europe. Only with policies

<sup>5</sup> “Vacancy management” refers to measures that allow copies or electronic versions of documentation for registration and notification to be accepted first, with the original material being submitted when circumstances permit.

<sup>6</sup> *Response Letter to the Request about Issues regarding Cosmetic Registration and Notification Management during Epidemic Prevention and Control*, NMPA, 27<sup>th</sup> April 2022, viewed 6<sup>th</sup> June 2022, <<https://www.nmpa.gov.cn/xxgk/fgwj/gzwl/gzwlzhzhp/20220427173951109.html>>

<sup>7</sup> *Announcement of Provisions for Management of Cosmetic Registration and Notification Dossiers*, State Council, 26<sup>th</sup> February 2021, viewed 18<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-03/04/content\\_5590288.htm](http://www.gov.cn/zhengce/zhengceku/2021-03/04/content_5590288.htm)>

<sup>8</sup> *Cosmetics Supervision and Administration Regulation (CSAR)*, State Council, 29<sup>th</sup> June 2020, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2020-06/29/content\\_5522593.htm](http://www.gov.cn/zhengce/content/2020-06/29/content_5522593.htm)>





that prevent short-term industry fluctuations can the regulations be implemented satisfactorily, to the benefit of companies, consumers and the industry as a whole. Detailed introductions and explanations are essential for the successful implementation of new regulations, as they help the industry fully understand how to comply with new regulations in a consistent way.

### Recommendations

- Implement streamlining and delegation in supplementary legislation to establish an efficient supervision system based on risk management, with companies bearing the responsibility for product quality and safety.
- Provide sufficient transition periods for changes that will have a significant influence on the industry and prepare flexible policies for grace periods on a case-by-case basis, to ensure a smooth and stable transition.
- Collect issues raised during the implementation of new regulations and launch necessary policy interpretations that are pertinent to the implementation and release of the regulations.

## 2. Encourage Safety Supervision in a Scientific Way to Boost Innovation in the Cosmetics Industry

### 2.1 Raw Material Safety Information Submission

#### Concern

In addition to challenges related to obtaining safety information for raw materials from suppliers, which need to be submitted by companies for product registration, there are also inconsistencies in the procedures for obtaining safety data, which poses a potential compliance risk for registered and notified products.

#### Assessment

According to the *Provisions for the Management of Cosmetics Registration and Notification Dossiers (Provisions)*, for newly registered cosmetics that contain functional raw materials—such as antiseptics, sun protection, colouring, hair dye, blemish removal and skin whitening—companies are now required to submit corresponding raw material safety information (reporting codes or details listed in Attachment 14 of the *Provisions*) as of 1<sup>st</sup> January 2022. In addition, applicants will need to provide safety information for raw materials

for all product registration from 1<sup>st</sup> January 2023.<sup>9</sup> The raw material reporting codes will be automatically generated after the raw material suppliers, or other authorised companies, submit the safety information via the Raw Material Safety Information Registration Platform, which also went into operation on 1<sup>st</sup> January 2022. Applicants can then link the codes to their raw material safety information documentation.

However, the results of an internal member survey conducted by the Cosmetics Working Group show little progress in the reporting of raw material safety information among raw material suppliers, with the majority of cosmetic companies only receiving reporting codes for less than 10 per cent of the total raw materials used, which seriously impedes the registration progress for regular cosmetics.

Furthermore, the combined raw material information reported by raw material suppliers is often different to that provided by cosmetics companies during registration. This is due to the adjustment of raw material production processes, different interpretations of the same materials and the failure of raw material suppliers to promptly inform downstream cosmetics companies of such adjustments, among other reasons, which pose compliance risks for cosmetics companies. Compounding this situation, raw material safety information forms and quality information documents that were previously collected from raw material suppliers are often lacking the signatures and seals that are now required for registration under the *Provisions*. The above factors have greatly hindered foreign cosmetics from entering the Chinese market.

#### Recommendations

- Accept new product registration applications when the reporting code for raw material safety information or safety information annex is missing, provided this information can be submitted later.
- Allow an entity's registrant or notifier to fill in raw material safety information, using their own signatures or seals as verification, instead of those of raw material suppliers.
- Regard the raw material safety information submitted by suppliers as being subject to in-market product risk monitoring and traceability.

<sup>9</sup> *Announcement of Provisions for Management of Cosmetic Registration and Notification Dossiers*, State Council, 26<sup>th</sup> February 2021, viewed 18<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-03/04/content\\_5590288.htm](http://www.gov.cn/zhengce/zhengceku/2021-03/04/content_5590288.htm)>





- Cancel the requirement of product re-registration and notification for those registered or notified before 1<sup>st</sup> January 2023 with formula changes in raw material components and content provided by suppliers, if the amount of raw material added in the formula, raw material manufacturer and trade name remain the same (except in cases where name changes are not for quality and safety reasons).
- Develop standardised guidelines for the registration of raw material composition and to identify the proportion of impurities to ensure a consistent raw material reporting standard is used by raw material suppliers and cosmetics companies.

## 2.2 Modern Risk Management System

### Concern

Due to the lack of detailed guidelines, as well as varying levels of capability among both regulators and companies, the procedure for evaluating and implementing the *Technical Guidelines for Cosmetics Products Safety Assessment* is extremely challenging, particularly with regard to innovative assessment methods like the Threshold of Toxicological Concern (TTC) and ‘read-across’.<sup>10</sup>

### Assessment

As of 1<sup>st</sup> January 2022, cosmetic product registrants and notifiers must conduct cosmetic safety assessments and submit reports based on the requirements specified in the *Technical Guidelines for Cosmetic Products Safety Assessment* before applying to either register special cosmetic products or notify general cosmetic products.<sup>11</sup> The guidelines adopt the widely-used principle of weight of evidence and modern safety assessment methods and tools, including TTC, read-across, chemical grouping and other popular non-testing assessment methods. This demonstrates that China’s cosmetics safety evaluation procedure is now in line with advanced, international safety evaluation concepts and methods. However, the supervision enforcement authorities, technical review experts and many cosmetics enterprises in China are not familiar

with these innovative assessment methods. In addition, most enterprises are unable to conduct comprehensive safety assessments due to varying levels of technical capability. Meanwhile, supervision enforcement authorities still lack the skills and practical experience to adequately review the assessment reports submitted by the few enterprises that do have assessment capabilities.

Most major economies and regions have either prohibited or are in the process of setting up a schedule to ban animal testing for cosmetics’ market approval. China is the only country which mandatorily requires animal testing for the registration of certain cosmetics. The *Provisions for the Management of Cosmetics Registration and Notification Dossiers* came into force on 1<sup>st</sup> May 2021, with the intention of allowing general cosmetics (including imported general cosmetics) that meet the required conditions for exemption from submitting results for toxicological testing on animals.<sup>12</sup> This is another important milestone for China in the gradual progress to replace mandatory animal testing. However, for special cosmetics, cosmetics that use new ingredients within the three-year monitoring period, and cosmetics for use by infants and children, as well as new ingredients in the Chinese market, several compulsory toxicological animal tests are still required for registration.

### Recommendations

- Promote alternatives to animal testing, and formulate detailed implementation rules for innovative, non-test assessment methods such as TTC and read-across.
- Phase out the requirement to submit animal test data for the registration of cosmetics in special cases where such data is still needed.

## 2.3 Scientific and Sound Adverse Effects Monitoring Rules for Cosmetics Products

### Concern

The incident report requirement contained in the *Measures for the Management of Cosmetics Adverse Reaction Monitoring*<sup>13</sup> fails to take a proportionate risk-based approach.

10 Read-across is when the already available data of a data-rich substance (the source) is used for a data-poor substance (the target) that is considered similar enough to the source substance to use the same data as the basis for a safety assessment. Elisabet Berggren, *Read-Across with Computational and In vitro Data*, DG Joint Research Centre, European Commission, viewed 11<sup>th</sup> May 2022, <<https://www.toxicology.org/events/shm/fda/docs/4%20SOT%20FDA%20Berggren%20Read-Across.pdf>>

11 *Technical Guidelines for Safety Assessment of Cosmetics (2021 Version) (No. 51 of 2021)*, NMPA, 9<sup>th</sup> April 2021, viewed 18<sup>th</sup> April 2022, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20210409160436155.html>>

12 *Announcement of Provisions for Management of Cosmetic Registration and Notification Dossiers*, State Council, 26<sup>th</sup> February 2021, viewed 18<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-03/04/content\\_5590288.htm](http://www.gov.cn/zhengce/zhengceku/2021-03/04/content_5590288.htm)>

13 *Announcement of the National Medical Products Administration on Publishing the Measures for the Management of Cosmetic Adverse Reaction Monitoring (No. 16, 2022)*, NMPA, 15<sup>th</sup> February 2022, viewed 20<sup>th</sup> April 2022, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/2022021165805149.html>>





### Assessment

The reasons for adverse reactions to cosmetic products are complex and varied. In addition to the cosmetic products themselves, individual allergies, external conditions, underlying diseases, and even diet and medication can trigger adverse reactions. To mitigate adverse reactions to cosmetics that are serious or may cause a greater societal impact, cosmetic product registrants and notifiers should investigate the possible reasons and propose appropriate measures.

The majority of mild adverse reactions to cosmetic products are reported by consumers. The descriptions provided of the reaction, symptoms and other factors are often not objective and scientific enough, making it difficult or even impossible to make accurate judgements about the exact causes of those adverse reactions. Furthermore, in practice, some consumers refuse to be contacted due to personal reasons, which makes follow-up impossible.

If it is necessary to submit a report whenever any suspicious adverse reactions are detected during testing period, this may lead to a large amount of unsubstantiated information on cosmetic products being collected and stored, yet the absolute number of adverse reaction reports is not an indication of actual product safety. The absolute number of adverse reactions reports can be used for initial screening to verify whether products are safe. However, it is necessary to conduct a comprehensive analysis that takes sales volume (product sales are significantly higher during new product launch periods or sales promotions), reaction types and the severity of reactions, as well as correlating evaluation results, into consideration to make an accurate judgement on product safety. High numbers of adverse reactions during sales promotions may be misjudged as severe cases and therefore likely to cause greater societal impact. This would result in subsequent investigations and analysis by monitoring agencies at all levels, which would be a significant waste of administrative resources.

### Recommendation

- Take into consideration the sales quantity, adverse reaction types, and cause and effect when determining product safety.

## 2.4 Feasible Regulatory Supervision Model and Pathway for Innovative Cosmetics Products



### Concern

China has not formulated or implemented specific regulations and standards for innovative cosmetics, such as personalised products and cosmetics used in conjunction with devices, which runs counter to the CSAR's principle of encouraging innovation and impedes the development of the cosmetics industry.

### Assessment

As economies across much of the world become increasingly service-driven, personalised services and cosmetics used in conjunction with devices are emerging as dominant market trends. Consumers are more likely to choose cosmetics according to, for example, their own skin conditions, among other personal preferences. A vast increase in consumer requirements for specific cosmetics has resulted, with personalised products now a fast-growing consumption segment for customers globally. During the China International Import Expos that have taken place so far, cosmetics companies showcased numerous personalised products that embody the latest international innovative technologies, and which proved very popular with attendees.

Personalised products are covered in the European Union's regulations relating to cosmetics and can be launched in the market as long as they meet relevant cosmetics quality and safety requirements. However, in addition to there being no regulations for personalised products in China, companies find there is no flexibility to launch such products. This is because Chinese regulations require that product formulas must be fixed before they can be launched, and also that an appropriate manufacturing licence must be held in order to undertake filling and compounding processes, meaning that personalised services (which can entail the creation of new formulas or dispensed package) cannot be carried out at point of sale.

Across the world, many different types of cosmetics used in conjunction with devices are being developed, in order to improve usage effect and the overall experience. However, in the *Provisions for the Management of Cosmetics Registration and Notification Dossier*, definition of this category as “cosmetics that





must be used in conjunction with devices” is too vague.<sup>14</sup> In conjunction with this, the associated management measures and standards are also not specific enough to guide industry players in implementing requirements in an innovative manner while ensuring compliance.

#### Recommendations

- Establish management and surveillance mechanisms for personalised cosmetics that include administrative provisions on registration and notification, production and sales, in order to allow market access and promote the development of, and meet the demand for, personalised cosmetics in China.
- Provide clear definition and scope of “cosmetics that must be used in conjunction with devices” and refine related detailed management requirements.
- Develop administrative standards with reference to different circumstances and risk control points related to product quality and safety.

### 3. Ensure the Smooth Implementation of the Provisions on the Management of Cosmetics Registration and Notification Dossiers

#### 3.1 Transparent and Unified Evaluation Standards and Guidelines

##### Concern

Due to significant changes following the implementation of the *Provisions on the Management of Cosmetics Registration and Notification Dossiers*,<sup>15</sup> local Medical Products Administrations have not yet been able to apply unified products and ingredients evaluation criteria, which is increasing companies’ operational burdens and impacting their marketing plans.

##### Assessment

There is a long-standing problem in that product reviewers in different regions of China have inconsistent review criteria. In addition, in the new provisions, the NMPA has promulgated new requirements for the registration dossier, including specification of ingredients, samples from trial-production and efficacy claims on packaging, among others. The requirements have changed considerably, so it is necessary for the authorities to formulate and promulgate detailed and

clear interpretations of each section of the registration dossier in a timely manner, and to determine nationwide unified criteria for review. Official interpretations of regulations and the process for implementing related requirements should also be communicated to companies in advance, to allow them to effectively prepare materials that ensure they are in compliance. It would also be beneficial for local supervisors to uniformly review the requirements, so as to avoid wasting companies’ resources.

#### Recommendations

- Formulate detailed, transparent and consistent criteria for the evaluation of cosmetics, as well as guidelines to allow manufacturers to compile registration dossiers.
- Conduct investigations and surveys prior to introducing new or controversial evaluation requirements and then publicly notify companies before such review requirements are implemented.

#### 3.2 Capacity Training for Evaluators and Manufacturers, and Improving Communication Between Different Stakeholders

##### Concern

There is currently a lack of systematic training, and insufficient communication channels between regulators and industry, with regard to implementation of the new requirements under the *Provisions for the Management of Cosmetics Registration and Notification Dossiers*,<sup>16</sup> which leads to different interpretations by different manufacturers, and delays in both registrations and implementation of the new regulations.

##### Assessment

Due to major changes to registration and notification in the *Provisions for the Management of Cosmetics Registration and Notification Dossiers*, stakeholders are struggling to comply with them. Although a large amount of training has been provided by third parties following the promulgation of the *Provisions*, the interpretations provided have been neither consistent nor authoritative, meaning the quality of the training was not assured.

In addition, communication between manufacturers and regulators is currently insufficient due to, among other reasons, a lack of personnel, which leads to

<sup>14</sup> *Announcement of Provisions for Management of Cosmetic Registration and Notification Dossiers*, State Council, 26<sup>th</sup> February 2021, viewed 18<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-03/04/content\\_5590288.htm](http://www.gov.cn/zhengce/zhengceku/2021-03/04/content_5590288.htm)>

<sup>15</sup> Ibid.

<sup>16</sup> Ibid.





delays in providing feedback to manufacturers. With the implementation of new regulations, there is a need for proper consultation to ensure that policies are interpreted by regulators in a unified way and to ensure a smooth registration and notification process for cosmetics.

### Recommendations

- Increase different forms of training by authoritative individuals, such as formal in-person training sessions, online interpretations and question-and-answer (Q&A) sessions, to provide an official interpretation of regulations and consistent answers to specific questions.
- Establish an open consultation and communication mechanism for different stakeholders to support the evaluation and registration of cosmetics.
- Establish a Q&A section on the NMPA's website, sharing regularly updated information on common challenges experienced during the registration process and providing an authoritative interpretation of relevant regulations and provisions.

## 4. Improve the Management of Efficacy Claims and Labelling

### 4.1 Administration of Efficacy Claim Evaluation



#### Concern

The ban on applying the 'read-across' method for efficacy evaluations of similar products, with an exception applied only to multi-shade makeup products, is inconsistent with global norms and results in the need for repetitive tests that increase companies' costs and put pressure on their limited testing resources.

#### Assessment

The read-across evaluation method<sup>17</sup> of similar formulas is an important basic principle and a practical tool in the R&D of cosmetic products. It is widely used within the cosmetics industry internationally in efficacy and safety evaluation. This method can be used for test formulas and marketing formulas at the R&D stage. In order to meet the needs of consumers for varied products,

<sup>17</sup> Read-across is when the already available data of a data-rich substance (the source) is used for a data-poor substance (the target) that is considered similar enough to the source substance to use the same data as the basis for a safety assessment. Elisabet Berggren, *Read-Across with Computational and In vitro Data*, DG Joint Research Centre, European Commission, viewed 11<sup>th</sup> May 2022, <<https://www.toxicology.org/events/shm/fda/docs/4%20SOT%20FDA%20Berggren%20Read-Across.pdf>>

manufacturers often develop multiple flavours or colours of a product based on the same basic formula. In addition, once the EU changes regulations on cosmetics preservatives, manufacturers often need to slightly adjust the formulas of preservatives. However, it is important to understand that such slight changes in essences, pigments and preservatives will not affect the efficacy of a product.

If all products need to be tested for efficacy, as required under the *Guidelines for Cosmetics Efficacy Claim Evaluation*,<sup>18</sup> it will not only be inconsistent with current industry practices, but will also put great pressure on already limited inspection and testing resources, resulting in an increase of testing costs and the delay of product launches. According to incomplete statistics from Cosmetics Working Group member companies, the testing costs of each enterprise will increase by hundreds of thousands, or even millions, of Chinese *yuan* under this requirement. Moreover, unnecessary repeated tests will not bring any benefits to consumers. On the contrary, the increase in costs will eventually be passed on to them.

### Recommendations

- Extend the application scope of the guiding principle of equivalent evaluations to all product efficacies, not only multi-colour cosmetics products.
- Accept an applicant's rationale as to why minor differences in formulas do not affect efficacy, and allow for slight adjustments of pigments, essences and antiseptics in formulas.

### 4.2 Administration of Labelling

#### Concern

The lack of detailed labelling implementation rules brings significant operational challenges to the whole industry.

#### Assessment

New requirements have been added to the *Administrative Measures for Cosmetics Labelling*,<sup>19</sup> obliging manufacturers to include more detail from the original label in Chinese on the labelling for the Chinese market. This includes the full list of ingredients, instructions

<sup>18</sup> *Guidelines for Cosmetics Efficacy Claim Evaluation*, NMPA, 9<sup>th</sup> April 2021, viewed 21<sup>st</sup> April 2022, <<https://www.nmpa.gov.cn/xxgk/ggtg/ggtg/20210409160321110.html>>

<sup>19</sup> *Administrative Measures for Cosmetics Labelling*, NMPA, 9<sup>th</sup> April 2021, viewed 21<sup>st</sup> April 2022, <<https://www.nmpa.gov.cn/xxgk/ggtg/ggtg/20210603171933181.html>>



for use, the shelf-life after opening, and any safety- or efficacy-related words. The *Administrative Measures* also require the Chinese name and date of expiry to be printed on the primary innermost packaging. However, companies encounter many minor and practical difficulties in the implementation of these regulations, including the following:

1. The printing area is limited, not only on small-sized products (<15 grams/15 millilitres), but also on many normal-sized products.
2. The Chinese name of a product, especially that of special cosmetics, can only be printed after being approved by the NMPA, hence the production cycle will be prolonged and the time to market delayed.
3. Imported products to be sold in China cannot use uniform packaging designed for the global market, requiring re-labelling of cosmetics to take place after import, which will increase product quality risks and trade costs.

Although companies can try to increase their labelling space by expanding the outer box, cosmetics packaging also needs to comply with the mandatory national standard *GB 23350 Restrictions on Excessive Packaging Requirements for Food and Cosmetics*.<sup>20</sup> Therefore, if relying only on traditional forms of labelling, the problem of insufficient labelling space cannot be fully resolved.

It is a global trend that electronic labels have been applied in other industries like pharmaceutical and medical devices. The prevalence of smart devices and the technological maturity of digital information systems provide the opportunity to expand the application of digital labelling technology to the fields of consumer goods.

Electronic labelling would meet supervisors' information acquisition requirements and allow traceability of consumer use, while also helping with anti-counterfeiting efforts. Furthermore, it would reduce the amount of packaging material waste, benefitting the environment.

In addition, the *Administrative Measures for Cosmetics Labelling* stipulate that the product safety and efficacy

claims on the Chinese label of an imported product should correspond to the relevant contents of the original label. Since the regulations and management of cosmetics varies widely in different countries, other countries and regions have not put forward similar requirements for imported cosmetics. This provision is equivalent to a disguised mandatory requirement for the labels of foreign original packaging of imported cosmetics to meet the requirements of Chinese regulations. If there are discrepancies, manufacturers must design labels only for export to China, which will seriously impact their global supply chains and logistics.

### Recommendations

- Issue implementation guidelines for the *Administrative Measures for Cosmetics Labelling* as soon as possible.
- Issue a series of supporting policies, such as the use of electronic labels, to resolve the difficulties of labelling for small-sized products.
- Allow the Chinese label to reflect selected efficacy claims within the scope of the *Classification Catalogue of Efficacy Claims*, and allow any information required by the laws and regulations of the region of origin to be either noted on, or covered by, the Chinese label.

### Abbreviations

CNY	Chinese Yuan
CSAR	Cosmetics Supervision and Administration Regulation
GACC	General Administration of Customs of China
NBS	National Bureau of Statistics
NMPA	National Medical Product Administration
Q&A	Question-and-Answer
R&D	Research and Development
TTC	Threshold of Toxicological Concern

<sup>20</sup> *Restrictions on Excessive Packaging Requirements for Food and Cosmetics*, Ministry of Industry and Information Technology (MIIT), 5<sup>th</sup> March 2020, viewed 18<sup>th</sup> April 2022, <[http://www.gdcdc.cn/upfile/2020/03/20200306164707\\_441.pdf](http://www.gdcdc.cn/upfile/2020/03/20200306164707_441.pdf)>



# Energy Working Group

## Key Recommendations

### 1. Gas

#### 1.1 Accelerate the Transition from Coal to Gas in China's Energy Mix

- Emphasise the role of gas in achieving carbon neutrality in China's energy policies.
- Accelerate reform of the gas infrastructure regulatory regime:
  - Open investment to all entities, including private companies and foreign-invested enterprises (FIEs).
  - Ensure open access to all upstream producers and downstream end-users.
  - Clarify the conditions of third-party access for natural gas (NG) infrastructure.
  - Optimise the terms of terminal use agreements (short, mid- and long-term) in tariffs, conditions of capacity attributions and prioritisation, and penalties.
  - Adopt non-discriminatory rules for the sale of infrastructure capacity.
- Encourage provincial pipeline companies to be open to both PipeChina and FIEs.
- Encourage PipeChina to be open to foreign equity.
- Improve downstream competition by giving smaller companies fair and open access to supply, and allowing city gas companies and industrial companies to source directly from gas producers.
- Encourage the building of gas storage systems, particularly underground storage facilities, that are open to all domestic and international investors.
- Develop underground gas storage in a market system with an independent commercial performance index.
- Continue upgrading the market-orientated pricing structure of NG and reduce the levels of gas distribution.
- Clarify market regulation to foster FIEs' direct investments in NG infrastructure to improve security of supply and reduce import needs.
- Encourage liquified NG bunkering by setting up national standards in line with international standards.
- Foster market transparency through early establishment of regulations on information-sharing and monitoring mechanisms.
- Switch from gas production based on coal gasification to biomethane and biogas production from biomasses.
- Incentivise the deployment of methane abatement measures and technologies along the gas value chain.

### 2. Renewable Energy and Power System

#### 2.1 Ensure European Companies Have Equal Access in the Renewable Energy (RE) Sector and Provide a Minimum Quota per Province

- Mandate provincial governments to diversify the ownership of RE projects, by giving five to ten per cent of project development rights to foreign players or Sino-foreign joint ventures, and





clearly define foreign investment as entities that are originally headquartered abroad, rather than foreign subsidiaries of domestic companies.

- Allow more flexibility on the change of shareholding of RE assets before the commercial operation date, and refine relevant regulations to differentiate between speculation and legitimate market activities.
- Further improve the transparency and accessibility of competitive allocation schemes, and increase the weighting of on-grid price components in the bidding criteria.
- Increase the quality of RE projects by setting targets for RE transmission (based on gigawatts per hour), ensuring better administration of the power system, optimising the planning process for new installations and increasing project alignment with international environmental, health and safety standards.
- Accelerate the digitalisation of RE projects by easing restrictions on data transmission and export.

## 2.2 Develop New, High-quality Power Infrastructure and a Well-functioning Power Market

- Enact overall planning and enhance coordination among multiple stakeholders along the supply chain, to set up a new power infrastructure that can integrate with traditional facilities to make the large-scale utilisation of renewables feasible.
- Accelerate the application of digital technology and smart power installations from both the distribution- and demand-side.
- Provide policy schemes to incentivise a wide deployment of decentralised power generation, and to facilitate microgrid penetration, and the use of energy storage.
- Promote green power grid products such as sulphur hexafluoride-free switchgears.
- Develop smart energy management platforms and software to stabilise and balance the load, and lower energy costs and consumption.
- Accelerate the operation of green power markets from pilot runs, expand their coverage, facilitate inter-provincial transactions, and encourage the procurement of long-term power purchase agreements (PPAs).
- Improve synergy among existing policy and market mechanisms such as PPAs, green electricity certificates, provincial renewables portfolio standards and the carbon market.
- Refine transaction rules to increase market accessibility and policy transparency for RE procurement, especially for international companies.

## 2.3 Enhance the Hydrogen Supply Chain and Use of Low-carbon Hydrogen Solutions



- Enhance efforts to invest and develop infrastructures for hydrogen production, transport and distribution.
- Adopt a certification scheme aligned with international standards, such as CertifHy in Europe, to define low carbon and/or renewable hydrogen.
- Reinforce mechanisms to incentivise the large-scale production of low-carbon or renewable-based hydrogen by electrolysis of water using curtailed electricity.
- Define and simplify specific safety regulations to be harmonised at the national level for hydrogen production, distribution, storage (such as liquid hydrogen) and usage (for example, hydrogen refuelling stations).
- Promote medium and long-distance hydrogen transportation using different methods, including





pipelines and/or shipping.

- Implement regulations in accordance with international bodies for liquid hydrogen to optimise hydrogen transportation and develop mobility usage while reducing total cost of ownership.
- Allow on-board storage type IV vessels to increase hydrogen storage density.
- Promote hydrogen usage for power generation, heating and for decarbonising highly polluting industries.

#### 2.4 Set Clear Targets and Policies for the Development of Bioenergy

- Recognise the role of bioenergy in securing energy supply and achieving decarbonisation targets.
- Define national policies and concrete actions for the development of biofuels and biogas (for electricity production), with binding short- and medium-term targets.
- Identify a portfolio of subsidies that provinces can adopt to foster the development of cellulosic bioethanol, biodiesel, biogas and biomethane plants.
- Accelerate government efforts to achieve the E10 policy target nationwide.
- Promote the development of biodiesel by policy mandate, such as the rollout of a nationwide B5 policy.

### 3. Energy Efficiency and Digitalisation

#### 3.1 Boost Innovation in Energy-efficiency (EE) Solutions

- Raise minimum energy performance standards (MEPs) and further expand the EE standards system, including but not limited to MEPs for buildings, data centres and consumer network connected devices.
- Strengthen international communications to harmonise mutual recognition on EE standards and certification schemes in China and the European Union (EU).
- Promote EE improvements for existing coal-fired power plants through equipment retrofitting, while adjusting MEP and greenhouse gas emission thresholds for new coal-fired power plants.
- Further expand EE demonstration and pilot projects, including fourth-generation district energy systems (DES), property EE solutions, the Top Runner Programme and EU-China joint EE projects.
- Promote the concept of total cost of ownership in DES, and evaluate EE objectives and results throughout an asset's life span.
- Further expand the green bond catalogue, set up a national EE innovation fund and establish preferential financing measures for energy service companies.

#### 3.2 Take an Integrated Approach Towards Net-zero Cities

- Adopt a circular economy approach and apply energy-saving solutions throughout urban infrastructure planning, construction and operations.
- Strengthen collaboration in both public and private areas throughout the city value chain, including policy-makers, business, infrastructure and real estate developers, city administrators, civil society and the financial sector.
- Establish a system of common technical standards with which to evaluate and assess environmental sustainability in a consistent and transparent way.
- Initiate and sponsor zero-carbon pilot projects at the local level before gradually scaling up to district and city level.





## Carbon Market Sub-working Group

### 1. Increase the Accuracy and Transparency of Carbon Emissions Monitoring, Reporting and Verification (MRV) in China's National Emissions Trading System (ETS)

- Upgrade the verification management regulations and relevant technical guidelines.
- Carry out a comprehensive assessment of verification agencies and strengthen their capacity according to new procedures and requirements, to determine the recommended list of verification agencies for the national ETS.
- Set up an accreditation institution to ensure the eligibility of verifiers.
- Ensure that public financing for verification is guaranteed, particularly in provinces where public finance faces challenges, to ensure the sustainability of verification.
- Release a specific administrative order to detail the rules for information disclosure.
- Actively explore innovative ways of improving verification work.
- Align China's MRV system with international standards.

### 2. Open the National Carbon Market to Institutional Investors Through Well-formulated Rules and Gradually Introduce Emissions Allowance Auctioning to Boost Market Trading and Enhance Market Liquidity

- Allow institutional investors to participate in the national carbon market, to boost market size and enhance carbon market liquidity.
- Release clear rules to incentivise institutional investors to play a positive role in the national carbon market.
- Develop carbon futures, forwards and options in the national ETS, to establish a complete financial trading, pricing and hedging system for China's carbon emission rights.
- Set a timeline to introduce auctions into the carbon allowance allocation mechanism.
- Build a healthy voluntary carbon market, restart the China Certified Emissions Reduction (CCER) mechanism and develop a clear policy on the harmonisation of CCERs with international carbon credits.

### 3. Facilitate Government, Civil Society and Business Exchanges Between the EU and China on the Latest Decarbonisation Policies and Actions to Reinforce Cooperation in Line with China's 2060 Carbon Neutrality Target and the EU Green Deal

- Engage with both European and Chinese businesses regarding the latest progress of policymaking and implementation, to achieve strategic decarbonisation targets in the EU and China.
- Provide support to domestic think tanks and facilitate their exchanges with EU peers on the rules, progress and impact of the EU's Carbon Border Adjustment Mechanism (CBAM) on EU-China trade and investment.



## Introduction to the Working Group

The Energy Working Group is composed of more than 200 equipment manufacturing, energy production and infrastructure companies, service providers and consultants along the energy value chain. The working group seeks to establish an effective and constructive dialogue on energy policies with relevant regulators, provide input on China's energy policy work and share best practices from European energy industries operating in China. The working group cooperates closely with the European Commission and actively participates in the European Union (EU)-China Energy Cooperation Platform. It also collaborates with the China Electric Power Planning and Engineering Institute, having jointly built the China-Europe Energy Innovation Cooperation network covering 350 major Chinese and European energy companies in four main sectors: smart energy, hydrogen, wind power and energy storage.

## Recent Developments

From September to October 2021, local governments instructed factories to limit power usage, curb output or even halt production until further notice. Severe power shortages occurred shortly afterwards across 20 provinces in China. The factors that led to the energy crunch varied across the country and affected different provinces to differing degrees.<sup>1</sup> The major theme across all regions, however, was the mismatch between high market prices for coal and the wholesale tariff for coal-fired power generators, which remains strictly controlled. In addition, China's 'dual-control' policy—which caps provincial energy consumption and energy intensity—led several local governments to take extreme measures to avoid overrunning their targets for the year.<sup>2</sup> Finally, extreme weather and intermittent renewables output also played a role in some regions. To ease the outages, China took a raft of emergency reform measures to boost coal production capacity and streamline the coal-electricity pricing mechanism. Abrupt power shortages seriously jeopardise industrial operations, creating short-term safety risks—especially in the chemical and healthcare industries—and undermine business confidence in the medium

to long-term. The working group expects the central government to institutionalise policy consultations with all industry stakeholders, including European companies. Local governments should also avoid one-size-fits-all compulsory measures to limit energy usage, and instead adopt realistic, localised planning that allows different regions to peak carbon emissions before 2030 and achieve carbon neutrality by 2060 (30/60 Goals) at a pace suitable for them.

As the national roadmap for decarbonisation, China's '1+N' policy framework is seen as the joint most significant future policy for European Chamber members, alongside those related specifically to restrictions on carbon emissions. On 24<sup>th</sup> October 2021, the '1'—the overarching guidance for realising the 30/60 Goals (*Working Guidance*)<sup>3</sup> was released by the central government; and two days later, the *first Action Plan for Carbon Dioxide Peaking Before 2030 (Action Plan)*<sup>4</sup> as published, marking the start of the 'N'—the detailed action plans for peaking emissions across specific sectors and industries.

Since the 2021 power shortages, the central government has repeatedly emphasised the importance of ensuring national energy security to stabilise economic growth. For instance, a major change in energy cap assessment was revealed at the Central Economic Work Conference in December 2021, with the announcement that newly added renewable capacity and feedstock energy would be excluded from total energy consumption control, thus transitioning from 'dual-control' of energy consumption and intensity to 'dual-control' of total carbon emissions and intensity.<sup>5</sup> This was echoed at the 2022 'Two Sessions', when President Xi Jinping reiterated that coal will continue to be the mainstay of the nation's energy mix.<sup>6</sup> The *14<sup>th</sup> Five-year Plan (14FYP) for the Modern Energy*

1 *The 2021 energy crisis: Implications for China's energy market and policies*, Oxford Energy Forum, March 2022, viewed 22<sup>nd</sup> April 2022, <<https://a9w7k6q9.stackpathcdn.com/wp-content/uploads/2022/03/OEF-131.pdf>>

2 *China warns two-thirds of regions for missing energy targets*, Reuters, 3<sup>rd</sup> June 2021, viewed 8<sup>th</sup> June 2022, <<https://www.reuters.com/business/energy/china-warns-two-thirds-regions-missing-energy-targets-2021-06-03/>>

3 *Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of the New Development Philosophy*, National Development and Reform Commission (NDRC), 24<sup>th</sup> October 2021, viewed 22<sup>nd</sup> June 2022, <[https://en.ndrc.gov.cn/policies/202110/t20211024\\_1300725.html](https://en.ndrc.gov.cn/policies/202110/t20211024_1300725.html)>

4 *Action Plan for Carbon Dioxide Peaking Before 2030*, NDRC, 27<sup>th</sup> October 2021, viewed 22<sup>nd</sup> June 2022, <[https://en.ndrc.gov.cn/policies/202110/t20211027\\_1301020.html](https://en.ndrc.gov.cn/policies/202110/t20211027_1301020.html)>

5 *China to ease energy use curbs to relieve economic pressures*, Reuters, 13<sup>th</sup> December 2021, viewed 23<sup>rd</sup> April 2022, <<https://www.reuters.com/markets/commodities/china-ease-energy-use-curbs-relieve-economic-pressures-2021-12-13/>>

6 You, Xiaoying, *Analysis: What does China's coal push mean for its climate goals?*, Carbon Brief, 29<sup>th</sup> March 2022, viewed 27<sup>th</sup> April 2022, <<https://www.carbonbrief.org/analysis-what-does-chinas-coal-push-mean-for-its-climate-goals>>





*System*<sup>7</sup> also stressed the role that coal will play in ensuring China's basic energy needs. The 14FYP unprecedentedly highlights the balancing capacity of the power system, and that, as a peaking source, gas will develop "where local circumstances permit", given fuel cost and availability considerations.<sup>8</sup> Whereas the 13FYP focussed on overcapacity, the 14FYP names coal as "the backstop of supply security" and excludes caps on coal consumption and coal-fired power capacity. It is clear that China will continue advancing the energy transition, but under the premise of supply security.

As a result of geopolitical tensions, worldwide fuel shortages and skyrocketing oil and gas prices, China is moving to reinforce energy security in every sector. In April 2022, the State Council issued instructions for setting up a unified national energy market<sup>9</sup> to improve the interconnectivity of energy supply chains and ensuring the standardisation of energy infrastructure and trading markets, thus helping China to withstand soaring global commodity prices while enhancing its domestic supply.

China will need to carefully balance energy supply security, price affordability and environmental sustainability. National and regional policies should be coordinated, industry-specific plans under the '1+N' policy framework rapidly rolled out, and a uniform mechanism for carbon emission measurements and verification established.<sup>10</sup> Experiences derived from European technology, solutions and applications can be used to address some of the fundamental challenges China is facing in its energy transition. According to the European Chamber's report, *Carbon Neutrality: The Role of European Companies in China's Race*

to 2060,<sup>11</sup> the majority of European companies have global decarbonisation pledges to fulfil and are already comparatively well advanced with their strategies: 40 per cent have established decarbonisation teams; and 67 per cent have achieved a basic level of preparation. At the government level, the EU is already deep into the process of developing and rolling out the European Green Deal to its 27 Member States. Much like China's provinces, each member state is at a different level of development and has unique socio-economic conditions, making the EU a logical institutional partner for China to collaborate with on decarbonisation.

## Key Recommendations

### 1. Gas

#### 1.1 Accelerate the Transition from Coal to Gas in China's Energy Mix

##### Concern

The transitional role of natural gas (NG) may be compromised by coal as energy security becomes a top priority in 2022, while many foreign companies still encounter difficulties in accessing gas infrastructures.

##### Assessment

##### The role of gas

In comparison to coal, NG is a more reliable, cleaner and safer energy source. In the *Working Guidance* and the *Action Plan*,<sup>12</sup> gas is acknowledged as a clean energy in the decarbonisation of commercial road transportation and vessels; as a peak-shaving facility in the power system, synchronising development with renewable energy (RE); and as a replacement of coal in heavily polluting sectors. However, the National Energy Administration's (NEA's) *Guiding Opinions of Energy Work in 2022*, emphasise coal's importance, particularly its combination with RE.<sup>13</sup> China has also cut import tariffs for coal to zero from May 2022 to March 2023. While coal may be regarded as the cornerstone for energy security in the short term, unabated coal, plus RE, will not be sufficient for China to achieve its 30/60

7 *China's 14<sup>th</sup> Five-year Plan for the Modern Energy System*, NDRC and National Energy Agency (NEA), 22<sup>nd</sup> March 2022, viewed 24<sup>th</sup> April 2022, <[https://www.ndrc.gov.cn/xxgk/zcfb/ghwb/202203/t20220322\\_1320016.html?code=&state=123](https://www.ndrc.gov.cn/xxgk/zcfb/ghwb/202203/t20220322_1320016.html?code=&state=123)>

8 *China's 14<sup>th</sup> Energy Five-year Plan: Pivoting toward a "modern energy system"*, IHS Markit, 13<sup>th</sup> April 2022, viewed 23<sup>th</sup> April 2022, <<https://ihsmarkit.com/research-analysis/chinas-14th-energy-fiveyear-plan-pivoting-toward-a-modern-ener.html>>

9 *China's "National Unified Market" – Standardizing the Domestic Market to Spur Internal Circulation*, China Briefing, 14<sup>th</sup> April 2022, viewed 22<sup>nd</sup> June 2022, <<https://www.china-briefing.com/news/chinas-national-unified-market-standardizing-the-domestic-market-to-spur-internal-circulation/>>

10 For more information on carbon emissions monitoring, reporting and verification, refer to the *Carbon Market Sub-working Group Position Paper 2022/2023*; for more recommendations on decarbonisation at local and national levels, refer to the European Chamber's report *Carbon Neutrality: The Role of European Companies in China's Race to 2060*, European Union Chamber of Commerce in China, 25<sup>th</sup> May 2022, viewed 31<sup>st</sup> May 2022, <<https://www.europeanchamber.com.cn/en/press-releases/3436>>

11 *Carbon Neutrality: The Role of European Companies in China's Race to 2060*, European Union Chamber of Commerce in China, 25<sup>th</sup> May 2022, viewed 31<sup>st</sup> May 2022, <<https://www.europeanchamber.com.cn/en/press-releases/3436>>

12 *Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of the New Development Philosophy*, NDRC, 24<sup>th</sup> October 2021, viewed 22<sup>nd</sup> June 2022, <[https://en.ndrc.gov.cn/policies/202110/t20211024\\_1300725.html](https://en.ndrc.gov.cn/policies/202110/t20211024_1300725.html)>; *Action Plan for Carbon Dioxide Peaking Before 2030*, NDRC, 27<sup>th</sup> October 2021, viewed 22<sup>nd</sup> June 2022, <[https://en.ndrc.gov.cn/policies/202110/t20211027\\_1301020.html](https://en.ndrc.gov.cn/policies/202110/t20211027_1301020.html)>

13 *Guiding Opinions of Energy Work in 2022*, NEA, 17<sup>th</sup> March 2022, viewed 17<sup>th</sup> May 2022, <[http://zfxgk.nea.gov.cn/2022-03/17/c\\_1310534134.htm](http://zfxgk.nea.gov.cn/2022-03/17/c_1310534134.htm)>





Goals. Therefore, the working group strongly advocates for NG to be brought back onto the agenda and play a transitional role.

### Non-discriminatory third-party access (TPA) to gas infrastructures

China's current NG transportation, distribution network and storage capacity are unable to satisfy the growth in demand and energy transition. It is positive that the *14FYP for the Modern Energy System* contains goals for 55–60 billion cubic metres (bcm) of gas storage capacity by 2025, the equivalent of around 13 per cent of gas demand, and over 230 bcm of domestic production by 2025.<sup>14</sup> The storage target implies that government estimates of gas demand are between 423–462 bcm by 2025.

Positive signs for gas market deregulation came with the establishment of the China Oil and Gas Piping Network Corporation (PipeChina) in 2020, which separates transmission and sales businesses, allowing for more market competition for third parties. In 2021, several provinces integrated their gas infrastructures into PipeChina. Under the guidance to accelerate the construction of a unified national market, gas supply chains are expected to be further interconnected, and the infrastructure and trading markets standardised. The working group recommends early establishment of regulations on information-sharing and monitoring mechanisms, allowing PipeChina to publish pipeline and terminal utilisation rates and spare capacity data by location. This would help foreign-invested enterprises (FIEs) access transparent information, thereby facilitating their marketing of gas in China.

FIEs can introduce advanced solutions and best practices into the Chinese NG market (operations and management) if encouraged to play a bigger role. Given that the upstream exploration and wholesale marketing are already open to foreign investors, it is critical to ensure the same applies to all midstream access—the infrastructure—at both the national and provincial level. A lack of access to midstream energy infrastructure upsets the delicate balance between centres of production and consumption, the NG system's ability to deal with seasonal changes and peaks in demand, and the possibility of optimising liquified NG (LNG)

import costs during winter peaks. Several government announcements on opening up midstream access have been made,<sup>15</sup> but real progress in the implementation of these policies is needed. The working group also advocates for more progress in PipeChina's opening to foreign equity, and that underground gas storage be developed in a market system with an independent commercial performance index so that it can fully function.

Production, importation, transportation, storage, distribution and smart metering along the NG supply chain must be carefully planned and well-coordinated, as both effectiveness and efficiency bottlenecks—such as TPA to LNG when state-owned enterprises (SOEs) are reluctant to free up terminal and pipeline infrastructures—restrict market opening, damage the diversification of supply and hinder energy transition. Domestic standards should also be aligned with international ones to promote LNG development, and distributed energy production taken into consideration in order to design efficient grids.

### Decarbonisation across the gas value chain

The long-term emissions benchmark for gas is net zero, therefore developing decarbonised gases will be critical. This can be achieved by capturing the carbon contained in the NG; developing biogas and tackling methane emissions. As well as NG, technical utilisation of biogas is mature enough today for wide commercialisation, yet, a lack of clear incentive policies and stable feedstock supply has led to biogas development lagging far behind. Tackling methane emissions from gas operations is also one of the best near-term opportunities.<sup>16</sup> Policy tools,<sup>17</sup> with the help of transparent and reliable emissions data, can effectively drive down methane emissions. European industries have a wealth of relevant experience in this area.

### Recommendations

- Emphasise the role of gas in achieving carbon

<sup>14</sup> China's 14<sup>th</sup> Five-year Plan for the Modern Energy System, NDRC and NEA, 22<sup>nd</sup> March 2022, viewed 24<sup>th</sup> April 2022, <[https://www.ndrc.gov.cn/xxgk/zcfb/ghwb/202203/t20220322\\_1320016.html?code=&state=123](https://www.ndrc.gov.cn/xxgk/zcfb/ghwb/202203/t20220322_1320016.html?code=&state=123)>

<sup>15</sup> For example, the creation of PipeChina; opening up of LNG terminals for third party access; *Work Plan for the Special Supervision of Fair Opening of NG Pipeline Networks and LNG Terminals*, NEA, 31<sup>st</sup> May 2021, viewed 7<sup>th</sup> June 2022, <[http://zfxgk.nea.gov.cn/2021-05/31/c\\_1310000748.htm](http://zfxgk.nea.gov.cn/2021-05/31/c_1310000748.htm)>; *Catalogue of Encouraged Industries for Foreign Investment (Edition 2022)(Draft)*, NDRC and MOFCOM, 10<sup>th</sup> May 2022, viewed 8<sup>th</sup> June 2022, <[https://hd.ndrc.gov.cn/yjzx/yjzx\\_add.jsp?SiteId=380](https://hd.ndrc.gov.cn/yjzx/yjzx_add.jsp?SiteId=380)>

<sup>16</sup> In the oil and gas sector, it is possible to avoid more than 70 per cent of current methane emissions with existing technology, and around 45 per cent could be avoided at no net cost.

<sup>17</sup> For example, leak detection and repair requirements, technology standards and bans on non-emergency flaring and venting.





- neutrality in China's energy policies.
- Accelerate reform of the gas infrastructure regulatory regime:
    - Open investment to all entities, including private companies and FIEs.
    - Ensure open access to all upstream producers and downstream end-users.
    - Clarify the conditions of TPA for NG infrastructure.
    - Optimise the terms of terminal use agreements (short, mid- and long-term) in tariffs, conditions of capacity attributions and prioritisation, and penalties.
    - Adopt non-discriminatory rules for the sale of infrastructure capacity.
  - Encourage provincial pipeline companies to be open to both PipeChina and FIEs.
  - Encourage PipeChina to be open to foreign equity.
  - Improve downstream competition by giving smaller companies fair and open access to supply, and allowing city gas companies and industrial companies to source directly from gas producers.
  - Encourage the building of gas storage systems, particularly underground storage facilities, that are open to all domestic and international investors.
  - Develop underground gas storage in a market system with an independent commercial performance index.
  - Continue upgrading the market-orientated pricing structure of NG and reduce the levels of gas distribution.
  - Clarify market regulation to foster FIEs' direct investments in NG infrastructure to improve security of supply and reduce import needs.
  - Encourage LNG bunkering by setting up national standards in line with international standards.
  - Foster market transparency through early establishment of regulations on information-sharing and monitoring mechanisms.
  - Switch from gas production based on coal gasification to biomethane and biogas production from biomasses.
  - Incentivise the deployment of methane abatement measures and technologies along the gas value chain.

## 2. Renewable Energy and Power System

### 2.1 Ensure European Companies Have Equal Access in the RE Sector and Provide a Minimum Quota per Province

#### Concern

European companies require a level playing field when competing with Chinese companies in the RE sector.

#### Assessment

Currently, most operational RE projects in China are controlled by a mere handful of companies, particularly SOEs, with foreign enterprises facing more constraints to develop, own or operate renewable assets. Significantly, China's 30/60 Goals have led power generation companies to pursue a more aggressive approach in obtaining development rights for RE projects, especially large-scale ones. Provincial governments are responsible for granting these development rights, while the central government still holds the approval right of provincial planning. It is particularly challenging for foreign players to obtain development rights for RE projects through the current open process. Setting a minimum quota per province and per year for foreign developers and/or investors to develop RE projects would attract additional foreign direct investment while bringing technological improvements.

Several hurdles have often prevented international players from participating in the RE sector. For instance, changing the shareholding of RE assets before commercial operation date is not permitted, in particular due to concerns about speculation.<sup>18</sup> A more flexible regulation would allow foreign players to invest across the whole life cycle of a RE asset. Also, the allocation of development rights for RE projects is not always fully transparent. To boost foreign investment in the projects, local governments should further improve the transparency and accessibility of competitive allocation schemes, and increase the weighting of on-grid price component in the bidding criteria (especially for offshore wind).<sup>19</sup>

<sup>18</sup> An investor having completed the filing procedures for a photovoltaic power plant may not transfer the project to another without consent of the filing authority before the project is brought online, according to the *Notice on Regulating the Order of Photovoltaic Power Plant Investment and Development*, NEA, 28<sup>th</sup> October 2014, viewed 6<sup>th</sup> July 2022, <[http://zfxgk.nea.gov.cn/auto87/201410/t20141029\\_1857.htm](http://zfxgk.nea.gov.cn/auto87/201410/t20141029_1857.htm)>.

<sup>19</sup> Since 2019, offshore wind power projects and their developers are selected by local NEAs through a competitive allocation scheme; *Offshore Wind Worldwide - Regulatory framework in selected countries*, Hogan Lovells, April 2022, viewed





The quality of RE projects also needs to be enhanced. In 2021, China brought 54.88 gigawatts (GW) of new solar power into operation, and added more offshore wind capacity than the rest of the world in the last five years.<sup>20</sup> Yet, equipment often operates below capacity, with the RE curtailment phenomenon being a long-standing problem.<sup>21</sup> Authorities should set targets based on installed capacity as well as the capacity connected to the grid; ensure better coordination among multiple players (central and local governments, grid, power generation companies and large electricity consumers); and consider local consumption capacity when planning new installment projects. Policies and project management requirements that encourage increased alignment with international environmental, health and safety standards should also be formulated to reduce long-term costs.

Finally, restrictions on RE projects' data transmission should be eased. The *14FYP for the Modern Energy System* reiterated the importance of digitalisation, an area in which European companies are well-qualified to contribute solutions. However, more flexibility is needed for convenient data transmission and data transparency. This will boost modern business models such as unattended maintenance and operations, thus increasing performance and driving down the costs of RE project operations.

### Recommendations

- Mandate provincial governments to diversify the ownership of RE projects, by giving five to 10 per cent of project development rights to foreign players or Sino-foreign joint ventures, and clearly define foreign investment as entities that are originally headquartered abroad, rather than foreign subsidiaries of domestic companies.
- Allow more flexibility on the change of shareholding of RE assets before the commercial operation date, and refine relevant regulations to differentiate between speculation and legitimate market activities.

<sup>12</sup> 12<sup>th</sup> May 2022, <[https://www.hoganlovells.com/en/publications/offshore-wind-worldwide\\_regulatory-framework-in-selected-countries](https://www.hoganlovells.com/en/publications/offshore-wind-worldwide_regulatory-framework-in-selected-countries)>

<sup>20</sup> Vetter, David, *China Built More Offshore Wind In 2021 Than Every Other Country Built In 5 Years*, *Forbes*, 26<sup>th</sup> January 2022, viewed 24<sup>th</sup> April 2022, <<https://www.forbes.com/sites/davidvetter/2022/01/26/china-built-more-offshore-wind-in-2021-than-every-other-country-built-in-5-years/?sh=288956744634>>

<sup>21</sup> Especially problematic for onshore wind power in northern areas, due to institutional causes such as the lack of co-ordination in power system administration, leading to transmission constraints, system imbalances and overcapacity, and ultimately to wind power curtailment; *Offshore Wind Worldwide - Regulatory framework in selected countries*, Hogan Lovells, April 2022, viewed 12<sup>th</sup> May 2022, <[https://www.hoganlovells.com/en/publications/offshore-wind-worldwide\\_regulatory-framework-in-selected-countries](https://www.hoganlovells.com/en/publications/offshore-wind-worldwide_regulatory-framework-in-selected-countries)>

- Further improve the transparency and accessibility of competitive allocation schemes, and increase the weighting of on-grid price components in the bidding criteria.
- Increase the quality of RE projects by setting targets for RE transmission (based on GW per hour), ensuring better administration of the power system, optimising the planning process for new installations and increasing project alignment with international environmental, health and safety standards.
- Accelerate the digitalisation of RE projects by easing restrictions on data transmission and export.

## 2.2 Develop New, High-quality Power Infrastructure and a Well-functioning Power Market

### Concern

The digitalisation movement in China's power system has occurred without overall coordination along the supply chain, and the market accessibility for green electricity is limited.

### Assessment

China's 'new infrastructure' proposal<sup>22</sup> has led to a lot of digitalisation movement in the power sector, much without a clear roadmap or coordination among the various players. Hasty investments and redundant construction will quickly lead to problems such as overcapacity, a focus on construction at the expense of operations, and poor integration with traditional infrastructure.

Alongside the digital upgrading of the main power grid, the digitalisation of power distribution and demand-side response is equally important. A smarter energy-production system that can make large-scale utilisation of renewables feasible should be established, and greener power equipment and technologies deployed. For example, 95 per cent of China's power grids use traditional switchgear technology, which contains the world's strongest GHG: sulphur hexafluoride (SF<sub>6</sub>).<sup>23</sup> As for demand-side management, it is essential to develop smart energy management platforms and software that monitor energy consumption data in real time, aiding grid operators in stabilising and balancing the load, and ultimately lowering costs and consumption.

<sup>22</sup> *How Can Foreign Technology Investors Benefit from China's New Infrastructure Plan?* China Briefing, 7<sup>th</sup> August 2020, viewed 23<sup>rd</sup> June 2022, <<https://www.china-briefing.com/news/how-foreign-technology-investors-benefit-from-chinas-new-infrastructure-plan/>>

<sup>23</sup> SF<sub>6</sub> is an extremely potent and persistent greenhouse gas that is primarily utilised as an electrical insulator and arc suppressant.





Many uncertainties surrounding China's power market remain, especially regarding green electricity trading. Since early 2020, demand for green energy among European companies has become increasingly urgent, due to concrete global targets set by their headquarters aimed at decarbonising operations. According to a European Chamber survey, European companies' China and global decarbonisation strategies are closely aligned, both being largely dependent on access to and investment in RE.<sup>24</sup>

While some European companies have achieved carbon neutrality already through the procurement of green electricity certificates (GECs), this is not sufficient for most large manufacturers, which need to purchase green energy directly. It is encouraging to see that, following continuous advocacy efforts by the European Chamber's Tianjin Chapter, preparation for the local green electricity transaction market started in July 2021; while in September 2021, China's green power trade pilot programme was officially launched,<sup>25</sup> helping to accelerate direct green electricity transactions. Yet, more actions are needed to enable large-scale corporate procurement of RE. First, transactions should be shifted from pilot phase to normal operation as soon as possible to establish stable market expectation and scale up transactions. The sources of RE involved in the market should also be expanded.<sup>26</sup> Second, inter-provincial transactions should be promoted to address the unequal demand and supply of RE across different regions in China. Third, long-term (five to ten years) power purchase agreements (PPAs) should be encouraged to provide guaranteed revenue streams for investors. Fourth, linking existing mechanisms—such as direct PPAs, GECs, provincial renewables portfolio standards (RPS) and the carbon emissions trading market—is urgently required to avoid double counting. Finally, improving market accessibility and policy transparency would give international companies confidence they can achieve their renewable consumption commitments for their operations in China. To facilitate this, transaction rules should be refined and clearly disclosed, with regular updates, such as minimum trading volumes and eligible industry sectors

<sup>24</sup> *Carbon Neutrality: The Role of European Companies in China's Race to 2060*, European Chamber, 25<sup>th</sup> May 2022, viewed 31<sup>st</sup> May 2022, <<https://www.eurochamber.com.cn/en/press-releases/3436>>

<sup>25</sup> *Pilot direct trading of green power launched*, *China Daily*, 8<sup>th</sup> September 2021, viewed 22<sup>nd</sup> June 2022, <<https://www.chinadaily.com.cn/a/202109/08/WS6137f32ba310efa1bd66dfa0.html>>

<sup>26</sup> Currently, the pilot programme is only open to large power users and utility-level, subsidy-free wind and solar projects.

for bulk trades.<sup>27</sup>

### Recommendations

- Enact overall planning and enhance coordination among multiple stakeholders along the supply chain, to set up a new power infrastructure that can integrate with traditional facilities to make the large-scale utilisation of renewables feasible.
- Accelerate the application of digital technology and smart power installations from both the distribution- and demand-side.
- Provide policy schemes to incentivise a wide deployment of decentralised power generation, and to facilitate microgrid penetration, and the use of energy storage.
- Promote green power grid products such as SF6-free switchgears.
- Develop smart energy management platforms and software to stabilise and balance the load, and lower energy costs and consumption.
- Accelerate the operation of green power markets from pilot runs, expand their coverage, facilitate inter-provincial transactions, and encourage the procurement of long-term PPAs.
- Improve synergy among existing policy and market mechanisms such as PPAs, GECs, provincial RPS and the carbon market.
- Refine transaction rules to increase market accessibility and policy transparency for RE procurement, especially for international companies.

## 2.3 Enhance the Hydrogen Supply Chain and Use of Low-carbon Hydrogen Solutions



### Concern

Although China has embraced the essential role that hydrogen can play in the process of decarbonisation, onerous or missing regulations are slowing down the proper scale-up of the supply chain, and not enough has been done to develop low-carbon hydrogen solutions.

### Assessment

Throughout 2021 and in early 2022, China reassessed the role hydrogen can play in the energy system, and

<sup>27</sup> *Addressing barriers to large-scale corporate renewable energy procurement in China*, Carbon Trust, March 2022, viewed 15<sup>th</sup> May 2022, <<https://www.carbontrust.com/zh/ziyuan>>





accelerated market development. In mid-2021, the government announced the fuel cell electric vehicles (FCEVs) national pilot scheme.<sup>28</sup> which proposed subsidies to support key cities in their deployment of both FCEVs and associated infrastructures. In December 2021, the *14FYP for Industrial Sectors' Green Development*<sup>29</sup> embraced hydrogen as a key solution in decarbonising hard-to-abate industries. Ultimately, in early 2022, the *14FYP for the Modern Energy System* and the *Medium- and Long-Term Plan for the Development of Hydrogen Energy Industry (2021-2035)* were published, laying out a national strategy for developing the hydrogen energy industry and complementing local plans.<sup>30</sup>

The *14FYP for the Modern Energy System* mainly focusses on energy security, which relies mostly on fossil fuels. It also maintains strong momentum in investment in RE when associated with storage solutions, for which hydrogen is essential. At the same time, the first-ever national hydrogen development plan confirms the molecule as an essential element in China's future energy system, and clarified the key targets for its development.<sup>31</sup>

Development of the industry also took place at local and individual company levels. A large number of provinces and cities enhanced their hydrogen strategies, with clear targets for FCEVs and infrastructure deployment. Both local and foreign companies are actively investing across the entire value chain, deploying the latest technologies related to green hydrogen production, conditioning, hydrogen refuelling stations<sup>32</sup> and FCEV manufacturing.

There are still several steps China must take to further support hydrogen deployment. The supply chain needs to be enhanced and become much more efficient. Although production scaling-up and cost reduction is

ongoing, thanks to technological progress, the rest of the supply chain (such as storage, transportation and dispensing) is still lagging due to missing regulations. Therefore, regulations regarding medium and long-distance hydrogen transportation using liquid hydrogen and/or NG pipelines must be implemented to foster an efficient and scalable supply chain while decreasing total cost of ownership.<sup>33</sup> Second, China needs to enhance development of infrastructures for hydrogen production, transport and distribution, as well as increases in hydrogen storage density by upgrading on-board storage to Type IV vessels and hence improving FCEV competitiveness.<sup>34</sup> Finally, China's numerous codes and standards on hydrogen value chains should be simplified and aligned with those already issued by internationally recognised bodies, such as the International Standards Organization,<sup>35</sup> to create a more sustainable and globally competitive market.<sup>36</sup>

China also needs to decarbonise hydrogen production. Options include promoting schemes such as using RE for water electrolysis, biomethane reforming and capturing existing low-carbon off-gases. This could be enhanced by a certification scheme aligned with international standards, such as the EU's CertifHy, to define low-carbon and renewable hydrogen production.

Hydrogen also has great potential to decarbonise heavy polluting industries. For instance, a hydrogen-based power system can act as a systemic 'buffer' for harmonising continuous production from fossil fuels, nuclear plants and intermittent production from renewables to optimise electricity supply and demand patterns.<sup>37</sup> Therefore, re-electrification from green or low-carbon hydrogen should be promoted, starting with pilot schemes. Plans are underway for electricity produced by large-scale RE projects in western and northern China to be transported through various

28 This scheme initially included three city alliances around Beijing, Shanghai and Guangdong, and was later extended to Hebei and Henan provinces.

29 *14FYP for Industrial Sectors' Green Development*, Ministry of Industry and Information Technology, 3<sup>rd</sup> December 2021, viewed 31<sup>st</sup> May 2022, <[https://www.miit.gov.cn/jgsj/jns/lszz/art/2021/art\\_6e16097b9b924904906bb4543d72e3ef.html](https://www.miit.gov.cn/jgsj/jns/lszz/art/2021/art_6e16097b9b924904906bb4543d72e3ef.html)>

30 Chipman Koty, Alexander, *China's Hydrogen Energy Industry: State Policy, Investment Opportunities*, China Briefing, 4<sup>th</sup> April 2022, viewed 24<sup>th</sup> April 2022, <<https://www.china-briefing.com/news/chinas-hydrogen-energy-industry-government-policies-foreign-investment-outlook/>>

31 According to the plan, China aims to lower costs for green hydrogen; explore hydrogen-related technology research and innovation; have 50,000 FCEVs on the road and produce 100,000–200,000 tonnes of hydrogen using renewable sources annually by 2025.

32 Ningjing Liu, *Sinopec to Build 1,000 Hydrogen Refuelling Stations by 2025*, Seneca ESG, 23<sup>rd</sup> February 2021, viewed 27<sup>th</sup> April 2022, <<https://www.senecaesg.com/blog/sinopec-to-build-1000-hydrogen-fueling-stations-by-2025/>>

33 Total cost of ownership is an estimate of all the direct and indirect costs involved in acquiring and operating a product or system over its lifetime.

34 Onboard hydrogen storage continues to be a key technical barriers for widespread adoption of hydrogen fuel cell vehicles. Type IV vessels are composite tanks made of carbon fibre with a polymer liner (thermoplastic). They are the lightest of the pressure vessels, making them most suitable for vehicle applications.

35 *ISO/TC 197 Hydrogen Technologies*, ISO, n.d., viewed 17<sup>th</sup> May 2022, <<https://www.iso.org/committee/54560.html>>

36 For more information on alignment with international standards, please refer to the *Standards and Conformity Assessment Working Group Position Paper 2022/2023*.

37 *Harnessing the Full Power of Renewable Energy with Hydrogen*, European Commission, 29<sup>th</sup> August 2016, viewed 26<sup>th</sup> May 2022, <<https://ec.europa.eu/programmes/horizon2020/en/news/harnessing-full-power-renewable-energy-hydrogen>>





carriers (pipelines, liquid hydrogen or ammonia) to the eastern region. In addition, in the heating sector, legislation, standards and remunerations to blend hydrogen into NG pipelines should be introduced.<sup>38</sup> Likewise, more support is needed to develop hydrogen usage as a feedstock for heavily-polluting industries such as steel, cement and glass.

### Recommendations

- Enhance efforts to invest and develop infrastructures for hydrogen production, transport and distribution.
- Adopt a certification scheme aligned with international standards, such as CertifHy in Europe, to define low carbon and/or renewable hydrogen.
- Reinforce mechanisms to incentivise the large-scale production of low-carbon or renewable-based hydrogen by electrolysis of water using curtailed electricity.
- Define and simplify specific safety regulations to be harmonised at the national level for hydrogen production, distribution, storage (such as liquid hydrogen) and usage (for example, hydrogen refuelling stations).
- Promote medium and long-distance hydrogen transportation using different methods, including pipelines and/or shipping.
- Implement regulations in accordance with international bodies for liquid hydrogen to optimise hydrogen transportation and develop mobility usage while reducing total cost of ownership.
- Allow on-board storage type IV vessels to increase hydrogen storage density.
- Promote hydrogen usage for power generation, heating and decarbonising highly polluting industries.

## 2.4 Set Clear Targets and Policies for the Development of Bioenergy

### Concern

The promotion of bioenergy use in China is hampered by a lack of the concrete actions and policy support necessary to ease implementation at the regional level.

### Assessment

As part of its 30/60 Goals, China has attached a growing importance to bioenergy, and is exploring

integrating bioenergy (such as bioethanol, biodiesel, biogas) into oil and gas pipelines to diversify the energy mix.

Cellulosic ethanol—produced from fibrous lignin contained in straw—is regarded as a good substitute for traditional gasoline in the transportation sector. Promoting cellulosic ethanol will help China reduce its dependence on gasoline while accelerating decarbonisation before total electrification and widespread application of hydrogen energy. If the E10 policy continues to advance in China,<sup>39</sup> and the annual consumption of biofuel ethanol reaches nine million tonnes, crude oil imports can be reduced by around 27 million tonnes, which should in turn cut carbon emissions by 21 million tonnes. However, preliminary research and achieving economies of scale in cellulosic ethanol production will require continuous capital investment. Government support and subsidies are therefore necessary to facilitate large-scale production of cellulosic ethanol, which will foster a mature market for biofuel.

Biodiesel can also provide alternatives to fossil fuels in the heavy transportation sector, and even in aviation and maritime transport. Animal fats, vegetable oils, used cooking oils and high-acidity oils are all good raw materials for producing biodiesel.<sup>40</sup> In terms of application, either pure biodiesel can be used (B100), or it can be blended with petro-diesel. While a B5 mandate is implemented in many European countries,<sup>41</sup> Shanghai has been the only Chinese city to implement it so far. As biodiesel is key to China's green transition in the transportation and agricultural sectors, a nationwide B5 mandate would accelerate this movement.

### Recommendations

- Recognise the role of bioenergy in securing energy supply and achieving decarbonisation targets.
- Define national policies and concrete actions for the development of biofuels and biogas (for electricity production), with binding short- and medium-term targets.
- Identify a portfolio of subsidies that provinces

<sup>39</sup> E10 petrol contains 10 per cent biofuel ethanol. See: *The Plan for Expanding Biofuel Ethanol Production and Promoting Ethanol Usage in Motor Vehicles*, NEA, 13<sup>th</sup> September 2017, viewed 27<sup>th</sup> April 2022, <[http://www.nea.gov.cn/2017-09/13/c\\_136606035.htm](http://www.nea.gov.cn/2017-09/13/c_136606035.htm)>

<sup>40</sup> An enzymatic process helps convert these tougher oils into biodiesel and improve production rates, while significantly reducing pollution caused by harsh chemicals.

<sup>41</sup> B5 is five per cent biodiesel, 95 per cent petroleum diesel.

<sup>38</sup> McDonald, Jeff & Robinson, J.; *Platts Expands Hydrogen Assessments; Efforts to Blend with Natural Gas Increasing*, S&P Global Platts, 1<sup>st</sup> April 2020, viewed 17<sup>th</sup> May 2022, <<https://www.spglobal.com/platts/en/market-insights/latest-news/natural-gas/040120-platts-expands-hydrogen-assessments>>





can adopt to foster the development of cellulosic bioethanol, biodiesel, biogas and biomethane plants.

- Accelerate government efforts to achieve the E10 policy target nationwide.
- Promote the development of biodiesel by policy mandate, such as the rollout of a nationwide B5 policy.

### 3. Energy Efficiency and Digitalisation

#### 3.1 Boost Innovation in Energy-efficiency (EE) Solutions

##### Concern

As China plans to shift from control of energy intensity to carbon intensity, it poses the risk that the importance of EE will be diluted.

##### Assessment

China has made remarkable achievements in EE, especially since introducing the binding ‘dual-control’ targets and the energy conservation inspection mechanism during the 11FYP period (2006–2010). From 1998 to 2020, China’s energy intensity dropped by around 45 per cent. However, as the Chinese economy entered the mid-to-late industrialisation phase, many provinces have been struggling to achieve their EE targets. Furthermore, China’s shift to carbon intensity control poses the risk that support for EE solutions may be diluted in the transition process. Energy efficiency, as the ‘first fuel’, should remain central to China’s energy transition roadmap; and the Chinese Government should reiterate its ambitions to strengthen innovative EE solutions and incentivise further EE improvements.

First, it is crucial to raise minimum energy performance standards (MEPs) and expand the EE standards system.<sup>42</sup> China also needs to collaborate with the EU on mutual recognition of EE standards and certification schemes, thereby reducing costs for importers and exporters. Second, efficiency increases can be attained through retrofitting<sup>43</sup> existing coal-fired power stations with carbon capture and storage systems, and adjusting MEP and greenhouse gas emissions thresholds for newly approved coal-fired power plants. Third, modern, smart district energy systems (DES) should be widely used to efficiently heat and cool buildings. Currently, more than 30 per cent of heat generated is

42 including but not limited to MEPs for buildings, data centres and consumer network-connected devices.

43 Work carried out to improve an existing building by making it more energy-efficient.

wasted during distribution, due to a lack of automatic control measures. The integration of a full-range of digital and mechanical solutions,<sup>44</sup> coupled with enforcement of pay-per-use regulations, is needed to significantly reduce energy losses and optimise overall performance. In addition, the concept of long-term total cost of ownership should be introduced, to ensure the functionality of the pipe systems and the district heating operations over time. Fourth, EE demonstration and pilot projects should be further expanded, including fourth-generation DES,<sup>45</sup> property EE solutions and the Top Runner Programme,<sup>46</sup> as well as EU-China joint EE projects. Finally, green finance instruments should be leveraged to incentivise EE innovation and the market as a whole. This can be done through further expanding the green bond catalogue,<sup>47</sup> setting up a national EE innovation fund and establishing preferential financing measures for energy service companies.

##### Recommendations

- Raise MEPs and further expand the EE standards system, including but not limited to MEPs for buildings, data centres and consumer network connected devices.
- Strengthen international communications to harmonise mutual recognition on EE standards and certification schemes in China and the EU.
- Promote EE improvements for existing coal-fired power plants through equipment retrofitting, while adjusting MEP and GHG emission thresholds for new coal-fired power plants.
- Further expand EE demonstration and pilot projects, including fourth-generation DES, property EE solutions, the Top Runner Programme and EU-China joint EE projects.
- Promote the concept of total cost of ownership in DES, and evaluate EE objectives and results throughout an asset’s life span.
- Further expand the green bond catalogue, set up a national EE innovation fund, and establish preferential financing measures for energy service companies.

44 These solutions include energy metering, hydraulic dynamic balancing, automatic control valves, frequency pump controls and artificial-intelligence-based operation/management systems.

45 *Distribution of district heating: 4<sup>th</sup> Generation*, Danfoss, June 2020, viewed 23<sup>rd</sup> June 2022, <<https://assets.danfoss.com/documents/57293/BE343939535432en-010101.pdf>>

46 Japan’s Top Runner Programme, introduced in 1999, is a set of EE standards for energy-intensive products, such as home appliances and motor vehicles.

47 *Green Bond Endorsed Projects Catalogue (2021 Edition)*, PBOC, 21<sup>st</sup> April 2021, viewed 29<sup>th</sup> April 2021, <<http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4342400/2021091617180089879.pdf>>





### 3.2 Take an Integrated Approach Towards Net-zero Cities

#### Concern

An integrated approach to the planning and operation of the urban ecosystem can boost energy efficiency while reducing overall emissions and costs.

#### Assessment

Cities today account for 70 per cent of global emissions and consume 78 per cent of primary energy.<sup>48</sup> Despite increasing focus on maximising energy efficiency in power infrastructure, factories, buildings, data centres and public transportation, progress has mostly taken place in isolation. A holistic, cross-sectoral approach to the planning and operations of the urban ecosystem should therefore be adopted.

Systemic efficiency, a circular economy approach to water, waste, and materials, can boost energy efficiency and decarbonise cities.<sup>49</sup> Systemic efficiency encompasses clean electrification, smart digital technology, and efficient buildings and infrastructure. The Suzhou Industrial Park is a leader in systemic efficiency through circularity of industrial waste and by-products. Accounting for more than 13 per cent of Suzhou's gross domestic product, the cluster's energy intensity has dropped by 10.3 per cent over the past four years. Clean energy consumption represents more than 75 per cent of its energy usage, the largest share among all national development zones in China. Significantly, more than 90 per cent of investment in the park comes from foreign-owned enterprises, and more than two-thirds of the industrial output value is created by foreign capital.<sup>50</sup> Companies in a cluster can scale up efficiency gains, driving shared value across the cluster and the surrounding areas. Therefore, local governments should initiate and sponsor pilot projects such as net-zero industrial parks, residential compounds and campuses.

To maximise EE, energy-saving solutions should be applied throughout the urban design and building process, and in the renovation of existing building

envelopes, heating, cooling, lighting and other facilities and equipment in public institutions and transport. For instance, district heating expansion could be coordinated with building renovations.<sup>51</sup>

#### Recommendations

- Adopt a circular economy approach and apply energy-saving solutions throughout urban infrastructure planning, construction and operations.
- Strengthen collaboration in both public and private areas throughout the city value chain, including policy-makers, business, infrastructure and real estate developers, city administrators, civil society and the financial sector.
- Establish a system of common technical standards with which to evaluate and assess environmental sustainability in a consistent and transparent way.
- Initiate and sponsor zero-carbon pilot projects at the local level before gradually scaling up to district and city level.

### Abbreviations

14FYP	14 <sup>th</sup> Five-year Plan
bcm	Billion Cubic Metres
COD	Commercial Operation Date
DES	District Energy System
EE	Energy Efficiency
ESCO	Energy Service Company
EU	European Union
FCEV	Fuel Cell Electric Vehicles
FIE	Foreign-invested Enterprise
GEC	Green Electricity Certificate
GHG	Greenhouse Gas
GW	Gigawatt
LNG	Liquefied Natural Gas
MEP	Minimum Energy Performance Standards
NDRC	National Development and Reform Commission
NEA	National Energy Administration
NG	Natural Gas
PPA	Power Purchase Agreement
RE	Renewable Energy
RPS	Renewables Portfolio Standard
SF6	Sulphur Hexafluoride
SOE	State-owned Enterprise
TPA	Third-Party Access

48 *Net Zero Carbon Cities: An Integrated Approach*, World Economic Forum, 11<sup>th</sup> January 2021, viewed 16<sup>th</sup> May 2022, <[http://www3.weforum.org/docs/WEF\\_Net\\_Zero\\_Carbon\\_Cities\\_An\\_Integrated\\_Approach\\_2021.pdf](http://www3.weforum.org/docs/WEF_Net_Zero_Carbon_Cities_An_Integrated_Approach_2021.pdf)>

49 Ibid.

50 *How industrial clusters can become net-zero carbon exemplars*, World Economic Forum, 11<sup>th</sup> March 2021, viewed 31<sup>st</sup> May 2022, <<https://www.weforum.org/agenda/2021/03/how-industrial-clusters-can-become-net-zero-carbon-exemplars/>>

51 *District Heating*, IEA, November 2021, viewed 15<sup>th</sup> May 2022, <<https://www.iea.org/reports/district-heating>>





## Carbon Market Sub-working Group

### Introduction to the Sub-working Group

The Carbon Market Sub-working Group advocates for functional domestic and international frameworks for greenhouse gas (GHG) emissions trading. It is a sub-working group of the European Chamber's Energy Working Group and consists of approximately 70 member companies that represent all aspects of the carbon market sector, including project developers, carbon funds, investors, lawyers, auditors and consultants, as well as financial institutions and companies under compliance obligations. The sub-working group seeks involvement in a carbon market that results in real and verifiable GHG reductions, while balancing economic efficiency with environmental integrity and social equity.

To deliver on the Paris Agreement's climate goals, the sub-working group advocates for market-orientated carbon pricing by:

- seeking to strengthen the credibility and functionality of today's carbon markets;
- calling for wider market access to China's carbon markets;
- promoting accelerated growth of high-integrity, voluntary markets with globally harmonised trading rules;
- fostering a framework for common, robust accounting rules to create a new, more ambitious international carbon trading mechanism; and
- building a professional community and networks that can deliver a just transition to net zero in the longer term.

### Recent Developments

On 22<sup>nd</sup> September 2020, at the United Nations (UN) General Assembly, President Xi Jinping pledged that China would peak emissions before 2030, and achieve carbon neutrality before 2060.<sup>1</sup> In line with these pledges, the Ministry of Environment and Ecology (MEE) and the State Council have issued a number

of key regulatory documents that allow for trading in China's national ETS to begin. The documents include guidelines and rules covering allowance allocation, legal compliance and institutional arrangements, monitoring, reporting and verification (MRV) of emissions, and data transparency.

In order to regulate the emissions allowance allocation to enterprises, on 30<sup>th</sup> December 2020, the MEE issued the *2019–2020 Implementation Programme for National Carbon Emissions Trading Quota Setting and Allocation (Power Generation Industry)* and the *List of Covered Entities for 2019–2020 National Carbon Emissions Trading Quota Management*.<sup>2</sup> The allowance allocation programme defines the list of entities in the power generation sector that are participating, and mentions for the first time that responsibility for carbon emissions control at the national level has now been transferred to enterprises. This is of great significance for promoting supply-side structural reforms targeting energy conservation and emissions reduction, as well as high-quality economic development that does not sacrifice either the environment or people's health,<sup>3</sup> because the entities covered by the ETS will have compliance obligations. This will engender more stringent adherence to regulations and incentivise decarbonisation actions at the enterprise level.

The MEE's *Measures for the Administration of National Carbon Emissions Trading (Measures)*<sup>4</sup> came into force on 1<sup>st</sup> February 2021, with the first compliance cycle running from January 2021 to 31<sup>st</sup> December 2021, covering 2019 and 2020 emissions. More than two thousand power companies have been allocated allowances, making it the world's largest ETS.<sup>5</sup> Other key emitting industries are expected to be included

<sup>1</sup> Full text of Xi's statement at the General Debate of the 75<sup>th</sup> Session of the United Nations General Assembly, Qiu Shi, 23<sup>rd</sup> September 2020, viewed 19<sup>th</sup> April 2022, <[http://en.qstheory.cn/2020-09/23/c\\_538398.htm](http://en.qstheory.cn/2020-09/23/c_538398.htm)>

<sup>2</sup> Notice on List of Covered Entities for 2019–2020 National Carbon Emissions Trading Quota Management, MEE, 30<sup>th</sup> December 2020, viewed 6<sup>th</sup> May 2022, <[http://www.mee.gov.cn/xxgk2018/xxgk/xxgk03/202012/t20201230\\_815546.html](http://www.mee.gov.cn/xxgk2018/xxgk/xxgk03/202012/t20201230_815546.html)>

<sup>3</sup> Meeting on Carbon Market Administrative Policy, MEE, 5<sup>th</sup> January 2021, viewed 15<sup>th</sup> June 2022, <[http://www.mee.gov.cn/ywdt/hjywnews/202101/t20210105\\_816140.shtml](http://www.mee.gov.cn/ywdt/hjywnews/202101/t20210105_816140.shtml)>

<sup>4</sup> Measures for the Administration of National Carbon Emissions Trading, MEE, 5<sup>th</sup> January 2021, viewed 19<sup>th</sup> April 2022, <[https://www.mee.gov.cn/xxgk2018/xxgk/xxgk02/202101/t20210105\\_816131.html](https://www.mee.gov.cn/xxgk2018/xxgk/xxgk02/202101/t20210105_816131.html)>

<sup>5</sup> The First Implementation Cycle of the National Carbon Market was Officially Launched, Xinhua, 6<sup>th</sup> January 2021, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-01/06/content\\_5577348.htm](http://www.gov.cn/xinwen/2021-01/06/content_5577348.htm)>





later, once conditions are met.

The *Measures* provide a high-level interim regulatory framework for carbon emission allowance allocation, registration, trading and settlement, and MRV, as well as the supervision and management of these activities. Provincial environment and ecology bureaus collected information from participating entities to open accounts in the registry and exchange platform, which was submitted to the MEE.

The MEE has established a three-tiered governance structure: the national authority (MEE) sets the rules and oversees the system, sharing joint oversight of trading activities with other regulators; provincial environment and ecology bureaus oversee the implementation of these rules; and municipal-level authorities assume local management duties.

On 30<sup>th</sup> March 2021, a draft of the *State Council Interim Regulation on the Management of Carbon Emissions Trading (Interim Regulation)* was published for comment.<sup>6</sup> The *Interim Regulation* addresses inter-ministerial coordination on overall ETS regulatory oversight and imposes higher-level penalties to deter non-compliance. It also leaves space for an absolute cap on allowance and sets more detailed rules on MRV and information disclosure.

On 19<sup>th</sup> May 2021, the MEE issued a series of rules for participating entities in the power generation sector on registering and interacting with the national registry systems, based in Hubei and Shanghai respectively.<sup>7</sup> These rules came into force on the date of issuance, further setting forth specific provisions on registration, settlement and trading, and providing direction for Hubei and Shanghai to formulate specific operating rules during the next stage.

On 16<sup>th</sup> July, the long-awaited National Carbon Trading System was finally launched on the Shanghai Environment and Energy Exchange. Trading started at Chinese yuan (CNY) 48 per tonne, with prices remaining modest on the opening day as expected. During the

initial stage of the market, spot trading of allowances was only carried out among 2,162 key emitting enterprises in the power sector; however, it is expected that financial institutions and individual investors will gradually join trading in the future. On 26<sup>th</sup> October 2021, the MEE issued the *Notice on the Clearing and Settlement of the Carbon Emission Allowances in the First Compliance Cycle of the National Carbon Emissions Trading Market*, stipulating that enterprises are permitted to offset no more than five per cent of their emissions via the China Certified Emissions Reduction (CCER) scheme. It further established that there is no restriction on the varieties and generation time of CCERs (except that those used must not come from emission-reduction projects already included under national carbon market allowance management). This means that tens of millions of tonnes of CCERs previously under the United Nation's (UN's) Clean Development Mechanism can enter the national carbon market, which will greatly enhance market vitality and increase the price of CCERs. In 2021, 160.4 million tonnes of CCERs were traded, marking a significant increase from the previous year.

Released in December 2021, the *Guidelines on Accounting Methodology and Reporting on GHG Emissions for Enterprises (revised)* regarding MRV:

- clarified the accounting boundaries and definition of units;
- intensified quality control and process management regarding emissions data;
- improved the accounting details and enhanced operability;
- ensured fairness and consistency;
- updated the average emissions factor for the national power grid; and
- added information disclosure requirements for technical service providers.

The first compliance cycle of the national emissions trading market was successfully concluded on 31<sup>st</sup> December 2021, achieving a 99.5 per cent performance completion rate. By that point, the national carbon market had run for 114 trading days, recording 162 million tonnes in cumulative trading volume as well as trading carbon emission allowances worth CNY 7.7 billion. The closing price on 31<sup>st</sup> December 2021 was CNY 54.22 per tonne, up 13 per cent from the opening price on the first day. More than half of the key emitting

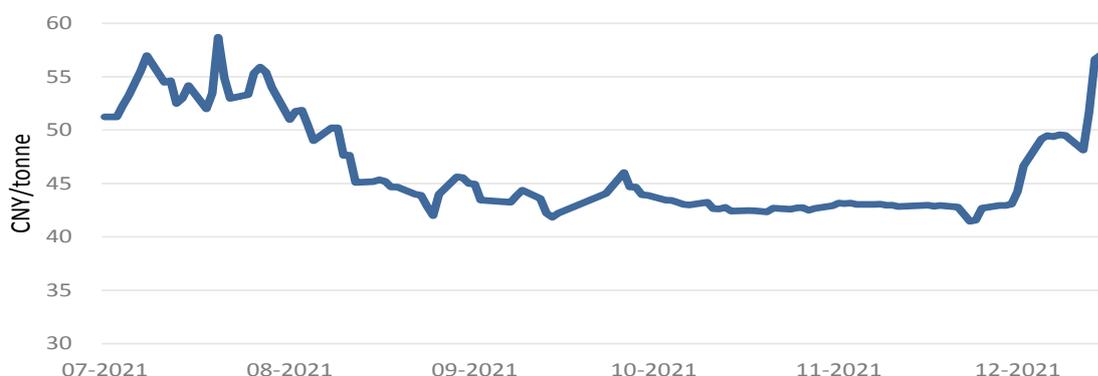
<sup>6</sup> *Call for Comments on Draft of the State Council Interim Regulation on the Management of Carbon Emissions Trading (Interim Regulation)*, MEE, 30<sup>th</sup> March 2021, viewed 6<sup>th</sup> May 2022, <[http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/202103/20210330\\_826642.html](http://www.mee.gov.cn/xxgk2018/xxgk/xxgk06/202103/20210330_826642.html)>

<sup>7</sup> *The Rules on Carbon Trading Registration Management (trial), the Rules on Carbon Trading Management (trial), and the Rules on Carbon Trading Settlement Management (trial)*, MEE, 19<sup>th</sup> May 2021, viewed 6<sup>th</sup> May 2022, <[http://www.mee.gov.cn/xxgk2018/xxgk/xxgk01/202105/20210519\\_833574.html](http://www.mee.gov.cn/xxgk2018/xxgk/xxgk01/202105/20210519_833574.html)>





Figure 1: Price trend in national carbon market (CNY/tonne), 2021 China Carbon Pricing Survey



units actively participated in market trading. Since the start of online trading, the operation of the national carbon market has been stable, and has helped to raise awareness of emissions reduction among enterprises, contributing to an increasingly active market.<sup>8</sup> In general, the role of the national carbon market as a key policy tool to control and reduce GHG emissions and to promote the realisation of China's carbon peaking and carbon neutrality goals has been gradually enhanced.

To date, China's ETS only covers the power generation sector; there is no official roadmap or timetable for expanding coverage to the other eight sectors that were nominated in the initial discussions of the national ETS.<sup>9</sup> The MEE is reportedly accelerating sectoral expansion and plans to include at least a few more by 2025. Although policymakers, policy advisors and market participants have raised different proposals regarding which of the eight sectors should be prioritised, the consensus is that cement and aluminium are the strongest candidates.<sup>10</sup> The gradual inclusion of more energy-intensive industries, including aviation, papermaking and building materials, and the introduction of more emitting entities with varying mitigation costs during the 14<sup>th</sup> Five-year Plan period

would help to give more play to the role of market-based carbon pricing.

The eight regional carbon markets in Shenzhen, Shanghai, Beijing, Guangdong, Tianjin, Hubei, Chongqing and Fujian have shown positive results in terms of emissions reduction,<sup>11</sup> and provided valuable experience for the central government to establish a national carbon pricing mechanism. Each province has set up respective carbon intensity-based caps on emissions, rather than the absolute caps implemented by other international ETS. The Chinese Government believes that this approach is the most suitable given the dual demands of achieving economic growth and emissions reduction, without compromising the country's energy security. Transitioning from carbon intensity-based allocation of allowances to an absolute cap on emissions is increasingly recognised as an important step to improve the effectiveness of the ETS, to incentivise transformational change both in the power sector and in other industrial sectors that will be added into the system in the coming years.

While the pilots will continue to operate parallel to the national ETS, it is anticipated that overlapping entities will be gradually integrated into the national market instead. Large emitting companies in various sectors other than power generation are still regulated by the respective regional markets, though some captive power plants in Beijing and Guangdong are gradually shifting

8 Slater, H., De Boer, D., Qian, G. & Shu, W., 2021 *China Carbon Pricing Survey*, *China Carbon Forum*, 22<sup>nd</sup> January 2022, viewed 19<sup>th</sup> April 2022, <[http://www.chinacarbon.info/wp-content/uploads/2022/02/EN\\_2021-China-Carbon-Pricing-Survey-Report.pdf](http://www.chinacarbon.info/wp-content/uploads/2022/02/EN_2021-China-Carbon-Pricing-Survey-Report.pdf)>

9 Petrochemicals, chemicals, building materials, steel, non-ferrous metals, papermaking and civil aviation, in addition to the power sector.

10 *In-depth Q&A: Will China's emissions trading scheme help tackle climate change?*, Carbon Brief, 24<sup>th</sup> June 2021, viewed 20<sup>th</sup> April 2022, <<https://www.carbonbrief.org/in-depth-qa-will-chinas-emissions-trading-scheme-help-tackle-climate-change>>

11 *The effectiveness of China's regional carbon market pilots in reducing firm emissions*, PNAS, 20<sup>th</sup> December 2021, viewed 15<sup>th</sup> June 2022, <<https://www.pnas.org/doi/10.1073/pnas.2109912118>>



to the national ETS. The pilots' role will decrease as the national ETS develops and an increasing number of entities shift to it from their regional ETS.<sup>12</sup> Yet, at the moment, there is very little information about how the incompatibility between the pilots and national ETS will be addressed (technical issues such as mismatched sectoral coverage and thresholds for inclusion), and what concrete milestones will be implemented when transitioning from regional pilots to a fully functioning national ETS.

The launch of the national ETS marks a significant step towards the goal of realising the intended role of carbon pricing, hence reducing China's emissions. Around 40 per cent of China's annual carbon emissions have so far been covered by the national ETS. With the continuous improvement of the carbon pricing mechanism, China's carbon market is expected to grow into a large market with a trading value of CNY 100 billion, which will provide a price signal and even financial support for carbon emissions reduction across the economy.<sup>13</sup>

The Paris Agreement provides a solid basis for the functioning of international carbon markets and reinforces global targets, transparency and the accountability of Parties, by allowing Parties to use international trading of emission allowances; establishing a framework for common robust accounting rules; and creating a new, more ambitious market mechanism. For much of the remaining work necessary to strengthen the system, and to develop a thriving market, the experience and involvement of European companies will be invaluable. In May 2022, the European Chamber released *Carbon Neutrality: The Role of European Business in China's Race to 2060*, a significant report that identifies areas in which EU-China cooperation can be deepened so that China can front load the technologies it needs to accelerate its carbon neutrality drive.<sup>14</sup> The sub-working group looks forward to cooperating proactively with the Chinese authorities in the coming years to promote an effective and vibrant carbon market that plays a major role in achieving China's carbon neutrality goals.

<sup>12</sup> *The first year of China's national carbon market reviewed*, China Dialogue, 17<sup>th</sup> February 2022, viewed 20<sup>th</sup> April 2022, <<https://chinadialogue.net/en/climate/the-first-year-of-chinas-national-carbon-market-reviewed/>>

<sup>13</sup> *How can China's national carbon market contribute to reducing emissions?* China Dialogue, 20<sup>th</sup> August 2021, viewed 19<sup>th</sup> April 2022, <<https://chinadialogue.net/en/climate/how-can-chinas-national-carbon-market-contribute-to-reducing-emissions/>>

<sup>14</sup> *Carbon Neutrality: The Role of European Companies in China's Race to 2060*, European Union Chamber of Commerce in China, 25<sup>th</sup> May 2022, viewed 31<sup>st</sup> May 2022, <<https://www.eurochamber.com.cn/en/press-releases/3436>>

## Key Recommendations

### 1. Increase the Accuracy and Transparency of Carbon Emissions Monitoring, Reporting and Verification (MRV) in China's National Emissions Trading System (ETS)

#### Concern

Although progress has been made in improving the accuracy and transparency of emissions data, detailed rules for information disclosure and legal support for stringent enforcement are still needed, as well as alignment of China's MRV system with international standards.

#### Assessment

##### Accuracy: improving MRV

The reliability of GHG emissions data is the cornerstone of any carbon pricing policy tool. To ensure the credibility of ETS data, it is important that an effective and accountable regulatory framework for MRV is enforced in relation to CO<sub>2</sub> emissions. It is also important to introduce an appeal mechanism to allow disputes arising from enforcement to be solved in a fair and efficient way. The following challenges still exist with China's ETS:

- 1) The 24 technical guidelines issued on MRV need to be modified in response to problems that have arisen in practice. The MRV of GHG emissions involves many varied industrial production procedures—including industrial sectors with complex industrial processes such as chemicals, petrochemicals, steel and cement—that require clear identification and definition of an abundance of factors, boundaries, methodologies and formulas. In the past eight years of measuring GHG emissions since the first guidelines were issued, manufacturers in these industrial sectors have provided a great deal of tangible feedback and suggestions based on their experiences, which should be taken into account when modifying technical guidelines relating to the nationwide ETS.
- 2) The supervision of the performance of verification agencies needs to be strengthened. The professionalism, compliance and technical capability of verifiers will greatly affect the credibility of the monitoring results. However, currently, each province selects verification agencies based on





their own criteria, due to the absence of a unified national rule. The draft of the *Interim Regulations on the Management of Carbon Emissions Trading*, released for public comment in March 2021, states that provincial governments will secure the agencies through public procurement to verify the GHG emissions of entities, but more details are yet to be released.<sup>15</sup>

- 3) In terms of violations by third-party verifiers, the revised draft cancels fines and instead says that violations will be recorded in the Corporate Social Credit System, and only bans offending entities from operating verification business for three years (Article 26).<sup>16</sup> This contrasts starkly with the outright ban that was stipulated in the earlier 2019 regulation. Given the expected demand for verification services and the potential shortage of experienced, well-qualified verifiers, there is a risk that insufficient penalties may leave the door open to potential fraud.
- 4) The capacity of enterprises in non-pilot regions to conduct MRV still needs to be enhanced. As the most important stakeholder in the process of MRV, enterprises must understand how to apply the guidelines in their own factories or installations, and how to respond to the requests of verifiers and authorities. Despite much training on MRV having been provided for enterprises, there is still strong demand for further capacity-building due to the complexity of the process and frequent changes to requirements. As multinational companies can help to improve MRV services overall, it is therefore important that market access for MRV service providers be based on technical capacity and worldwide track record rather than nationality. Currently, foreign companies are not yet allowed access to this market at all; they can only provide secondary consulting on processes but cannot conduct the official MRV.

### Transparency: promoting the disclosure of climate-related information at the enterprise level

To run effectively, markets rely on an unimpeded flow of information, clear rules and rigorous oversight. The Carbon Market Sub-working Group therefore advocates for more transparency in market activity, aggregated if necessary to protect commercially sensitive information.

<sup>15</sup> *Call for Comments on Draft of the State Council Interim Regulation on the Management of Carbon Emissions Trading*, MEE, 30<sup>th</sup> March 2021, viewed 19<sup>th</sup> April 2022, <[http://www.mee.gov.cn/xxgk/xxgk06/202103/t20210330\\_826642.html](http://www.mee.gov.cn/xxgk/xxgk06/202103/t20210330_826642.html)>

<sup>16</sup> *Ibid.*

The MEE, under the State Council, is responsible for regularly disclosing information on carbon emission allowance trading and on the completion status of carbon emission allowances submitted by entities each year. By the end of the first half of 2022, the MEE had not yet disclosed the total emissions and total allocated allowances from the first compliance period, which leaves uncertainties over the status of compliance and market balances.

In a well-designed system, the regulator should develop a transparent platform and provide access to complete, unrestricted data on trading, emissions and compliance. This would promote business confidence in the environmental and financial integrity of China's ETS. It would also provide an additional level of scrutiny, allowing for early detection of systemic risks.

Furthermore, stakeholders need market information regarding supply and demand imbalances, and CO<sub>2</sub> emissions in order to design and implement a sound compliance strategy. The platform for information disclosure of power generation should be easily accessible and trackable. Companies that are already engaged in the early stages of evaluating the impact of carbon pricing policies on their businesses and strategies should be encouraged to share information on their governance and risk management best practices.

There is a range of policies on carbon-related information disclosure across China's provinces. Apart from the pilot carbon markets, there are five provinces that have issued measures on GHG information disclosure (Shaanxi, Sichuan, Jiangxi, Jilin and Zhejiang). In addition, the central government is including information disclosure in the key performance indicators (KPIs) of local governments. Therefore, all provinces will report the progress of work on disclosure in their annual progress reports.

In December 2021, the MEE issued the *Measures for the Administration of Legal Disclosure of Enterprise Environmental Information*,<sup>17</sup> which represents China's latest push to standardise and mandate environmental, social and governance (ESG) reporting for companies. This provides another tool for the government to hold market entities accountable for violations of

<sup>17</sup> *Measures for the Administration of Legal Disclosure of Enterprise Environmental Information*, MEE, 18<sup>th</sup> December 2021, viewed 19<sup>th</sup> April 2022, <[https://www.mee.gov.cn/xxgk/xxgk02/202112/t20211221\\_964837.html](https://www.mee.gov.cn/xxgk/xxgk02/202112/t20211221_964837.html)>





environmental regulations. A wide range of market entities—including both those that engage in production with a high environmental impact and those that finance such projects—will need to submit an annual report detailing environmental information, such as emissions of carbon and pollutants, pollution control facilities and history of environmental violations, among others.<sup>18</sup>

While the new regulations on information disclosure will likely boost transparency for large emitters, it is uncertain what level of transparency will be required for ETS-related data. In the regional pilot markets, regulators have consistently declined to release full data sets that are easily comparable year-on-year, usually opting instead to give an approximation of the number of allowances distributed each year, the number of market participants and the share of participants meeting annual compliance obligations.

To further improve the accuracy and transparency of carbon-related information in China's national ETS, it is necessary to release a specific administrative order, detailing the exact requirements for the disclosure of data, the pace at which disclosure is expected and an overall timeline for the procedure. Moreover, it is important to actively explore new ways of conducting verification work. This should include taking advantage of the technical standards and management system of the MEE and its local branches.

The practical challenges facing China's ETS should be taken into account, and the experience of other environmental market mechanisms and data management systems should be drawn upon, with regard to verification agency qualifications, standardisation, pricing and methodologies. Aligning China's MRV with international standards avoids reinventing the wheel, while contributing to building a harmonised international carbon market. China should also establish an accreditation authority that has open, detailed and transparent rules for organisations applying for accreditation. It can regularly conduct in-depth audits of these organisations, spot-checking projects and accompanying sites, thus ensuring their eligibility to be third-party verifiers. In the interests of transparency, a list of qualified verifiers should be disclosed to the

public on an annual basis.

#### Recommendations

- Upgrade the verification management regulations and relevant technical guidelines.
- Carry out a comprehensive assessment of verification agencies and strengthen their capacity according to new procedures and requirements, to determine the recommended list of verification agencies for the national ETS.
- Set up an accreditation institution to ensure the eligibility of verifiers.
- Ensure that public financing for verification is guaranteed, particularly in provinces where public finance faces challenges, to secure the sustainability of verification.
- Release a specific administrative order to detail the rules for information disclosure.
- Actively explore innovative ways of improving verification work.
- Align China's MRV system with international standards.

## 2. Open the National Carbon Market to Institutional Investors Through Well-formulated Rules and Gradually Introduce Emissions Allowance Auctioning to Boost Market Trading and Enhance Market Liquidity 🌸

#### Concern

Although it is widely recognised that the participation of institutional investors is critical for market-based price formation, market liquidity and resilience, financial institutions and non-compliance entities are not yet allowed to participate in China's carbon market.

#### Assessment

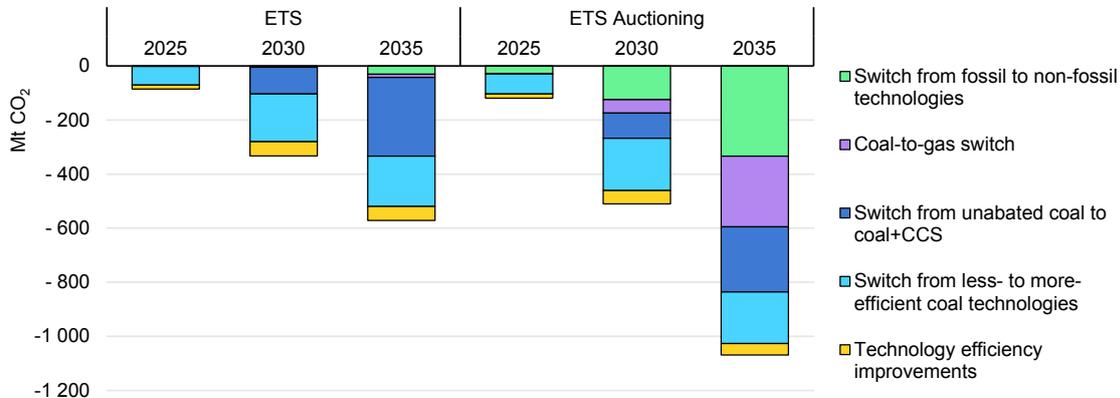
China's carbon market has so far limited trading to covered enterprises only, and has been dominated by the bulk transactions of state-owned enterprises that were made in order to meet their emission reduction targets. Although the Chinese Government has indicated that when conditions are ready the national carbon market will be opened up to institutional investors, such as financial institutions, only covered entities in the power sector can currently trade. There is also scope for regulators to explore the potential for providing additional and varied trading products (for example, forwards, futures and options), which

<sup>18</sup> China ESG Reporting – New Measures on Disclosure of Enterprise Environmental Information, China Briefing, 23<sup>rd</sup> February 2022, viewed 19<sup>th</sup> April 2022, <<https://www.china-briefing.com/news/china-esg-reporting-disclosing-enterprise-environmental-information/>>





Figure 2: Factors yielding additional emissions reductions in the ETS and ETS Auctioning Scenarios compared with the No-Carbon-Pricing Scenario, 2025–2035, IEA and Tsinghua University<sup>20</sup>



would be able to efficiently drive price discovery of the true value of carbon reductions.<sup>19</sup> Diversifying market participants and trading products are important steps to enhance liquidity and create additional stakeholders to ensure healthy development of the market over time.

The ETS would be more effective in terms of cutting emissions if emissions allowance auctioning was gradually introduced, making enterprises more aware of carbon costs. Allowances in China’s ETS are currently allocated for free, based on a unit’s actual generation during the first compliance period (2019–2020). With free allowance allocation, the carbon cost imposed by the ETS remains limited, as only entities facing allowance deficits need to purchase allowances for compliance. This is a key factor in why the regional markets have not been very active, and consequently not led to effective pricing.

Traditionally, ETSs are introduced with emissions allowances being allocated freely as a measure to assist the transition to address competitiveness and carbon leakage concerns. Nonetheless, gradually phasing out free allocation has two main advantages that often eventually outweigh these concerns. First, auctions increase the incentive for participants to mitigate their emissions by requiring them to purchase their right to

emit, truly applying the ‘polluter pays principle’ relative to their contribution to climate change.<sup>21</sup> Allowance auctioning in China’s output-based ETS would make it more attractive to switch to non-fossil and gas fuel sources, leading to faster decommissioning of existing coal-fired units and fewer installations of new ones. Second, auctions create new revenues that can be invested in low-carbon technologies, or used to address distributional impacts and electricity affordability. The higher the share of allowance auctioning, the deeper and quicker power sector decarbonisation is likely to be.

Gradually phasing in allowance auctioning according to a clear timeline would accelerate the energy transition, allowing market participants time to adapt to the system while creating a stronger market signal that China is strengthening its decarbonisation actions through a market-orientated approach.

Co-ordinating the ETS with other market-based policies, such as the CCER offsetting scheme, could further accelerate the energy transition while reducing the cost of emissions. In March 2017, all applications related to CCER projects and registration were suspended (due to a low trading volume and lack of standardisation in carbon audits), and have not yet resumed. In November 2021, the State Council announced that the Beijing Green Exchange will host the national trading platform

<sup>19</sup> Forward and futures contracts are the agreement between two parties to buy and sell an asset at a specified price by a certain date, while options give buyers the right, but not the obligation, to buy or sell an underlying asset at an agreed-upon price and date. Price discovery is the overall process, whether explicit or inferred, of setting the spot price or the proper price of an asset, security, commodity or currency.

<sup>20</sup> *The Role of China’s ETS in Power Sector Decarbonisation*, IEA, April 2021, viewed 19<sup>th</sup> April 2022, <<https://www.iea.org/reports/the-role-of-chinas-ets-in-power-sector-decarbonisation>>

<sup>21</sup> The ‘polluter pays principle’ is the commonly held belief that those who cause pollution should bear the costs.



of CCERs. According to the Shanghai Environment and Energy Exchange, the government was actively preparing for the relaunch of CCER in 2022. Analysts assume that, after the scheme resumes, low trading volumes will no longer be a problem once more sectors are included in the national ETS.<sup>22</sup>

The voluntary carbon market is a crucial tool for funding climate solutions. There should be no contradiction between a company cutting its own emissions and using high-quality voluntary carbon credits to compensate for residual emissions. Looking ahead, the working group is anticipating a clear policy on the usage of offsets, such as the eligibility for CCER application, the types of CCERs to be used and the harmonisation of CCERs with international carbon credits.

#### Recommendations

- Allow institutional investors to participate in the national carbon market to boost market size and enhance carbon market liquidity.
- Release clear rules to incentivise institutional investors to play a positive role in the national carbon market.
- Develop carbon futures, forwards and options in the national ETS to establish a complete financial trading, pricing and hedging system for China's carbon emission rights.
- Set a timeline to introduce auctions into the carbon allowance allocation mechanism.
- Build a healthy voluntary carbon market, restart the CCER mechanism and develop a clear policy on the harmonisation of CCERs with international carbon credits.

### 3. Facilitate Government, Civil Society and Business Exchanges Between the EU and China on the Latest Decarbonisation Policies and Actions to Reinforce Cooperation in Line with China's 2060 Carbon Neutrality Target and the EU Green Deal

#### Concern

In order to achieve their ambitious climate targets, both the EU and China need to incentivise wide-ranging and

exclusive exchanges on the latest policies and actions among multiple stakeholders, which will help to achieve political reciprocity, and boost EU-China commercial cooperation and trade relations.<sup>23</sup>

#### Assessment

Climate change requires collective action on a global scale because most GHG emissions accumulate over time and mix globally. Moreover, emissions by any agent—individuals, communities, companies or countries—affect other agents. International climate change negotiations have traditionally been driven at a national level, but the 2015 Conference of the Parties (COP) in Paris resulted in the recognition that an important role can and should be played by local governments, cities, the private sector and civil society.<sup>24</sup> The Paris Agreement entered into force at the end of 2016.<sup>25</sup> As a long-lasting agreement, it establishes a broad desire for controlling climate change. The agreement has mechanisms for countries to come back to the table to propose new plans,<sup>26</sup> but of course the responsibility for staying the course lies with everyone.

In September 2021, the EU and China issued a Joint Press Communiqué following the Second EU-China High-level Environment and Climate Dialogue, and during COP26, the United States and China released a Joint Glasgow Declaration on Enhancing Climate Action in the 2020s. Although China was generally seen as a constructive contributor at COP26, there is increasing attention being paid to China's domestic efforts to reduce its reliance on coal. Most analyses of long-term pathways see carbon pricing playing a key role in these efforts.<sup>27</sup>

Looking into the EU Green Deal and China's 30/60 Goals, both parties seem to share many common objectives related to achieving a low-carbon economy and the UN's Sustainable Development Goals (SDGs). Of particular relevance are SDG13 (taking urgent action to combat climate change and its impacts),

23 For more information on EU-China climate cooperation, please refer to the *Energy Working Group Position Paper 2022/2023*.

24 One example of this multi-stakeholders and bottom-up initiative is the US Climate Alliance created in 2017: *US States Form Alliance to Meet Paris Climate Commitments*, *Financial Times*, 6<sup>th</sup> June 2017, viewed 20<sup>th</sup> April 2022, <<https://www.ft.com/content/27c5bad2-4895-11e7-919a-1e14ce4af89b>>

25 *Adoption of the Paris Agreement*, UNFCCC, 12<sup>th</sup> December 2015, viewed 20<sup>th</sup> April 2022, <<https://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf>>

26 The Paris Agreement's pledge and review mechanism aims to secure and increase the level of ambition among the Parties and is essential to keep the world on a low-emissions pathway.

22 *What is the China Certified Emission Reduction scheme and why is it important for Beijing's carbon neutral goal?*, *South China Morning Post*, 31<sup>st</sup> January 2022, viewed 5<sup>th</sup> May 2022, <<https://www.scmp.com/business/article/3165425/what-china-certified-emission-reduction-scheme-and-why-it-important>>





and SDG7 (ensuring access to affordable, reliable, sustainable and modern energy for all). They pave the way for businesses in the EU and China to engage and cooperate to create mutually beneficial commercial opportunities in the transition to a low-carbon economy.

Both China and the EU have recognised that market-based instruments are one of the most cost-effective policy tools in addressing climate change. As such, they have been cooperating on ETS since 2014, with joint projects to support emissions trading in China. In view of these successful past exchanges, a Memorandum of Understanding to Enhance Cooperation on Emissions Trading was signed between both parties,<sup>28</sup> which saw the establishment of an EU-China policy dialogue on ETS. This dialogue now takes place regularly at director general or vice minister level. The sub-working group expects that the EU and China will maintain close exchanges and cooperation on ETS in the next couple of years, aiming to demonstrate how the two largest carbon markets in the world can jointly adopt and improve their carbon pricing policies and measures to achieve ambitious climate targets.

Perhaps the most controversial EU measure is the Carbon Border Adjustment Mechanism (CBAM), which is now in the legislative process. The related GHG emissions reporting is likely to start from 2023 on carbon-intensive imports to counter carbon leakage. The CBAM is viewed as an instrument of fair competition within the EU – it ensures foreign companies bear the same environmental costs as European competitors. However, Chinese commentators are unsure about the EU's motivation for creating the CBAM and criticise its scope, design, risks and compatibility with the Paris Agreement and the World Trade Organization.<sup>29</sup>

China exports more manufactured goods and services to the EU than any other country. Unsurprisingly, the introduction of the CBAM—the pace of which may be accelerated according to proposals by some EU Member States—has thus raised concerns among Chinese stakeholders. To overcome this, not only should the EU communicate CBAM policies more

transparently and frequently, but China should also proactively conduct rigorous research, encourage effective bilateral or multilateral dialogues, formulate coping strategies, and explore a cooperative rule-setting process. Above all, multilateralism and cooperativeness are urgently needed to move the global climate agenda forward.<sup>30</sup>

### Recommendations

- Engage with both European and Chinese businesses regarding the latest progress of policymaking and implementation, to achieve strategic decarbonisation targets in the EU and China.
- Provide support to domestic think tanks and facilitate their exchanges with EU peers on the rules, progress and impact of the EU's CBAM on EU-China trade and investment.

### Abbreviations

CBAM	Carbon Border Adjustment Mechanism
CCER	Chinese Certified Emission Reduction
CNY	Chinese Yuan
CO <sub>2</sub>	Carbon Dioxide
COP	Conference of the Parties
ESG	Environmental, Social and Governance
ETS	Emissions Trading System
EU	European Union
GHG	Greenhouse Gas
KPI	Key Performance Indicators
MEE	Ministry of Ecology and Environment
MRV	Monitoring, Reporting and Verification
SDGs	Sustainable Development Goals
UN	United Nations

27 Slater, H., De Boer, D., Qian, G. & Shu, W., 2021 *China Carbon Pricing Survey*, *China Carbon Forum*, 22<sup>nd</sup> January 2022, viewed 19<sup>th</sup> April 2022, <[http://www.chinacarbon.info/wp-content/uploads/2022/02/EN\\_2021-China-Carbon-Pricing-Survey-Report.pdf](http://www.chinacarbon.info/wp-content/uploads/2022/02/EN_2021-China-Carbon-Pricing-Survey-Report.pdf)>

28 *EU and China step up cooperation on climate change and clean energy*, EU Commission, 16<sup>th</sup> July 2018, viewed 20<sup>th</sup> April 2022, <[https://ec.europa.eu/info/news/eu-and-china-step-cooperation-climate-change-and-clean-energy-2018-jul-16\\_en](https://ec.europa.eu/info/news/eu-and-china-step-cooperation-climate-change-and-clean-energy-2018-jul-16_en)>; <[https://ec.europa.eu/clima/system/files/2018-07/20180713\\_mou\\_en.pdf](https://ec.europa.eu/clima/system/files/2018-07/20180713_mou_en.pdf)>

29 *EU-China climate policy – balancing cooperation and pressure*, MERICS, 30<sup>th</sup> July 2021, viewed 20<sup>th</sup> April 2022, <<https://merics.org/en/short-analysis/eu-china-climate-policy-balancing-cooperation-and-pressure>>

30 *EU-China Roundtable on Carbon Border Adjustment Mechanism*, Agora Energiewende, July 2021, viewed 20<sup>th</sup> April 2022, <[https://static.agora-energiewende.de/fileadmin/Projekte/2021/2021-02\\_EU\\_Lead\\_markets/A-EW\\_222\\_EU-China\\_CBAM\\_WEB.pdf](https://static.agora-energiewende.de/fileadmin/Projekte/2021/2021-02_EU_Lead_markets/A-EW_222_EU-China_CBAM_WEB.pdf)>





# Fashion and Leather Working Group

## Key Recommendations

### 1. Amend the Product Quality Law 5

#### 1.1 Remove the Abstract Term ‘Unqualified Product’ and Introduce the Concept of ‘Safe Product’, and Confirm Whether a Product’s Conformity with Mandatory National Standards or a Product Having Unreasonable Risk Can Be Used as Criteria for Judging its Safety and Initiating Administrative Penalties

- Remove the term ‘unqualified product’ and introduce the term ‘safe product’.
- Confirm whether a product’s conformity with national standards, or its potential to cause unreasonable risk, can be used as criteria in assessing its safety and initiating administrative penalties.
- Ensure that voluntary standards cannot be used as the basis for administrative penalties.

#### 1.2 Confirm That if Products Fail to Satisfy Their Declared Quality Standards Enterprises Only Assume Civil Responsibility

- Clarify that enterprises shall only bear civil liability for a safe product that does not meet the quality standards claimed by the enterprise, and shall not be subject to administrative penalties.

### 2. Revise the Mandatory National Standard GB 18401 National General Safety Technical Code for Textile Products 5

- Launch the revision of *GB 18401-2010* as early as possible, and consider adjusting the colour fastness criteria for special products.
- Take the half-grade-difference into consideration as a general safety conformity scale and apply it when judging the conformity of a product.
- Change colour fastness from being a ‘key quality item’ to a ‘normal quality item’ when making national-, provincial- or city-level implementation rules for product inspections, and apply it in product inspections, to facilitate a change in the safety scale and judging standard for product conformity.
- Include the test for dyes and auxiliaries that pose a risk of harming personal health in the safety assessment of mandatory standard *GB 18401*.

### 3. Take Resolute Action to Curb the Sale of Fake Goods Online and Promote Industrial Self-governance 4

- Call on grassroots courts, especially local intellectual property (IP) courts, to be more proactive in identifying the relevant responsibilities of platforms in individual cases and ensure various network platforms, including social media, actively fulfil their social and legal responsibilities for IP rights (IPR) protection.
- Supervise and encourage courts at all levels throughout China to actively strengthen IPR protection online by sharing case studies of ground-breaking judgments.
- Classify platforms (for example, traditional e-commerce and social media platforms) according to modes of query, channels of information display, methods of user access, payment and settlement, and other technical features, and set up proper administrative measures.
- Reconsider the guarantee scheme under the E-Commerce Law and introduce a court system to



give a decision whether or not a guarantee should be accepted and the measures against the infringement be withdrawn.

- Encourage the development and improvement of standards related to the protection of IPR in e-commerce and promote them to be adopted in relevant legislation.
- Take heed of and respect effective IPR protection models agreed between rights holders and platforms.

#### 4. Release the Implementing Legislation for the Personal Information Protection Law (PIPL) as Soon as Possible, to Provide Companies with Clear Guidance on Data Compliance and Secure Cross-border Data Transfer

- Encourage enterprises to abide by relevant regulation through internal contracts and corporate commitments.
- Encourage and promote the reasonable autonomy of enterprises and industries for general e-commerce operations.

#### 5. Allow Enterprises to Not Display Recommended Product Standards on Imported Apparel 2

- Clarify that apart from domestic compulsory standards, imported clothing and leather products do not need to display a Chinese product standard on the product nor mandatorily implement voluntary standards.

## Introduction to the Working Group

Established in 2016, the Fashion and Leather Working Group is comprised of 12 members, mainly from European fashion and leather industry, that produce and import high-end apparel, leather bags, suitcases, shoes and other fashion-related products for the Chinese market. The working group represents the high-end consumer goods industry when communicating with relevant policymakers on common industry issues.

Since its establishment, the working group has actively followed relevant legislative developments and offered recommendations for creating an orderly market environment that protects the rights and interests of consumers.

## Recent Developments

The working group covers the following sectors: textiles, clothing, leather goods and high-end consumer goods. The following policy updates over the past year have

had a significant impact on European Chamber member companies operating in the industry:

### 1. Product Quality Law

The working group has been closely following the latest revision of the Product Quality Law since it was first announced in 2019.<sup>1</sup> In 2021, due to the COVID-19 pandemic, the department responsible for drafting the revision within the State Administration for Market Regulation (SAMR) made slow progress; no updated draft proposal was released and the SAMR did not arrange any consultation in 2021 with important external stakeholders, whereas they had done so with the European Chamber and other foreign chambers of commerce in October 2020. The working group notes that the Product Quality Law is part of the SAMR's legislative work plan for 2022,<sup>2</sup> and expects significant

1 *Revision of the Product Quality Act in full swing*, State Administration for Market Regulation (SAMR), 25<sup>th</sup> April 2019, viewed 15<sup>th</sup> April 2022, <[http://www.samr.gov.cn/xw/zj/201904/t20190425\\_293135.html](http://www.samr.gov.cn/xw/zj/201904/t20190425_293135.html)>

2 *Notice of the SAMR on the Issuance of the Legislative Work Plan for 2022*, SAMR, 26<sup>th</sup> April 2022, viewed 10<sup>th</sup> May 2022, <[https://gkml.samr.gov.cn/nsjg/fgs/202204/t20220427\\_344262.html](https://gkml.samr.gov.cn/nsjg/fgs/202204/t20220427_344262.html)>





progress over the coming year, including a draft being submitted for public comments.

## 2. Textiles - Technical Specification for Identification of Fibre Content (GB/T 29862)

At the beginning of 2022, the Technical Committee of Textile Standardisation (TC209) announced amendments to *GB/T 29862*.<sup>3</sup> Since the types and content of fibres are vital to the quality of textiles, textile and garment enterprises have always applied the standard, even though it is not mandatory but recommended. However, today the standard no longer meets industry needs, as new materials, new technologies and new products are being developed and applied, which require technical requirements within the standard to be changed accordingly. The revision process is expected to last 18 months and end in June 2023.<sup>4</sup>

## 3. Measures for the Administration of Customs Import-Export Commodity Inspection Credit-Acceptance (Draft for Comment)

In October 2021, the General Administration of Customs (GAC) issued the *Measures for the Administration of Customs Import-Export Commodity Inspection Credit-Acceptance (Draft for Comment)*.<sup>5</sup> Through these measures, the GAC launched an innovative supervision model that will accept results from laboratories and testing agencies both within China and from abroad with regard to the inspection of import and export commodities. This initiative will make the import and export of goods more convenient and will save enterprises time and costs in customs clearance. The measures are similar to those piloted by Shanghai Customs for some years, which have been welcomed by importers,<sup>6</sup> and the working group looks forward to their release.

## 4. Duty-free Business Policy of Hainan Free Trade Port (FTP)

According to the *General Plan for the Construction of the Hainan Free Trade Port (General Plan)*,<sup>7</sup> Hainan island will be developed into a free trade port with a high level of openness. The *General Plan* also indicates that Hainan will create a global duty-free shopping and fashion consumption centre to support China's 'dual circulation' policy. This is an attractive proposition for European fashion brands, many of which are looking to invest in the Hainan FTP, and expect to open and own directly-operated duty-free shops there. However, the specific duty-free policies of Hainan's retail market are unclear, which has raised concerns among companies. There is already a batch of duty-free franchisees currently operating in Hainan with special quotas, and it has yet not been clarified whether or not other retail companies will be treated equally to them and be extended the same duty-free quota.<sup>8</sup>

## 5. International Consumption Centres

On 19<sup>th</sup> July 2021, the Chinese Government approved Shanghai, Beijing, Guangzhou, Tianjin and Chongqing to take the lead in developing international consumption centres.<sup>9</sup> The concept of international consumption centres was introduced in China's 14<sup>th</sup> Five-year Plan. If the cities that have been selected demonstrate high-level opening-up and institutional innovation, this will increase investment confidence among international fashion brands. The working group is looking forward to more favourable policies being launched that will help to further promote investment in these cities.

3 *Textiles - Technical specification for identification of fibre content (GB/T 29862)*, General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) and the Standardisation Administration of China (SAC), 12<sup>th</sup> November 2013, viewed 10<sup>th</sup> April 2022, <<http://www.gb688.cn/bzgk/gb/newGblInfo?hcno=78E12DC297A27F3AB95C25986FD71586>>

4 *Revision of Textiles — Technical Specification for Identification of Fiber Content*, National Public Service Platform for Standards Information, 31<sup>st</sup> December 2021, viewed 10<sup>th</sup> April 2022, <<http://std.samr.gov.cn/gb/search/gbDetailed?id=BF447BF930E7F2C1E05397BE0A0A44D2>>

5 *Measures for the Administration of Customs Import-Export Commodity Inspection Credit-Acceptance (Draft for Comment)*, GAC, 8<sup>th</sup> October 2021, viewed 10<sup>th</sup> April 2022, <<http://www.customs.gov.cn/customs/302452/302329/zjz/3938404/index.html>>

6 *Notice on Further Optimising the Inspection of Imported Clothing*, Shanghai Customs District, 3<sup>rd</sup> October 2020, viewed 10<sup>th</sup> April 2022, <[http://shanghai.customs.gov.cn/shanghai\\_customs/423405/zfxxgkml4748/3834963/index.html](http://shanghai.customs.gov.cn/shanghai_customs/423405/zfxxgkml4748/3834963/index.html)>

7 *General Plan for the Construction of Hainan Free Trade Port (General Plan)*, State Council of the Central Committee of the Communist Party of China, 1<sup>st</sup> June 2020, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/2020-06/01/content\\_5516608.htm](http://www.gov.cn/zhengce/2020-06/01/content_5516608.htm)>

8 There are currently a dozen entities operating franchises in Hainan that are qualified to distribute duty-free products with a given quota of Chinese yuan 100,000 per tourist per year. Whether these special enterprises will continue enjoying the privilege and other types of companies be treated differently after Hainan launches the independent customs operation in 2025 is a big concern for foreign companies, as any differentiation would constitute unfair competition.

9 *The First Batch of International Consumer Centre Cities Set Up in Five Places*, *People's Daily*, 17<sup>th</sup> August 2021, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-08/17/content\\_5631627.htm](http://www.gov.cn/xinwen/2021-08/17/content_5631627.htm)>





## Key Recommendations

### 1. Amend the Product Quality Law 5

#### 1.1 Remove the Abstract Term ‘Unqualified Product’ and Introduce the Concept of ‘Safe Product’, and Confirm Whether a Product’s Conformity with Mandatory National Standards or a Product Having Unreasonable Risk Can Be Used as Criteria for Judging its Safety and Initiating Administrative Penalties

##### Concern

The concept of ‘unqualified product’ is too abstract, which results in severe administrative penalties being imposed upon enterprises that make mistakes in labelling.

##### Assessment

Various local law enforcement authorities have defined ‘unqualified products’ differently, and the ambiguity of the concept has resulted in the current scope of ‘non-conforming products’ being too broad. Since the term ‘unqualified product’, referred to in the Product Quality Law,<sup>10</sup> has not been clearly defined, considerable administrative resources that could be used to combat products in the market that are unsafe or pose a risk to people’s lives are instead wasted on supervising safe but substandard products, which ultimately does not protect consumer safety. It also results in companies potentially facing serious administrative penalties for minor labelling defects.

Furthermore, this practice is not in line with certain provisions of the World Trade Organization Agreement on Technical Barriers to Trade (WTO/TBT).<sup>11</sup> For instance, in China, violation of a declared voluntary standard results in classification as an ‘unqualified product’, for which the enterprise is punished as for violation of a mandatory standard. However, the WTO/TBT only allows mandatory standards to be applied in consideration of national security, prohibition of fraud, and health, safety and environmental protection. As discussed in the Recent Developments section, in response to the impact of the COVID-19 pandemic, China is trying to develop several international consumer cities or regions, which increases the

necessity for a Product Quality Law that is in line with international standards to safeguard the integration of domestic and foreign trade.<sup>12</sup>

When comparing foreign and domestic administrative priorities and practices related to product quality, it is clear that the European Union (EU), the United States and other developed countries put more focus on safety-related standards. In the textiles sector, for instance, there are more than a hundred safety-based criteria in Europe—derived from the General Product Safety Directive<sup>13</sup> and the Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH)<sup>14</sup>—that deal with carcinogens, mutagens, reproductive toxicity, sensitisation, endocrine disorders and environmental protection; whereas in China there are only two safety-related chemical standards – covering azo and formaldehyde.

Due to this lack of safety standards, China’s market supervision and inspection authorities are not sufficiently able to protect consumers’ health and safety. Meanwhile, the current government enforcement focus is more on non-safety-related standards, which hinders innovation and the development of the industry overall as companies concentrate on conforming with these requirements. Therefore, the working group recommends the concept of a ‘safe product’ be adopted, and that a product’s conformity with mandatory national standards and its potential unreasonable risk should be confirmed as the criteria for judging its safety, to resolve current challenges faced by the industry, including those outlined below.

#### Challenge 1

Companies that produce and sell goods need to include a large amount of product information on labels, meaning that production and sales involves many departments (which may include foreign agencies). It is therefore inevitable that some faults or translation errors may occur, resulting in incomplete or inaccurate product labelling information. Currently, due to the lack of a clear specification of ‘unqualified products’ in the Product Quality Law, companies are often subject to

10 Product Quality Law, National People’s Congress (NPC), 7<sup>th</sup> January 2019, viewed 10<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/201901/7f507d5963074e9ebc73c986e155b931.shtml>>

11 *Technical Barriers to Trade Agreement*, WTO, 1<sup>st</sup> January 1980, viewed 10<sup>th</sup> April 2022, <[https://www.wto.org/english/docs\\_e/legal\\_e/17-tbt\\_e.htm](https://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm)>

12 For more information about the WTO/TBT rule, please see Key Recommendation 1 of the *Standardisation and Conformity Assessment Working Group Position Paper 2022/2023*.

13 *General Product Safety Directive*, European Commission, 11<sup>th</sup> January 2018, viewed 10<sup>th</sup> April 2022, <[https://ec.europa.eu/info/general-product-safety-directive\\_en](https://ec.europa.eu/info/general-product-safety-directive_en)>

14 *REACH*, European Commission, 24<sup>th</sup> August 2016, viewed 10<sup>th</sup> April 2022, <[http://ec.europa.eu/environment/chemicals/reach/reach\\_en.htm](http://ec.europa.eu/environment/chemicals/reach/reach_en.htm)>





high administrative penalties for minor product label defects unrelated to safety, which greatly increases the burden on companies. In recent years, the SAMR has implemented a traceability management system for product quality issues, aimed at combatting counterfeit and substandard products at the source. The working group welcomes the traceability management system initiative. However, all local market supervision agencies involved in the value chain of a product—from where the product is inspected to where the producer or importer is located to where the products are stocked—are obliged to enforce the traceability system in relation to ‘unqualified products’, which again brings the ambiguity of the term to the fore, in particular as local enforcement officials focus on inaccurately labelled products rather than products with safety problems. If the law is not changed, valuable administrative resources will continue to be wasted, which will multiply difficulties for enterprises.

### Challenge 2

Current voluntary standards are numerous and categorised in different systems, including ‘local standards’, ‘industrial standards’ and ‘national standards’. For instance, there are over 1,300 voluntary national standards related to textile and leather technology and the garment industry in general, and more than 2,000 voluntary industry standards related to textiles. In some cases, different standards and regulations are misaligned or conflict with one another. As a result, it is challenging and burdensome for enterprises to accurately determine the voluntary standards that are applicable.

### Challenge 3

Despite the large number of voluntary standards, they do not address certain special characteristics of specific products. For example, the generalised assessment indicators for the colour fastness of leather products in *QB/T 1333 Handbag and Knapsack*—the widely applied standard for handbag and knapsack products—did not take into account the special characteristics of suede materials, which led to significantly differing opinions among many experienced testing agencies. Some enterprises faced administrative penalties as a result, which provided a basis for professional claimants to purchase such products with the ulterior motive of demanding large amounts of compensation. It was not until 2018 that special regulations accounting for the special characteristics of suede materials were included in the revised version of *QB/T 1333*. In view of the

sheer number of voluntary standards, revising them to take into consideration the special characteristics of all products would be an extremely onerous task. Therefore, enforcing the law and implementing administrative penalties in line with voluntary standards is not a scientific approach.

### Challenge 4

Voluntary standards include requirements and assessment methods for general characteristics of detailed product types, and are significantly influenced by the features of existing products, raw materials and technologies. Enterprises that engage in technological innovation, such as working with new materials or innovative manufacturing processes, or that choose non-harmful natural colourants over artificial synthetic chemical colourants may face the risk of administrative penalties or being targeted by professional claimants. This leads to some being more risk averse with regard to innovation, which in turn hinders the drive towards creating and sustaining a natural, green environment free from harmful substances. The working group believes that this goes against the original objectives and spirit of the Product Quality Law, which is intended to improve product quality.

In the third and fourth challenges detailed here, if the Product Quality Law uses voluntary standards as a recommendation and reference—and an enterprise’s civil liability can be based on whether a product or its description actually misleads consumers and causes them losses—it would be more in line with China’s legal principles that administrative laws uphold justice, and punishment will be proportional to the damage caused. Such application of the law would give enterprises more room to innovate independently and raise product quality, and would also be in line with the current reform blueprint for simplifying administrative procedures.

### Recommendations

- Remove the term ‘unqualified product’ and introduce the term ‘safe product’.
- Confirm whether a product’s conformity with national standards, or its potential to cause unreasonable risk, can be used as criteria in assessing its safety and initiating administrative penalties.
- Ensure that voluntary standards cannot be used as the basis for administrative penalties.





## 1.2 Confirm that if Products Fail to Satisfy their Declared Quality Standards, Enterprises Only Assume Civil Responsibility

### Concern

The application of administrative penalties on enterprises whose products fail to satisfy their declared quality standards is a waste of public resources and overburdens enterprises, as such a failure should only be deemed a breach of contract with consumers.

### Assessment

When a product does not meet the quality standards claimed by the enterprise (such as voluntary standards), but complies with mandatory national standards without unreasonable danger, China's Standardisation Law,<sup>15</sup> the Civil Code<sup>16</sup> and the Protection of Consumer Rights and Interests Law<sup>17</sup> clearly state the enterprise has broken its commitment to the consumer on product quality, and should be liable for liquidated damages.

This stance unfairly increases enterprises' contractual obligations and responsibilities, and unbalances market regulation. Consumer demand for new products, new materials and new processes is constantly increasing, requiring enterprises to focus more on reinvention and continual innovation. Therefore, to protect people's health and safety, the final version of the revised Product Quality Law should provide enterprises with a relatively fair and reasonable legal environment that fosters production innovation and promotes production quality improvements. Frequent fines would have the opposite effect and hinder the development of enterprises, as well as the overall level of national innovation.

The 2017 revision of the Standardisation Law specifies that compulsory national standards must be implemented, while encouraging the adoption of other standards such as voluntary, group and enterprise standards. This was a critical step in making administrative management more efficient and aligned with international practices. The working group welcomed the accurate scoping of voluntary standards in the Standardisation Law, and

<sup>15</sup> Standardisation Law, NPC, 4<sup>th</sup> November 2017, viewed 10<sup>th</sup> April 2022, <[http://www.npc.gov.cn/zgrdw/npc/xinwen/2017-11/04/content\\_2031446.htm](http://www.npc.gov.cn/zgrdw/npc/xinwen/2017-11/04/content_2031446.htm)>

<sup>16</sup> *Civil Code of the People's Republic of China*, NPC, 28<sup>th</sup> May 2020, viewed 10<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202006/75ba6483b8344591abd07917e1d25cc8.shtml>>

<sup>17</sup> Protection of Consumer Rights and Interests Law, NPC, 25<sup>th</sup> October 2013, viewed 10<sup>th</sup> April 2022, <[http://www.npc.gov.cn/zgrdw/npc/xinwen/2013-10/26/content\\_1811773.htm](http://www.npc.gov.cn/zgrdw/npc/xinwen/2013-10/26/content_1811773.htm)>

recommends the alignment of revisions to the Product Quality Law, and ensuring that voluntary standards are indeed, by definition, 'voluntary'; that is, their nature as a standard for regulating civil liability relationships is recognised.

### Recommendation

- Clarify that enterprises shall only bear civil liability for a safe product that does not meet the quality standards claimed by the enterprise, and shall not be subject to administrative penalties.

## 2. Revise the Mandatory National Standard GB 18401 National General Safety Technical Code for Textile Products

### Concern

Including colour fastness of textiles as a compulsory testing item under standard *GB 18401*<sup>18</sup> does not make sense as it is merely a burden to enterprises and is in no way related to a product's safety.

### Assessment

The mandatory national standard *GB 18401* requires several colour fastness tests, including water resistance, perspiration resistance, dry rubbing resistance and saliva fastness. Colour fastness refers to "the ability of the colour of a textile to withstand various effects during processing and use, expressed in terms of the degree of discolouration and the degree of staining of the lining fabric". It is the consensus of the textile industry that this fastness to dyeing is a physical performance indicator that does not directly affect personal health or the safety of life and property. In other words, it is the dyes and auxiliaries themselves that may have a direct impact on personal health and the safety of life and property, thus the relevant authorities should establish a preventive management mechanism for the chemical hazards of dyes and auxiliaries in the entire textile chain. At present, there are no relevant domestic laws, regulations or mandatory assessments that do this.

In other countries' laws and regulations on textiles, the dyeing fastness performance is included in the standards or certifications voluntarily adopted by enterprises. The chemical risks from dyes and auxiliary

<sup>18</sup> *National Standard GB 18401 National General Safety Technical Code for Textile Products*, AQSIQ & SAC, 14<sup>th</sup> January 2018, viewed 10<sup>th</sup> April 2022, <<http://www.gb688.cn/bzgk/gb/newGbInfo?hcno=52C1F4CBDE863F5095D7C9D17FE3F71>>





substances are assessed and controlled separately.

Taking mulberry silk fabric as an example, the colour fastness is generally not high because it is composed of natural protein fibre, which is vulnerable to high temperature, and therefore cannot tolerate high temperature dyeing/colour fixation in the dyeing process. Especially when the colours being used are dark or black, the extra dyestuff cannot be absorbed by fibre within the dyeing time, which results in dye molecules accumulating on the fibre surface and forming floating colours, which impacts the results of colour fastness tests. To improve the colour fastness, fabric factories add various auxiliaries in dyeing in spite of the resulting environmental hazards and health and safety risks.

The short fibres of grinding, lint, velvet and other velvet fabric products are very easily rubbed off. In the rubbing colour fastness test, test institutions hold varying opinions on whether or not short fibres should be taken into account, as well as how it should be done, when assessing the staining level, which leads to inconsistent conclusions because the existence of short fibres will directly affect the inspector's visual rating results.

Denim fabric is one of the most popular fabrics globally, but the characteristics of indigo dyes cause the dye to be adsorbed by the cellulose fibres only through van der Waals forces, i.e., physical action, with almost no chemical bonding between the fibres, resulting in a low colour fastness. Although consumers generally accept the wash fading characteristics of denim fabrics, denim manufacturers continue to strengthen the colour fastness of their fabrics in order to meet the standard requirements for colour fastness. In this process, denim manufacturers constantly strengthen the washing and colour-floating treatment of their blanks and finished products, and increase the finishing process, generating a large amount of waste water and emissions, which is not conducive to overall environmental protection and sustainable development requirements.

Assessment of colour fastness is always based on visual measurement by the tester under certain light conditions, and the differences between the skills and capability of the testers, their subjectivity and so on directly impact the test results.

In 2020, the SAMR conducted a project titled 'Verification

of the Testing Capacity for Perspiration Resistance Colour Fastness of Textiles and Silk Products (CNCA-20-13)' among national inspection and test institutions.<sup>19</sup> Those participating represented nearly all the leading advanced test laboratories and agencies, including provincial quality supervision and inspection centres, customs technical centres, fabric inspection test laboratories, and civil and foreign test agencies. The results show that 32.8 to 39 per cent of institutions reported a half-grade-difference in the test of the staining level of BNH-2 blue cotton sticky fabric; and 21.5 to 35.9 per cent reported a half-grade-difference with RNH-2 red silk fabric. In other words, about one third of laboratories found a half-grade-difference in the test for perspiration colour fastness. This suggests that a half-grade-difference of colour fastness is an approved scale of conformity.

In national-, provincial- and city-level market inspections, colour fastness is a 'key quality item' and mandatory test item as per the *Implementation Rules of National Inspections on Product Quality*.<sup>20</sup> In cases of non-conformity, a product will be determined as unqualified. Despite the half-grade-difference having been verified as an approved scale of conformity, such a result usually causes the product to be downgraded from 'qualified product' to 'unqualified product'. This results in enterprises being punished by market surveillance authorities and the company's credibility being harmed.

According to the *Notice on the Organisation of the Review of Mandatory National Standards in 2021*,<sup>21</sup> TC209 launched a review of *GB 18401-2010* in September 2021, encompassing the applicability, conformity, effectiveness and other aspects of the standard. As of mid-2022, the conclusions of the review have not been made public.

#### Recommendations

- Revise *GB 18401-2010* as soon as possible, and consider adjusting the colour fastness criteria for special products.
- Take the half-grade-difference into consideration as a general safety conformity scale and apply it when

<sup>19</sup> *Final Report of Proficiency Testing Programme on Tests for Colour Fastness to Perspiration of Textiles and Silks*, SAMR, September 2020, viewed 10<sup>th</sup> April 2021, <<http://www.cnca.gov.cn/zl/nlyz/xmss/202009/W020200928369465129012.pdf>>

<sup>20</sup> *Implementation Rules of National Inspections on Product Quality*, SAMR, 31<sup>st</sup> July 2020, viewed 10<sup>th</sup> April 2022, <[http://gkml.samr.gov.cn/nsjg/zljdj/202007/t20200731\\_320439.html](http://gkml.samr.gov.cn/nsjg/zljdj/202007/t20200731_320439.html)>

<sup>21</sup> *Notice on the Review of Mandatory National Standards in 2021*, SAC, 15<sup>th</sup> September 2021, viewed 10<sup>th</sup> April 2022, <[https://www.samr.gov.cn/bzjss/tzgg/202109/t20210917\\_334847.html](https://www.samr.gov.cn/bzjss/tzgg/202109/t20210917_334847.html)>





judging the colour fastness of a product.

- Change colour fastness from being a 'key quality item' to a 'normal quality item' when making national-, provincial- or city-level implementation rules for product inspections, and apply it in product inspections, to facilitate a change in the safety scale and judging standard for product conformity.
- Include a test for dyes and auxiliaries that pose a risk of harming personal health in the safety assessment of mandatory standard *GB 18401*.

### 3. Take Resolute Action to Curb the Sale of Fake Goods Online and Promote Industrial Self-governance 4

#### Concern

Fake goods are still being sold on social media platforms in China, and the lack of effective enforcement of rules and regulations is harming the legitimate rights of a growing number of right holders.

#### Assessment

Over the last few years, China's e-commerce industry has developed dramatically in both the number and format/structure of platforms and businesses, while various innovative promotion methods have also emerged, placing increasingly higher demands on companies conducting daily supervision and administration. Combatting the sale of fake products through social media is quite different than through e-commerce platforms. For instance, while online platform owners and intellectual property right (IPR) holders themselves can run searches and monitor e-commerce platforms, due to their openness to user access, it is more difficult to effectively supervise social media due to the levels of confidentiality involved. This makes selling counterfeit goods via, for example, WeChat Moments, more convenient, with sales volumes potentially far exceeding that of other online platforms. In addition, in recent years, more and more mini apps and livestreaming platforms have been taking advantage of the secrecy of social circles, the uncertainty of the origin of certain goods and the convenience of third-party payments. The owners of some of these apps and platforms are leveraging these conditions to rampantly sell counterfeit goods through 'livestreaming rooms' and so-called 'group buying'. This makes monitoring counterfeit sales extremely

challenging for both rights holders and law enforcement agencies.

On 24<sup>th</sup> August 2020, the Judicial Committee of the Supreme People's Court (SPC) adopted the *Official Reply on Several Issues Concerning the Application of Law to Disputes over Internet-related IPR Infringement*,<sup>22</sup> which requires network platforms to bear joint liability with network users and platform operators for any damages caused through the fault of the network platform.

On 10<sup>th</sup> September 2020, the SPC issued the *Notice Regarding Issuing Guiding Opinions on the Trial of Intellectual Property (IP) Civil Cases Involving E-commerce Platforms*,<sup>23</sup> which further increases and clarifies the responsibilities and obligations of platforms to prevent and protect IPR in their daily business activities. The notice emphasises that if the platform operator "knows" or "should know" that a business owner operating on the platform infringes upon IPR, it should take necessary measures following the principle of "reasonable prudence"; the reasonableness of the measures taken by platform operators has also been further clarified and refined therein. The *Measures for the Supervision and Administration of Network Transactions*,<sup>24</sup> which went into effect on 1<sup>st</sup> May 2021, further refine the management responsibilities of e-commerce platforms regarding the review and registration of operators on the platform. It stipulates that operators of third-party trading platforms must take necessary measures to protect the rights of the exclusive use of registered trademarks and the name rights of companies.

On 31<sup>st</sup> August 2021, the SAMR drafted the *Decision on Amending the E-commerce Law (Draft for Comments)*.<sup>25</sup> As fashion and leather brands suffer deeply from sales of counterfeit goods online, the working group paid close attention to the legislation and raised a strong

22 *Official Reply on Several Issues Concerning the Application of Law to Disputes over Internet-related IPR Infringement*, Supreme People's Court (SPC), 12<sup>th</sup> September 2020, viewed 10<sup>th</sup> April 2022, <<http://www.court.gov.cn/fabu-xiangqing-254921.html>>

23 *Notice from the SPC regarding Issuing Guiding Opinions on the Trial of Intellectual Property Civil Cases Involving E-commerce Platforms*, SPC, 10<sup>th</sup> September 2020, viewed 10<sup>th</sup> April 2022, <<http://www.court.gov.cn/fabu-xiangqing-254931.html>>

24 *Measures for the Supervision and Administration of Network Transactions*, SAMR, 15<sup>th</sup> March 2021, viewed 10<sup>th</sup> April 2022, <[http://www.samr.gov.cn/xw/zj/202103/t20210315\\_326928.html](http://www.samr.gov.cn/xw/zj/202103/t20210315_326928.html)>

25 *SAMR Circular on the Decision on Amending the E-commerce Law (Draft for Comments)*, SAMR, 31<sup>st</sup> August 2021, viewed 10<sup>th</sup> April 2022, <[https://www.samr.gov.cn/hd/zjdc/202108/t20210831\\_334252.html](https://www.samr.gov.cn/hd/zjdc/202108/t20210831_334252.html)>





objection to the guarantee provisions introduced in the amendment. These provisions state that as long as the in-platform operator provides a guarantee for potential losses caused by IP infringement to the e-commerce platform operator, the platform operator can temporarily suspend the measures taken against the suspected infringement. The working group believes this provision will very likely be abused for profit by malicious counterfeiters or even e-commerce platforms. For example, in the peak season of online sales (such as the 'Double 11' period), infringing products can be sold if a deposit is made, which will cause huge or even irreparable damage to right holders.

At the same time, the working group has also noted that the national recommended standard *GB/T 39550-2020 Management of IP Protection on E-Commerce Platforms*<sup>26</sup> puts forward detailed constructive opinions on the protection and management of IPR on e-commerce platforms, including the daily management responsibilities, effective measures to combat IP infringement, as well as some functional requirements like data sharing with supervision departments or having to establish a dedicated in-house IP department. It is advised that these kinds of standards be continually improved, so as to establish good references for further revisions to the E-commerce Law, and potentially for judicial decisions and law enforcement practices.

#### Recommendations

- Call on grassroots courts, especially local IP courts, to be more proactive in identifying the relevant responsibilities of platforms in individual cases and ensure various network platforms, including social media, actively fulfil their social and legal responsibilities for IPR protection.
- Supervise and encourage courts at all levels throughout China to actively strengthen IPR protection online by sharing case studies of ground-breaking judgments.
- Classify platforms (for example, traditional e-commerce and social media platforms) according to modes of query, channels of information display, methods of user access, payment and settlement, and other technical features, and set up proper administrative measures.
- Reconsider the guarantee scheme under the

E-Commerce Law and introduce a court system to assess whether or not a guarantee should be accepted and the measures against the infringement be withdrawn.

- Encourage the development and improvement of standards related to the protection of IPR in e-commerce and promote their adoption in relevant legislation.
- Take heed of and respect effective IPR protection models agreed between rights holders and platforms.

#### 4. Release the Implementing Legislation for the Personal Information Protection Law (PIPL) as Soon as Possible, to Provide Companies with Clear Guidance on Data Compliance and Secure Cross-border Data Transfer

##### Concern

Promulgation of the PIPL and the *Data Exit Security Assessment Measures* present new and serious compliance challenges for multinational companies' (MNCs') cross-border data transfers.

##### Assessment

The PIPL has high requirements for, and positively promotes, the protection of personal information, covering the majority of consumer information.<sup>27</sup> However, it also poses challenges for companies from a compliance perspective, particularly regarding the separate consents of multiple information owners required for various forms of data collection and outbound transfer.

Article 4 of the *Data Exit Security Assessment Measures (Measures)*,<sup>28</sup> released on 7<sup>th</sup> July 2022 by the Cyberspace Administration of China, states that where a critical information infrastructure operator or a personal information processor that: a) processes personal information of up to one million individuals provides personal information overseas; or b) provides the personal information of 100,000 individuals or sensitive personal information of 10,000 individuals abroad cumulatively since 1<sup>st</sup> January of the previous year, it should be declared to the national network

26 *GB/T 39550-2020 Management of IP Protection on E-Commerce Platforms*, SAMR and SAC, 9<sup>th</sup> November 2020, viewed 10<sup>th</sup> April 2022, <<http://openstd.samr.gov.cn/bzgk/gb/newGbInfo?hcno=E315E3B122771E0D38B843BC19E6E5F4>>

27 Personal Information Protection Law, NPC, 20<sup>th</sup> August 2021, viewed 10<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202108/a8c4e3672c74491a80b53a172bb753fe.shtml>>

28 *Data Exit Security Assessment Measures*, Cyberspace Administration of China, 7<sup>th</sup> July 2022, viewed 10<sup>th</sup> July 2022, <[http://www.cac.gov.cn/2022-07/07/c\\_1658811536396503.htm](http://www.cac.gov.cn/2022-07/07/c_1658811536396503.htm)>





information department through the local provincial network information department. According to the thresholds set in the *Measures*, most companies will fall under its scope and will therefore need to undergo security assessment for personal information data transfers overseas. Therefore, foreign companies are highly concerned that whether the national and regional internet information departments will have enough manpower and resources to complete such a vast number of assessments in a timely manner once the regulation takes effect in September 2022.<sup>29</sup>

In the course of future law enforcement, the authorities should take into consideration the need for frequent daily data-sharing within international group corporations, as well as the huge costs involved in the associated compliance, and the negative impact on global operations of MNCs that time-consuming assessments conducted by the authorities will have. Instead of carrying out strict industry-wide regulation, it would be advisable to instead encourage non-critical infrastructure industries to carry out reasonable and effective regulation through internal contracts and corporate commitments. This would help to prevent a dampening of investment confidence and avoid the adverse consequence of global supply chains being transferred out of China.

#### Recommendations

- Encourage enterprises to abide by relevant regulation through internal contracts and corporate commitments.
- Encourage and promote the reasonable autonomy of enterprises and industries for general e-commerce operations.

### 5. Allow Enterprises to Not Display Recommended Product Standards on Imported Apparel

#### Concern

Although existing laws do not clearly state whether or not imported apparel and leather products should display a product standard number, some market surveillance agencies require it for use in product inspection, which is unnecessarily burdensome for enterprises.

#### Assessment

In practice, companies that do not label their products with a Chinese standard number may be rejected by store owners or penalised by government inspection authorities, which causes many inconveniences for companies.

Paragraph 3 of Article II of China's Standardisation Law states that mandatory standards must be implemented and that the use of recommended standards is encouraged.<sup>30</sup> According to the law, recommended product standards are not to be mandatorily implemented. However, in practice, if law enforcement departments make it compulsory for imported clothing and leather goods to display a product standard number, and consider it as a basis for sampling, this recommended product standard becomes mandatory by default, which is not in line with the legislative intent of the Standardisation Law.

The reason why such product standards are recommended is because the content of the provisions do not involve personal or personal property safety, but only the product's raw production control requirements. Therefore, failure to comply with such standards will not cause harm to consumers or damage their personal property.

Products manufactured abroad must be produced according to the standards or technical specifications of the place of production. As Chinese voluntary production or product execution standards may differ, they should not be applied to certain products that will be imported to China. Due to their inability to meet domestic product standards, a large number of foreign-produced products that can be sold without problem abroad are unable to be sold in China, which limits consumers' choices.

Many other industries have recognised this problem and raised it with relevant government authorities, which has led to provisions being made in relevant Chinese standards or standard interpretations that "imported products do not need to be marked with a product standard number"—illustrating that the application of domestic recommended product standards is not mandatory—such as the following examples:

<sup>29</sup> Please also see the *Cybersecurity Sub-working Group Position Paper 2022/2023* for more information regarding data cross-border transfer.

<sup>30</sup> Standardisation Law, NPC, 4<sup>th</sup> November 2017, viewed 10<sup>th</sup> April 2022, <[http://www.npc.gov.cn/zgrdw/npc/xinwen/2017-11/04/content\\_2031446.htm](http://www.npc.gov.cn/zgrdw/npc/xinwen/2017-11/04/content_2031446.htm)>





**Example 1, cosmetics:** According to Article 6.6 of the *National Compulsory Standard GB 5296.3: Instruction for Use of Consumer Products – General Labelling for Cosmetics*,<sup>31</sup> “cosmetics should be marked with the national or industry standards used”. However, the *Implementation Guide for GB 5296.3* allows that “imported cosmetics do not need to be marked with a production licence number, sanitary licence number nor a product standard number”.

**Example 2, food and beverage:** Article 4.1.10 of *GB 7718-2011 General Labelling Rules for Pre-packaged Food*,<sup>32</sup> clearly states that “pre-packaged food manufactured and sold in China should be marked with the referred standard number and serial number of that product (excluding imported pre-packaged food).”

**Example 3, cross-border trade:** According to Article 4.1.3.1 of the *Notice on Improving the Supervision on the Import of Cross-border E-commerce Retail (Document 486)*,<sup>33</sup> released by the Ministry of Commerce and five other departments, “products that comply with standards and technical specifications of quality, safety, health, environment, and labelling of the country of origin need not comply with Chinese standards. Consumers bear their own risks.”

#### Recommendation

- Clarify that, apart from domestic compulsory standards, imported clothing and leather products do not need to mandatorily implement voluntary standards nor display a Chinese product standard number on the product.

## Abbreviations

AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
EU	European Union
FTP	Free Trade Port
GAC	General Administration of Customs
IP	Intellectual Property
IPR	Intellectual Property Right
MNC	Multinational Corporation
NPC	National People’s Congress
PIPL	Personal Information Protection Law
REACH	Registration, Evaluation, Authorisation and Restriction of Chemicals
SAC	Standardisation Administration of China
SAMR	State Administration for Market Regulation
SPC	Supreme People’s Court
TBT	Technical Barriers to Trade
TC209	Technical Committee of Textile Standardisation
WTO	World Trade Organization

<sup>31</sup> *National Compulsory Standard GB 5296.3: Instruction for use of consumer products – General labelling for Cosmetics*, SAMR & SAC, 17<sup>th</sup> June 2008, viewed 10<sup>th</sup> April 2022, <<https://openstd.samr.gov.cn/bzgk/gb/newGbInfo?hcno=86DDF327060B99B817E89EF7BD0052C2>>

<sup>32</sup> *GB 7718-2011 General Labelling Rules for Pre-packaged Food*, National Health Commission, 20<sup>th</sup> April 2011, viewed 10<sup>th</sup> April 2022, <<https://sppt.cfsa.net.cn:8086/staticPages/9058ADC5-AFC3-4586-9798-D0170F6F879C.html>>

<sup>33</sup> *Notice of Six Departments on Improving the Supervision on Import of Cross-border E-commerce Retail (Document 486)*, State Council, 1<sup>st</sup> December 2018, viewed 10<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2018-12/01/content\\_5345041.htm](http://www.gov.cn/xinwen/2018-12/01/content_5345041.htm)>



# Healthcare Equipment Working Group

## Key Recommendations

### 1. Increase the Role of Market Forces in the Procurement of Medical Devices by Giving Greater Weighting to Device Quality and Clinical Needs

#### 1.1 Prioritise Value-based Procurement and Improve Enforcement Procedures in Volume-based Procurement (VBP) 2

- Determine quality and clinical requirements as the main criteria for deciding VBP tenders, as opposed to procurement prices.
- Establish an inter-ministerial communication platform to ensure that VBP tendering and implementation of tendering results adhere to generally accepted principles of VBP tenders, particularly in terms of realising procurement volume, terms of delivery and payment as agreed in the tender.
- Limit VBP to genuine large-volume procurement, in general at the provincial level or above.
- Grant a transitional period before implementation of VBP tenders at the provincial level or above, to allow winning bidders time to prepare sufficient inventory.
- Set sufficient intervals between VBP tenders to allow procurement agencies to evaluate the clinical application of VBP products in hospitals, quality of services and reliability of supply.
- Increase new innovative consumable medical devices available to patients by procuring outside VBP tenders, and conduct clinical evaluations of these new products to allow them to participate in the next round of VBP with a reasonable and justified price.

#### 1.2 Optimise the Legislative and Administrative Framework for Hospital Payment Reform to Promote the Use of Innovative Treatment Methods 2

- Update cost factors and ratios in diagnosis-related groups (DRG) and diagnosis intervention packets (DIP) regularly to establish a reasonable payment standard.
- Establish a reasonable pathway to market for innovative treatment methods to accelerate patients' access to new medical technologies.
- Optimise the DRG sub-groups to adapt them to clinical requirements and allow flexibility to meet the varying needs of different regions.

#### 1.3 Regularly Update the Healthcare Service Catalogue to Promote the Use of Innovative Treatment Methods 2

- Adhere to and implement the separation of medical consumables from medical service pricing items.
- Strengthen policy mechanism, including increasing medical treatment prices to discourage the illegal multiple use of disposable medical devices.
- Accelerate the dynamic adjustment of pricing catalogues to facilitate patients' access to innovative treatment methods and state-of-the-art medical devices.

### 2. Continue to Advance the Development of Regulatory Science and Accelerate the Promotion of Innovation

#### 2.1 Introduce Innovative Regulatory Methods for Standalone Medical Software

- Allow software such as controller-type software and pre-processing software to be registered as





standalone software.

- Remove the requirement to specify the version number of each software module in applications for registration of medical systems.
- Remove mandatory compliance of medical software with *GB/T 25000.51-2016*.
- Assign low-risk medical software to class I and enhance rules for risk classification.
- Streamline the requirements for registration alteration when only minor modifications are made to medical software, and provide a guideline defining which modifications qualify as 'minor'.
- Allow supplementary registration of recall-related software modifications, to allow for quick updates to medical software and reduce risks for patients and clinicians, with modifications approved afterwards.

## 2.2 Harmonise Regulatory Requirements for Relocating Manufacturing from Overseas to China with International Practices 2

- Broaden the scope of foreign-invested enterprises, making National Medical Products Administration (NMPA) *Announcement No. 104* applicable if the import registrant and the domestic factory eventually belong to the same corporate firm.

## 2.3 Formulate a Sharing of Responsibilities between Manufacturers, Service Providers and Hospitals in Post-market Supervision

- Formulate specific requirements for medical institutions and service providers to report real and effective adverse events or defect information to manufacturers.
- Require the NMPA and the National Health Commission (NHC) to jointly develop regulations on the use of medical devices, with specific requirements and articles on penalties.

## 3. Simplify Maintenance of Existing Registration Details when Mandatory Standards are Updated 2

- Accelerate the conversion from mandatory industrial standards to recommended ones according to the China's Standardisation Law and international practices.
- Simplify the process for changing registration details triggered by the revision of mandatory standards and shorten the review time for registration alteration.
- Establish procedures to avoid repeated testing, taking reference from International Organization for Standardization/International Electrotechnical Commission test reports.
- Build up regulatory capacity to enable fast and smooth processing of registration alteration.

## 4. Promote the Application of High-quality, High-precision Medical Devices in Public Hospitals

- Promote the concept of value-based procurement, ensuring the best outcome when using limited public resources.
- Limit the application of the Government Procurement Law to funds administered by the Ministry of Finance and its local agencies.
- Increase transparency in the evaluation of import applications and invite experts from foreign-invested enterprises to participate in expert panels.
- Grant transitional periods for the importation of medical devices when manufacturers are in the process of relocating manufacturing into China.



## 5. Align Different Policies and Develop a Roadmap to Guide and Support the Refurbishment and Remanufacturing of Medical Equipment in China

- Develop a roadmap and industrial development plan to guide and support medical equipment refurbishment and remanufacturing in China.
- Facilitate the transformation of IEC standard, *IEC 63077:2019 Good Refurbishment Practices for Medical Imaging Equipment*, into a Chinese standard.
- Develop a workable policy for medical equipment to be imported for repair, including for remanufacturing and refurbishment.

## 6. Promote Market Access for High-precision and Innovative In-vitro Diagnostics (IVDs)

### 6.1 Reflect IVDs' Technical Features in Medical Treatment Pricing Catalogues

- Consider the special characteristics of IVDs and the differences in methodology when formulating the amended version of the *National Medical Services Pricing Catalogue*.
- Include different diagnosis methods and technologies in provincial procurement catalogues, and purchase according to the quality of diagnostic products and the principles of accuracy and sensitivity.
- Ensure that only validated reagents are used with IVD devices.

### 6.2 Shorten the Pre-market Approval Time for Initial Registration and Registration Alteration

- Increase reviewers' training on registration documentation requirements among and with industry to provide more clarity and predictability during the file review phase.
- Establish a notification channel for simple, literal, non-critical modifications, such as labelling amendments and changes to the instruction for use.
- Establish a unified procedure for domestic and imported IVD reagents to allow for the change of manufacturing site through a notification to the responsible Medical Products Administration.
- Accelerate the issuance of registration certificates after internal approval has been given by the NMPA.
- Grant a grace period of six months for using an invalidated registration certificate after approval has been granted for minor changes to registration details.

## Introduction to the Working Group

Medical devices, including in-vitro diagnostics (IVD), play a crucial role in the prevention, diagnosis and treatment of diseases, while supporting and monitoring the convalescence of patients in hospitals, clinics and those undergoing homecare. Therefore, medical devices are key to improving the overall health of the population as laid down in the strategic plan Healthy China 2030.<sup>1</sup>

Members of the European Chamber's Healthcare

Equipment Working Group invest heavily in developing innovative treatments, and fully support the government's efforts to ensure patients' access to state-of-the-art, safe, efficacious and affordable medical devices. They maintain this commitment by investing in modern Chinese research, development and production facilities, as well as in the education of Chinese doctors and healthcare professionals. The working group has established contact with major stakeholders both in China and in Europe. It organises regular meetings with the National Medical Products Administration (NMPA) as well as Health Security Administrations (HSAs) and Health Commissions at different government levels to

<sup>1</sup> *Outline of Healthy China 2030*, State Council, 25<sup>th</sup> October 2016, viewed 18<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2016-10/25/content\\_5124174.htm](http://www.gov.cn/xinwen/2016-10/25/content_5124174.htm)>





get first-hand information on regulatory and healthcare policy developments, and to present suggestions from the European medical device industry.

To enhance international cooperation, in 2007, the working group established contact with the European Coordination Committee of the Radiological, Electromedical and Healthcare Information Technology Industry (COCIR), a major medical technology industry association based in Europe. In April 2014, the European Chamber founded the Consumable and Disposable Medical Devices (CDMD) Advisory Committee, a group consisting of Chinese subsidiaries of international market leaders in the field of consumable medical devices and IVD.

The Healthcare Equipment Working Group wishes to continue to engage in a constructive dialogue with all relevant government agencies, both at the national and provincial/local level in China.

## Recent Developments

After the disruption caused to the medical device market in the first half of 2020, China's health authorities managed to control the spread of COVID-19 in the second half of 2020 and throughout 2021, which brought stability to business development. In 2021, imports of medical devices grew by 18.4 per cent year-on-year to United States dollar (USD) 50.2 billion.<sup>2</sup> However, when that figure is broken down, it shows huge disparities between different product categories. For example, imports of IVD instruments grew by 49.9 per cent, indicating that health authorities want to strengthen the ability of the healthcare system to enable early diagnosis of infectious and other diseases. However, over the same period, imports of ventilators—a device high in demand during the initial outbreak of COVID-19—fell by 13.6 per cent.

In March 2022, a large-scale outbreak of COVID-19 in Shanghai resulted in temporary closures of numerous foreign- and Chinese-invested medical device manufacturing facilities. Because of the variety and complexity of medical devices, manufacturers depend more heavily on global supply chains than many other industries. Delays of imports of components at major

harbours, and the reduction in road freight arising from the Shanghai lockdown led to disruptions in production all over China, and caused a great deal of uncertainty over the economic outlook. Findings from a flash survey conducted by the European Chamber in April 2022 show that, as a result of China's imposition of more stringent COVID-19 containment measures, 58 per cent of respondents reported having decreased their 2022 revenue projections; 23 per cent are considering shifting current or planned investments out of China to other markets; and 77 per cent report that China is now a less attractive investment destination.<sup>3</sup>

In 2021, government procurement legislation was a major topic for the working group. Encouragingly, the Ministry of Finance (MOF) published an authoritative notice, stating that “government procurement shall give equal treatment to products domestically produced in China [...] by local and foreign enterprises.” However, while market access improved for products manufactured in China by foreign-invested enterprises (FIEs), procurement of imported medical devices became more restricted. In a notice published on 10<sup>th</sup> August 2021, the MOF stated that public hospitals carrying out procurement within their regular budget—whatever the source of the budget—must apply government procurement rules,<sup>4</sup> implying that, in accordance with to the Government Procurement Law (GPL),<sup>5</sup> public hospitals must preferably buy medical devices manufactured in China.

Controlling medical expenses remains a priority for the Chinese health authorities. One tool to achieve this is volume-based procurement (VBP) for CDMD. After a first VBP tender in September 2021, IVD reagents were procured by VBP in Anhui Province.<sup>6</sup> As the number of VBP tenders increased rapidly in the second half of 2020, the process of VBP tendering has become more mature and transparent; however, there is still

<sup>2</sup> *Annual Summary: Summary and Analysis of China's 2021 Medical Device Import and Export Figures*, China Business Intelligence Network, 29<sup>th</sup> January 2022, viewed 18<sup>th</sup> April 2022, <<https://baijiahao.baidu.com/s?id=1723216923120288591&wfr=spider&for=pc>>

<sup>3</sup> *Flash Survey: COVID-19 and the War in Ukraine: The Impact on European Business in China*, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 5<sup>th</sup> May 2022, <<https://www.eurochamber.com.cn/en/publications-archive/973>>

<sup>4</sup> *Reply of the MOF to Petition No.8584 on the Fourth Session of the 13<sup>th</sup> National People's Congress*, MOF, 10<sup>th</sup> August 2021, viewed 12<sup>th</sup> April 2022, <[http://gks.mof.gov.cn/jytafwgk\\_8304/2021jytafwgk\\_1/rddbgyfwgk/202108/t20210810\\_3744263.htm](http://gks.mof.gov.cn/jytafwgk_8304/2021jytafwgk_1/rddbgyfwgk/202108/t20210810_3744263.htm)>

<sup>5</sup> Government Procurement Law (2014 Amended Version), National People's Congress, 31<sup>st</sup> August 2014, viewed 25<sup>th</sup> June 2022, <[http://jrs.mof.gov.cn/zhuanti2019/ppp/zcfbPPP/201410/t20141030\\_1155101.htm](http://jrs.mof.gov.cn/zhuanti2019/ppp/zcfbPPP/201410/t20141030_1155101.htm)>

<sup>6</sup> *Trial Development of Volume-based Procurement of Reagents for Clinical Application in Anhui Province*, Central Government of the People's Republic of China, 26<sup>th</sup> September 2021, viewed 18<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-09/26/content\\_5639398.htm](http://www.gov.cn/xinwen/2021-09/26/content_5639398.htm)>





a tendency for tenders to be decided mainly by price, possibly compromising quality of treatment.

The second major tool aimed at controlling healthcare expenses are case-based payment systems for hospital treatment. Starting from early 2022, the National Healthcare Security Administration (NHSA) is conducting a three-year trial phase for diagnosis-related groups (DRG), a disease classification system widely used in European Union (EU) Member States, and big data diagnosis-intervention packages (DIP), an alternative payment system developed in China.<sup>7</sup> The trial covers almost all cities in China.

### Regulatory Environment

In February 2021, the State Council issued the revised *Regulation on the Supervision and Administration of Medical Devices (Order No. 739)*,<sup>8</sup> the highest-level legal document on medical device regulation in China. *Order No. 739* is aimed at increasing regulatory efficiency and promoting innovation, and in many respects brings Chinese regulation in line with international best practices.

The Centre for Medical Device Evaluation (CMDE) has improved its internal management by standardising the work of evaluators through operation procedures, and increasing predictability of the evaluation process by establishing an internal quality control system.

Communication with manufacturers has also improved, though additional channels for consultation prior to submissions would further increase regulatory efficiency.

In March 2021, the NMPA and the Standardisation Administration of China (SAC) published the *Opinion on Further Promoting the High-quality Development of Medical Device Standardisation*.<sup>9</sup> Subsequently, China's standardisation bodies accelerated their updates to relevant standards, with the gap between international and Chinese standards narrowing.

<sup>7</sup> Notification by the National Healthcare Security Administration on a Three-Year Plan to Roll-out DRG/DIP Payment Reforms, NHSA, 26<sup>th</sup> November 2021, viewed 18<sup>th</sup> April 2022, <[http://www.nhsa.gov.cn/art/2021/11/26/art\\_37\\_7406.html](http://www.nhsa.gov.cn/art/2021/11/26/art_37_7406.html)>

<sup>8</sup> Regulation on the Supervision and Administration of Medical Devices, State Council, 2021, viewed 18<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2021-03/18/content\\_5593739.htm](http://www.gov.cn/zhengce/content/2021-03/18/content_5593739.htm)>

<sup>9</sup> Opinion on Further Promoting the High-quality Development of Medical Device Standardisation, NMPA and SAC, 2021, viewed 19<sup>th</sup> April 2022, <<https://www.nmpa.gov.cn/xxgk/fgwj/gzwlj/gzwljlx/20210330170905141.html>>

In addition, the CMDE and the NHSA have strengthened their cooperation by sharing data and increasing technical consultation, striving for integration of regulatory and procurement processes, and addressing insufficient consistency in medical device classification, nomenclature and code assignment.

## Key Recommendations

### 1. Increase the Role of Market Forces in the Procurement of Medical Devices by Giving Greater Weighting to Device Quality and Clinical Needs

#### 1.1 Prioritise Value-based Procurement and Improve Enforcement Procedures in Volume-based Procurement (VBP)

##### Concern

The medical device industry is facing challenges in VBP activities, particularly with regard to the criteria for selecting winning tenders, which tend to be based on price at the expense of product quality and clinical requirements, as well as in terms of enforcing agreed VBP.

##### Assessment

In 2019, the State Council published the *Work Plan on High-value Consumables Governance (Work Plan)*,<sup>10</sup> stipulating a framework for medical device VBP. Since the *Work Plan* was released, procurement agencies at different levels have conducted more than 120 VBP tenders with very different procedures and rules. However, the frequency of VBP tenders and the absence of central guidelines on tender management caused considerable challenges for bidders.

The industry supports the efforts of the NHSA and local HSAs to control expenses and promote economies of scale, justifying lower prices for higher quantities. In nationwide VBP tenders, prices decreased by around 80 per cent, meaning that the winning bidders had to streamline their operations to cut costs while maintaining the quality of their products and services. At the same time, as elective surgeries decreased due to COVID-19 prevention measures, delivery costs increased, which—combined with complicated procurement procedures—led to challenges for manufacturers. Moreover, in a few provinces and cities, the actual procurement volume

<sup>10</sup> Work Plan on High-value Consumables Governance, State Council, 31<sup>st</sup> July 2019, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2019-07/31/content\\_5417518.htm](http://www.gov.cn/zhengce/content/2019-07/31/content_5417518.htm)>





did not meet the contractually agreed volume. In other cases, some hospitals asked for additional discounts after the minimum price had already been agreed on, or delayed payments. Solving these issues requires cooperation among different government departments, as tendering falls under the responsibility of local HSAs while hospital management is under local Health Commissions.

Although a certain—often too small—percentage of new and innovative consumable medical devices can be procured outside of VBP, health authorities do not encourage hospitals to use this option. Furthermore, when adding such consumable medical devices into the next round of VBP, the guiding price should be based on the results of clinical evaluations.

#### Recommendations

- Determine quality and clinical requirements as the main criteria for deciding VBP tenders, as opposed to procurement prices.
- Establish an inter-ministerial communication platform to ensure that VBP tendering and implementation of tendering results adhere to generally accepted principles of VBP tenders, particularly in terms of realising procurement volume, terms of delivery and payment as agreed in the tender.
- Limit VBP to genuine large-volume procurement, in general at provincial level or above.
- Grant a transitional period before implementation of VBP tenders at the provincial level or above, to allow winning bidders time to prepare sufficient inventory.
- Set sufficient intervals between VBP tenders to allow procurement agencies to evaluate the clinical application of VBP products in hospitals, quality of services and reliability of supply.
- Increase the new innovative consumable medical devices available to patients by procuring outside VBP tenders, and conduct clinical evaluations of these new products to allow them to participate in the next round of VBP with a reasonable and justified price.

## 1.2 Optimise the Legislative and Administrative Framework for Hospital Payment Reform to Promote the Use of Innovative Treatment Methods 2

### Concern

Far-reaching reforms of hospital financing—especially new methods to calculate the amount of reimbursement

by public healthcare insurance for diagnosis and treatment, such as DRG and DIP—are putting financial pressure on hospitals, which may result in reduced procurement and utilisation of innovative and high-quality medical devices.

### Assessment

Public hospitals in China mainly rely on three sources of income: payments through public healthcare insurance; co-payment by patients; and state subsidies, with prices for medical services controlled by provincial governments. Currently, the income of most public hospitals barely meets their expenses, mainly due to underestimation of labour costs. Due to current COVID-19 prevention measures, public hospitals are facing increasing challenges, such as restrictions on receiving patients, and the diversion of resources to prevent COVID-19 and related infections in medical personnel, all of which result in a decrease of hospital revenues.

Meanwhile, hospital payment system reform has been accelerated, following the NHSA's publication of the *Three-year Work Plan for DRG/DIP Payment Reform*.<sup>11</sup> This plan stipulates that by the end of 2025, DRG/DIP is to be applied in most hospitals, thereby handing over responsibility for cost control to them. DRG is a mature cost calculation system that could have a negative impact if not implemented properly. For example, if a treatment fee calculated by DRG is too low, hospitals may tend to choose products with lower prices over better quality but higher priced ones. It may also hinder market access for new medical technologies. In addition, DRG is based on historical data from the previous three years and does not reflect fast-changing cost structures. This can result in discrepancies between the theoretical payment standards and reality. Noting that, it is necessary to ensure that the sub-group of DRG can meet current clinical demands.

One aim of China's healthcare reform is to sufficiently value the labour of medical personnel. Compared with other professions in China, medical personnel are relatively underpaid.<sup>12</sup> Gradually increasing salaries of

11 *Three-year Work Plan for DRG/DIP Payment Reform*, NHSA, 19<sup>th</sup> November 2021, viewed 25<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-11/28/content\\_5653858.htm](http://www.gov.cn/zhengce/zhengceku/2021-11/28/content_5653858.htm)>

12 *Representative of National People's Congress Proposed Four Points to Improve Treatment of Medical Personnel*, China Healthcare, 25<sup>th</sup> May 2020, viewed 7<sup>th</sup> May 2022, <<https://www.cn-healthcare.com/articlewm/20200525/content-1116152.html>>





medical personnel in China or identifying other ways to incentivise quality of care would also benefit patients, and constitutes a cost factor that needs to be figured into DRG budgets.

#### Recommendations

- Update cost factors and ratios in DRG and DIP regularly to establish a reasonable payment standard.
- Establish a reasonable pathway to market for innovative treatment methods to accelerate patients' access to new medical technologies.
- Optimise the DRG sub-groups to adapt them to clinical requirements and allow flexibility to meet the varying needs of different regions.

### 1.3 Regularly Update the Healthcare Service Catalogue to Promote the Use of Innovative Treatment Methods 2

#### Concern

Irregular or delayed updates to the healthcare service catalogue can hinder patients' access to innovative treatment methods.

#### Assessment

The inclusion of medical treatments in a catalogue of state-approved treatment methods and assigning prices is a pre-condition for public hospitals to offer a diagnosis and related treatment to patients. However, while China's healthcare reform is intended to improve the value of the country's medical service, this is not reflected in the most recent *National Medical Treatment Pricing Catalogue*, which was published in 2012, with a new version under preparation by the NHTA. The speed of innovation in medical devices is such that many treatment methods listed in the 2012 pricing catalogue have already been discarded or modified, while more innovative treatment methods and medical devices are not included. As there is currently no nationwide approval procedure and timeline for adding new technology, this leads to delays in clinical application, while new treatment methods at the provincial level still need to be approved by the NHTA.

For many treatments, single-use medical devices—such as implants—are the most significant price factor in a medical bill. Tightly-controlled treatment pricing therefore gives hospitals only one option: to use relatively cheap single-use medical devices, which may lead to the quality of treatment being compromised. At

the same time, designated prices for some treatments are too low, resulting in multiple uses of disposable medical devices, which goes against the regulations of both the NMPA and the NHC, and risks patients' health.<sup>13&14</sup> Additionally, for certain treatments, single-use medical devices are bundled into medical service pricing items, which greatly limits clinicians' choice and use of innovative medical technology.

#### Recommendations

- Adhere to and implement the separation of medical consumables from medical service pricing items.
- Strengthen policy mechanism, including increasing medical treatment prices to discourage the illegal multiple use of disposable medical devices.
- Accelerate the dynamic adjustment of pricing catalogues to facilitate patients' access to innovative treatment methods and state-of-the-art medical devices.

## 2. Continue to Advance the Development of Regulatory Science and Accelerate the Promotion of Innovation

### 2.1 Introduce Innovative Regulatory Methods for Standalone Medical Software

#### Concern

The life-cycle of standalone software is much shorter than that of other medical devices, therefore applying traditional regulatory concepts decelerates development of the medical software industry in China and inhibits patients' access to innovative diagnosis and treatment.

#### Assessment

Medical software modules, such as controllers and pre-processing software, are designed to be installed on different medical device hardware. In the EU and other major economies, such software modules can be registered independently from the hardware. In China, however, hardware and software modules must be registered as one entity, and the exact version number of each software module must be specified during registration. This means that each time software

<sup>13</sup> Reply to Enquiry No. 1718 (No. 184 under Medical and Sports Category) of the Third Plenary Meeting of the 13<sup>th</sup> National People's Consultative Conference, NMPA, 4<sup>th</sup> August 2020, viewed 8<sup>th</sup> May 2021, <<https://www.nmpa.gov.cn/zwgkjyta/zhxta/20200804171454155.html>>

<sup>14</sup> The Ministry of Health Issues a Regulation that Disposable Medical Devices Shall Not be Used Repeatedly (in Chinese), Central People's Government of the People's Republic of China, 25<sup>th</sup> July 2006, viewed 8<sup>th</sup> May 2021, <[http://www.gov.cn/jrzq/2006-07/25/content\\_345790.htm](http://www.gov.cn/jrzq/2006-07/25/content_345790.htm)>





modules are modified, a large number of costly and time-consuming registration alterations are required, which delays employment of state-of-the-art software in hospitals.

The international standard *ISO/IEC 25051:2014 Software Engineering - Systems and Software Quality Requirements and Evaluation - Requirements for Quality of Ready to Use Software Product and Instructions for Testing* is a non-mandatory standard for software development. In China, it has been transformed into *GB/T 25000.51-2016*. While this is also a recommended standard, the NMPA requirement for full compliance makes it *de facto* mandatory.

Unlike the EU, China classifies no software as a low-risk class I medical device, but always as either class II or class III medical devices instead, which require type testing and clinical evaluation or trial procedures. Furthermore, the NMPA defines software recalls as a major product modification, which necessitates registration change. However, such modifications can only be implemented after approval from the NMPA, which is a regulatory inconsistency that leaves the industry in an impossible situation.

#### Recommendations

- Allow software such as controller-type and pre-processing software to be registered as standalone software.
- Remove the requirement to specify the version number of each software module in applications for registration of medical systems.
- Remove mandatory compliance of medical software with *GB/T 25000.51-2016*.
- Assign low-risk medical software to class I and enhance rules for risk classification.
- Streamline the requirements for registration alteration when only minor modifications are made to medical software, and provide a guideline defining which modifications qualify as 'minor'.
- Allow supplementary registration of recall-related software modifications to allow for quick updates to medical software and reduce risks for patients and clinicians, with modifications approved afterwards.

## 2.2 Harmonise Regulatory Requirements for Relocating Manufacturing from Overseas to China with International Practices

### Concern

Though the NMPA simplified the policy for the registration of products whose manufacture has been moved to China, it stipulates that the legal manufacturer of such products must be the enterprise established in China by the licence holder of the imported products, which is not common practice for multinational companies (MNCs).

### Assessment

Many MNCs have dozens of legal entities, one of which may be the licence holder of medical devices imported to China. In most cases, these entities are not direct investors of the factory in China. Requiring all import registrants to directly invest in the domestic factory for all products whose manufacture has been transferred to China goes against common practice for MNCs. This will have an impact on decision-making processes when companies are considering relocating their manufacturing from overseas to China.

Moreover, if the import registrant and the domestic factory eventually belong to the same corporate firm, the quality management system (QMS) of the domestic factory would become consistent with and traceable to the import registrant, which has the licensed QMS. In such cases, product quality is guaranteed, and accelerated registration should apply, in accordance with the NMPA *Announcement on Matters Related to the Production of Imported Medical Device Products in a Chinese Factory (2020, No. 104)*.<sup>15</sup>

### Recommendation

- Broaden the scope of FIEs, making NMPA *Announcement No. 104* applicable if the import registrant and the domestic factory eventually belong to the same corporate firm.

<sup>15</sup> *Announcement on matters related to the production of imported medical device products in a Chinese factory (2020, No. 104)*, NMPA, 25<sup>th</sup> September 2020, viewed 14<sup>th</sup> April 2022, <<https://www.nmpa.gov.cn/xxgk/ggtg/qtggtg/20200925152407171.html>>



### 2.3 Formulate a Sharing of Responsibilities between Manufacturers, Service Providers and Hospitals in Post-market Supervision

#### Concern

While the NMPA is strengthening the regulatory framework for post-market supervision, including after-sales service, maintenance and recall, the current lack of a clear division of responsibilities can delay or even prevent necessary corrective actions.

#### Assessment

Adverse event monitoring and re-evaluation play a critical role in the post-market supervision of medical devices. They also act as important communication channels among manufacturers, service providers and medical institutions. Currently, there are two regulations governing medical device usage: the *Administrative Measures for Use Quality Supervision of Medical Devices*,<sup>16</sup> and the *Administrative Measures for Clinical Use of Medical Devices*.<sup>17</sup> The content of these two measures is similar but emphasised differently, which has resulted in confusion among device users. This is particularly the case with regard to after-sales and the maintenance of medical devices, as the measures do not establish specific requirements for medical institutions to monitor and report adverse events.

Manufacturers are unable to obtain timely or complete information during the collection and investigation of adverse events, which precludes comprehensive analysis and evaluation in some cases and therefore prevents timely risk analysis evaluation and risk control. Inaccurate descriptions of product defects or adverse events, for example—with different organisations and institutions providing different descriptions of device defects and adverse events—hinders information exchange, product risk control and improvement, and decision-making for drug supervision and health administrative departments.

#### Recommendations

- Formulate specific requirements for medical institutions and service providers to report real and effective adverse events or defect information to manufacturers.

<sup>16</sup> *Administrative Measures for Use Quality Supervision of Medical Devices*, NMPA, 2015, viewed 14<sup>th</sup> April 2022, <<https://www.nmpa.gov.cn/ylqx/ylqxfgwj/ylqxbmgzh/20151021120001725.html>>

<sup>17</sup> *Administrative Measures for Clinical Use of Medical Devices*, NHC, 12<sup>th</sup> January 2021, viewed 14<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2021/content\\_5600085.htm](http://www.gov.cn/gongbao/content/2021/content_5600085.htm)>

- Require the NMPA and the NHC to jointly develop regulations on the use of medical devices, with specific requirements and articles on penalties.

### 3. Simplify Maintenance of Existing Registration Details when Mandatory Standards are Updated 2

#### Concern

The promulgation of revised mandatory standards often requires time-consuming and costly changes to the registration details of medical devices, which can disrupt their supply to the Chinese market.

#### Assessment

The State Council's *Order No. 739* stipulates that after mandatory standards are implemented, medical device registrants must promptly identify the differences between their product's technical requirements and the mandatory standards, and change registration details accordingly.

Mandatory standards account for 21 per cent of all medical device standards, including major ones such as the *GB 9706* series for medical equipment.<sup>18</sup> If a mandatory standard is updated, it will result in many registration alterations, which are time-consuming and costly, particularly for products that need to apply more than one mandatory standard. Not only do such changes increase the burden of registrants, they may also affect product supply and clinical use if processes are delayed during registration, such as product type testing. If the revision of mandatory standards affects products that are part of VBP, there will be an even wider impact.

Changes to registration triggered by the revision of mandatory standards requires additional type testing. At present, the quantity and testing capacity of qualifying test institutes are far below industry needs. To address this problem, on 12<sup>th</sup> May 2022, the MOF issued the *Notice on Issuing the Central Infrastructure Investment Budget (Appropriation) of the Medical Device Testing Capacity-building Project in 2022*.<sup>19</sup>

<sup>18</sup> *Annual Report of China's Medical Device Standard Management 2021*, NMPA, 18<sup>th</sup> February 2022, viewed 14<sup>th</sup> April 2022, <<https://www.nmpa.gov.cn/ylqx/ylqxfjgdt/20220218145010154.html>>

<sup>19</sup> *Notice on Issuing the Central Infrastructure Investment Budget (Appropriation) of the Medical Device Testing Capacity-building Project in 2022*, MOF, 12<sup>th</sup> May 2022, viewed 14<sup>th</sup> May 2022, <[http://jjs.mof.gov.cn/zxzyzf/jjzc/202205/t20220512\\_3809965.htm](http://jjs.mof.gov.cn/zxzyzf/jjzc/202205/t20220512_3809965.htm)>





Many Chinese standards lag behind the corresponding International Organization for Standardization (ISO) or International Electrotechnical Commission (IEC) standards, which most imports comply with when they are listed in the country of origin. To qualify for such standards, those products have been marketed abroad for many years and proved safety and effectiveness in clinical use. It can therefore be deduced that simplifying the process of changing registration as a result of mandatory standards being revised will not cause new risks to the safety and effectiveness of medical devices, and therefore re-testing is not required.

#### Recommendations

- Accelerate the conversion from mandatory industrial standards to recommended ones according to the Standardisation Law and international practices.
- Simplify the process for changing registration details triggered by the revision of mandatory standards and shorten the review time for registration alteration.
- Establish procedures to avoid repeated testing, taking reference from ISO/IEC test reports.
- Build up regulatory capacity to enable fast and smooth processing of registration alteration.

### 4. Promote the Application of High-quality, High-precision Medical Devices in Public Hospitals

#### Concern

The MOF's 2021 announcement that all procurement by public hospitals is to be considered 'government procurement', with a preference for procuring 'made in China' medical devices, could deprive patients of access to high-quality, high-precision imported devices.

#### Assessment

After the Foreign Investment Law (FIL) entered into force on 1<sup>st</sup> January 2020,<sup>20</sup> its slow implementation at the local level became a source of concern for FIEs. Despite the FIL's provision that products manufactured in China by FIEs will receive equal treatment in government procurement activities, the 'buy-China policy'—i.e., preferential treatment of Chinese brands—

continued in local procurement.<sup>21</sup>

The working group welcomes the MOF's assurance that products domestically produced in China by FIEs will be treated equally to Chinese brands, and expects this to be stringently implemented at the local level. However, with regard to imported medical devices, the MOF's new extended definition of government procurement contradicts previous practices where hospitals using their own funds had the option to buy imported medical devices.

Hospitals need a huge variety of medical devices: for example, there are 500,000 different types of medical devices available in the European market, most of which are manufactured in small quantities. It is unrealistic to expect to manufacture all these devices to a high quality in China, therefore imported medical devices help to ensure high-quality supply. Application of sub-standard medical devices may cause suffering to patients, and in the long-term lead to increased medical expenses. Therefore, international best practices emphasise the clinical value, not just the price, when deciding tenders.

Applications for hospital procurement of imported medical devices need to be approved by expert committees. To ensure decisions are fact-based, international expertise is required. While European medical device enterprises have expressed willingness to expand investment and manufacture additional medical devices in China,<sup>22</sup> the high regulatory hurdles involved in relocating production are time-consuming.

Due to the vast number of medical devices required, FIEs will always need to sell a mix of locally produced and imported products. As medical systems often consist of both locally manufactured and imported components, restrictions on imports may negatively affect FIEs readiness to invest further resources in the Chinese market.

#### Recommendations

- Promote the concept of value-based procurement, ensuring the best outcome when using limited public

20 Foreign Investment Law, National People's Congress, 15<sup>th</sup> March 2019, viewed 12<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/201903/121916e4943f416b8b0ea12e0714d683.shtml>>

21 *Healthcare Equipment Working Group Position Paper 2021/2022*, European Union Chamber of Commerce in China, 23<sup>rd</sup> September 2021, viewed 12<sup>th</sup> April 2022, pp. 253–254, <[https://www.europeanchamber.com.cn/en/publications-archive/953/Healthcare\\_Equipment\\_Working\\_Group\\_Position\\_Paper\\_2021\\_2022](https://www.europeanchamber.com.cn/en/publications-archive/953/Healthcare_Equipment_Working_Group_Position_Paper_2021_2022)>

22 Orally expressed during visits to member companies.





resources.

- Limit the application of the GPL to funds administered by the MOF and its local agencies.
- Increase transparency in the evaluation of import applications and invite experts from FIEs to participate in expert panels.
- Grant transitional periods for the importation of medical devices when manufacturers are in the process of relocating manufacturing into China.

## 5. Align Different Policies and Develop a Roadmap to Guide and Support the Refurbishment and Remanufacturing of Medical Equipment in China

### Concern

Current unclear policies and harsh regulations in China prevent remanufacturing and refurbishment of medical equipment for the Chinese market, which increases medical expenses and contradicts the national strategy to develop a green circular economy.

### Assessment

Refurbishment and remanufacturing of medical equipment can reduce expenses, save natural resources and decrease environmental pollution. As per international practices, original equipment manufacturers (OEMs) of large-scale medical imaging equipment, such as magnetic resonance imaging (MRI) or computed tomography (CT) machines, have established mature quality control and standardised refurbishment processes. The IEC standard, *IEC 63077: 2019 Good Refurbishment Practices for Medical Imaging Equipment* has been published to meet global demand for safe and effective refurbished medical equipment. The standard strongly promotes the use of, and market access for, refurbished medical imaging equipment and the importance of uniform practices worldwide.

In recent years, the working group has observed some positive changes in policies driving the development of a circular economy in the medical device industry. For instance, *Order No. 7 on Amending the Administrative Measures for the Import of Electromechanical Products* was published by the Ministry of Commerce (MOFCOM) in 2018.<sup>23</sup> In Article 30 of this legislation a provision has

<sup>23</sup> *Amending the Administrative Measures for the Import of Electromechanical Products*, MOFCOM, 10<sup>th</sup> October 2018, viewed 7<sup>th</sup> April 2021, <<http://www.mofcom.gov.cn/article/b/c/201811/20181102804608.shtml>>

been added: “Used mechanical and electrical products that appear in the *List of Commodities Forbidden to Be Imported*, and under the conditions of environmental protection and safety products, can be imported for repairing (including re-manufacturing) and re-export with the consent of the MOFCOM.” Although this policy supports the development of inbound medical device repair (including remanufacturing) business in some free trade zones (FTZs), the actual implementation process for the import of used parts is still unclear.

In addition, some policies from other government departments still act as barriers to the refurbishment and remanufacturing of medical equipment in China. For example, *Order No. 739* forbids the import of used medical devices that have expired or are considered ‘invalid’ or ‘obsolete’ without defining these terms. Such ambiguity in messaging will confuse industry players and prevent them from investing in the refurbishing and remanufacturing of medical equipment in support of China’s national circular economy strategy.

### Recommendations

- Develop a roadmap and industrial development plan to guide and support medical equipment refurbishment and remanufacturing in China.
- Facilitate the transformation of IEC standard, *IEC 63077:2019 Good Refurbishment Practices for Medical Imaging Equipment*, into a Chinese standard.
- Develop a workable policy for medical equipment to be imported for repair, including for remanufacturing and refurbishment.

## 6. Promote Market Access for High-precision and Innovative In-vitro Diagnostics (IVDs)

### 6.1 Reflect IVDs’ Technical Features in Medical Treatment Pricing Catalogues

#### Concern

At present, medical treatment pricing catalogues do not reflect products’ technical features, which puts innovative diagnostic methods at a disadvantage.

#### Assessment

In clinical practice, IVD devices and reagents are the basis for correct diagnosis of diseases. Manufacturers are permanently developing new IVD products to increase the accuracy, sensitivity, specificity, stability and speed of diagnosis methods. Correct diagnosis is a





precondition for efficacious treatment; whereas a wrong diagnosis may be very costly for the healthcare system. Testing for COVID-19 provides a very pertinent example – a false-negative test result may not only delay treatment of one patient but also be a starting point of a mass infection.

Different prices should be assigned to diagnosis methods of different accuracy, sensitivity and reliability in national and provincial medical treatment pricing catalogues to avoid hospitals operating at a loss. Currently, in most cases, the same price is assigned to different diagnosis methods.

The tendency in procurement to cut prices across the board may lead to the use of reagents that do not suit the designated IVD device. Because IVD devices and reagents are developed as one complete system, replacing reagents with cheaper but unverified alternatives may lead to a serious deterioration in the quality/accuracy of diagnosis.

#### Recommendations

- Consider the special characteristics of IVDs and the differences in methodology when formulating the amended version of the *National Medical Services Pricing Catalogue*.
- Include different diagnosis methods and technologies in provincial procurement catalogues, and purchase according to the quality of diagnostic products and the principles of accuracy, sensitivity.
- Ensure that only validated reagents are used with IVD devices.

## 6.2 Shorten the Pre-market Approval Time for Initial Registration and Registration Alteration

#### Concern

Under the new registration framework promulgated by the NMPA, new and amended registrations for IVD reagents in China take much longer than in Europe and face increasing uncertainties during technical evaluation.

#### Assessment

In September 2021, the NMPA promulgated new registration regulations for IVDs, which came into force after a very short transition period of just two months, compared with the EU's *Regulation (EU)*

2022/112 registration transition period of five years.<sup>24</sup> On 15<sup>th</sup> November 2021, the CMDE published the *Announcement on Issuing the Folder Structure of the Electronic Application Catalogue for the Registration of Medical Devices (No. 15, 2021)*,<sup>25</sup> followed by a public consultation on the *Filing Review Requirements for Various Registration Types*.<sup>26</sup>

After these regulations came into force in 2022, criteria for accepting registration documents appeared to be ambiguous. For example, different reviewers at the CMDE and its sub-centres gave conflicting instructions on which documents need to be supplemented after initial evaluation. Additionally, when the manufacturing site of imported IVD reagents is changed, the NMPA requires the filing of a time-consuming registration change, whereas domestic products in the same situation only need to undergo a far simpler notification process. For example, modification of the registration of imported IVD reagents includes chemical tests for three consecutive batches, meaning the whole approval procedure takes about a year longer than for domestic products. This is one example of remaining redundant changed-registration testing requirements and performance data requirements faced by FIEs.

Furthermore, after internal approval has been given by the NMPA, it takes usually two to four weeks to issue the new registration certificate. During this period, the manufacturer is unable to produce using either the new or the old registration. As the manufacture of reagents requires a continuous flow, these gaps cause serious disruptions in the value chain.

#### Recommendations

- Increase reviewers' training on registration documentation requirements among and with industry to provide more clarity and predictability during the file review phase.
- Establish a notification channel for simple, literal, non-critical modifications, such as labelling amendments

<sup>24</sup> *Regulation (EU) 2022/112 of the European Parliament and of the Council of 25 January 2022 amending Regulation (EU) 2017/746 as regards transitional provisions for certain in vitro diagnostic medical devices and the deferred application of conditions for in-house devices*, EUR-Lex, 25<sup>th</sup> January 2022, viewed 26<sup>th</sup> April 2022, <[https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2022.019.01.0003.01.ENG](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2022.019.01.0003.01.ENG)>

<sup>25</sup> *Announcement on Issuing the Folder Structure of the Electronic Application Catalogue for the Registration of Medical Devices (No. 15, 2021)*, CMDE, 15<sup>th</sup> November 2021, viewed 27<sup>th</sup> June 2022, <<https://www.cmde.org.cn/xwdt/shpgzgg/gztg/20211115161000245.html>>

<sup>26</sup> *Filing Review Requirements for Various Registration Types*, NMPA, 25<sup>th</sup> February 2022, viewed 26<sup>th</sup> April 2022, <<https://www.nmpa.gov.cn/xxgk/zhqyj/zhqyjlxq/20220302135737184.html>>



and changes to the instruction for use.

- Establish a unified procedure for domestic and imported IVD reagents to allow for the change of manufacturing site through a notification to the responsible Medical Products Administration.
- Accelerate the issuance of registration certificates after internal approval has been given by the NMPA.
- Grant a grace period of six months for using an invalidated registration certificate after approval has been granted for minor changes to registration details.

## Abbreviations

CDMD	Consumable and Disposable Medical Device
CMDE	Centre for Medical Device Evaluation
COCIR	European Coordination Committee of the Radiological, Electromedical and Healthcare Information Technology Industry
DIP	Diagnosis-intervention Package
DRG	Diagnosis-related Groups
EU	European Union
FIE	Foreign-invested Enterprise
FIL	Foreign Investment Law
GPL	Government Procurement Law
HSA	Health Security Administration
IEC	International Electrotechnical Commission
ISO	International Organization for Standardization
IVD	In-vitro Diagnostics
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
NHSA	National Healthcare Security Administration
NMPA	National Medical Products Administration
OEM	Original Equipment Manufacturer
SAC	Standardisation Administration of China
USD	United States Dollar
VBP	Volume-based Procurement





# Maritime Manufacturing and Industrial Services Working Group

## Key Recommendations

### 1. Provide a Comprehensive Roadmap Detailing How the Maritime Sector Will be Included in China's 2060 Carbon Neutrality Pledge 🌱

#### 1.1 Increase Foreign Companies' Access to Green Demonstration Projects and Pilot Projects

- Involve foreign companies in green demonstration projects and pilot projects by improving their access to such initiatives.
- Develop and implement a transparent and open mechanism that allows all companies—both Chinese and foreign—to contribute to the development and construction of the green infrastructure needed to successfully decarbonise domestic shipping in China.
- Establish a decarbonisation task force involving policymakers and businesses, both Chinese and foreign.

#### 1.2 Support Decarbonisation of the Domestic Fleet by Clarifying the Application Process and Timeline for Certification of Maritime Equipment Imported from Abroad for Installation on China-flagged Vessels 🌱

- Ensure that the Maritime Safety Administration Type Approval Certificate application process is transparent, and clearly designate a single point of contact to liaise with and to whom relevant documentation should be submitted.
- Issue official documentation once the application has been received.
- Stipulate the timeframe for reviewing an application from when it is received to when the permits will be issued.
- Create a mechanism that allows companies to track their applications.

### 2. Issue Guidance on the Transportation of Liquefied Natural Gas (LNG)

#### 2.1 Accelerate the Deployment of LNG Bunkering and Ship-to-Ship Regulations along Coastal Areas

- Issue relevant local guidelines for ship-to-ship transfers and LNG bunkering in Chinese coastal areas.
- Increase cooperation with European ports offering similar services, to better understand hazard identification analysis and hazard and operability analysis workshop results and the corrective actions that have been implemented.

#### 2.2 Authorise LNG Transportation on Domestic Waterways at Both the National and Provincial Level

- Issue relevant local guidelines promoting safe transportation of LNG on domestic waterways, making the adoption of large-capacity LNG carriers and LNG storage under atmospheric conditions possible.
- Invite foreign-invested companies and foreign experts to share their insights and recommendations with regulators.



### 3. Advance the Opening-up of the Cruise Market in China and Support the Restart of Business Operations 3

- Issue a plan with a clear timeline for cruise businesses in China to restart international operations.
- Allow foreign-invested cruise operators to offer 'cruises to nowhere' departing from Chinese ports.
- Allow foreign-invested travel agencies to sell tickets directly to Chinese customers.

### 4. Ease Cross-border Movement of Foreign Experts, Managers and Specially-trained Maritime Engineers/Maintenance Workers 2

- Ease COVID-related travel restrictions and implement a fast-track programme for foreign maritime experts, managers and specially-trained engineers, and facilitate foreign marine technicians' access to Chinese ports.

### 5. Amend Value-added Tax (VAT) Regulations on Imported Ship Components from Outside China for Assembly Onboard

- Exempt imported ship components for assembly onboard from VAT payments, in line with international practice, in order to foster the domestic ship-repair-and-conversion business.

## Introduction to the Working Group

The Maritime Manufacturing and Industrial Services Working Group (previously the Shipbuilding Working Group) represents European companies that design, manufacture, maintain and repair ships, as well as maritime equipment manufacturers and technology providers, classification societies, maritime service providers and cruise operators.<sup>1</sup>

While the maritime sector plays an essential role in satisfying the increasing global demand for cleaner and safer transportation systems—with the decarbonisation of shipping being vital to delivering on global climate ambitions—the green and digital transformation of maritime and offshore operations present challenges and opportunities for both European and Chinese companies in terms of supplying new innovative solutions. Furthermore, as ships and associated maritime technology and equipment fall into the category of 'dual-use' technology, China defines the maritime sector as a strategic sector that is subject to national security and sovereignty considerations.<sup>2</sup>

<sup>1</sup> Classification societies establish and maintain technical standards for various industries.

<sup>2</sup> 'Dual-use' technology and/or equipment refers to that which is suitable for both civilian and military purposes.

## Recent Developments

Coming from a record-low base in 2020, due to the COVID-19 crisis coming on top of several years of a sluggish market, the world's shipbuilding industry experienced a surge in growth in 2021, with orders reaching a level not seen since the mid-2000s. Shipbuilders are optimistic that strong orders will continue for several years past 2025, for several reasons. First, new International Maritime Organization (IMO) measures, driven by regulatory changes related to the decarbonisation of shipping, will take effect as of 2023.<sup>3&4</sup> Shipowners need to either invest in efficiency improvements or place orders for new vessels to replace or upgrade part of their non-compliant fleet. Second, as the global economy slowly rebounded from the impact of the outbreak of COVID-19, resurgent demand and depleted inventories, coupled with congestion at major ports, sent shipping freight rates soaring during 2021,

<sup>3</sup> The purpose of these new IMO measures is to steer ocean-going ships closer to Paris Agreement targets. Two IMO indexes—the Efficiency Existing Ship Index (EEXI) and the Carbon Intensity Indicator (CII)—have been established to provide shipowners with a reference point by which to reduce their greenhouse gas (GHG) emissions levels: *Understanding New IMO Decarbonization Measures: EEXI And CII*, Bureau Veritas, 3<sup>rd</sup> May 2021, viewed 8<sup>th</sup> April 2022, <<https://www.bvsolutions-m-o.com/magazine/understanding-new-imo-decarbonization-measures-eexi-and-cii>>

<sup>4</sup> See for example: *Sustainable maritime fuels – 'Fit for 55' package: the FuelEU Maritime proposal*, European Parliament, 11<sup>th</sup> April 2022, viewed 13<sup>th</sup> April 2022, <[https://www.europarl.europa.eu/thinktank/en/document/EPRS\\_BRI\(2021\)698808](https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2021)698808)>





allowing shipping lines to invest in fleet expansion.<sup>5</sup> Third, the global trend of shipyard consolidation has continued, primarily with a view to streamline operations and invest in developing new technologies. This has impacted yard space availability.<sup>6&7</sup>

According to the China Association for National Shipbuilding Industry (CANSI), China completed 39.7 million deadweight tonnage (DWT) in 2021,<sup>8</sup> and reclaimed its position as the largest shipbuilding nation in the world in terms of annual order volume by compensated gross tonnage (CGT). In 2021, China accounted for half of the global total of 45.7 million CGT in new orders made during the year,<sup>9</sup> while orders received for export ships also increased. As a result, the orderbooks of Chinese state-owned shipyards are full until 2025, with the exception of a few yards in northeast China, and the orderbooks of smaller private shipyards are full past 2023.<sup>10</sup> China's ship exports in 2021 grew by 18.6 per cent year-on-year to reach United States dollars (USD) 22.47 billion, with exports to Europe totalling USD 4.6 billion.<sup>11</sup> Bulk carriers, oil tankers and container ships continue to dominate China's ship exports, accounting for 57 per cent of the total.<sup>12</sup>

Moreover, the global orderbook for merchant ship newbuildings at the end of 2021 accounts for 12.8 per cent of the existing fleet's capacity.<sup>13</sup> China now has become the second largest owner of the global fleet

after Greece, accounting for about 16 per cent of the world's tonnage, equating to 329 million DWT.<sup>14</sup>

### Regulatory developments

There is a number of regulatory developments with regard to China's pledge to peak carbon emissions before 2030 and achieve carbon neutrality by 2060 that are worth highlighting, including:

- On 26<sup>th</sup> October 2021, the State Council issued the *Carbon Peak 2030 Action Plan*, which declares support for the use of liquified natural gas (LNG) as a transition fuel for ships, and prompts Chinese shipbuilders to develop electric and LNG-powered vessels. The plan also states that the upgrading and conversion of old ships must be accelerated, and the use of shore power by ships in port promoted. In addition, demonstration applications of coastal and inland green intelligent ships are to be carried out.<sup>15</sup>
- On 3<sup>rd</sup> December 2021, the Ministry of Industry and Information Technology (MIIT) released the *14<sup>th</sup> Five-year Plan for Green Development of Industry*, which details that China aims to accelerate the development of green intelligent ships, and lays out a proposal for the comprehensive utilisation of solid waste from marine engineering equipment. The plan also seeks to restrict the use of hazardous substances in ships by formulating inspection guidelines and building a database of hazardous substances covering the entire industrial chain.<sup>16</sup>
- On 21<sup>st</sup> January 2022, the Ministry of Transport (MOT) adopted the *14<sup>th</sup> Five-year Plan for Development of Green Transport Industry*—on which the working group advocated for more specific targets in respects of port infrastructure decarbonisation, green-powered vessels and green maritime financing bonds, among others—laying out the general targets for decarbonisation of China's vessel fleets in the near term.<sup>17</sup> These include reducing carbon dioxide (CO<sub>2</sub>) emissions per unit of transport turnover of operating vessels by 3.5 per cent by 2025 (taking 2020 as the baseline), and reducing

5 Costas Paris, *Ship Orders Surge as Carriers Rush to Add Capacity*, *The Wall Street Journal*, 8<sup>th</sup> June 2021, viewed 11<sup>th</sup> April 2022, <<https://www.wsj.com/articles/ship-orders-surge-as-carriers-rush-to-add-capacity-11623179052>>

6 Shin Watanabe, *Chinese state-owned shipbuilder lets shipyard go under in rare move*, *Nikkei Asia*, 2<sup>nd</sup> December 2021, viewed 11<sup>th</sup> April 2022, <<https://asia.nikkei.com/Business/Companies/Chinese-state-owned-shipbuilder-lets-shipyard-go-under-in-rare-move>>

7 *Mid-Sized Shipyards Consolidating and Restructuring due to Downturn*, *The Maritime Executive*, 9<sup>th</sup> November 2020, viewed 11<sup>th</sup> April 2022, <<https://www.maritime-executive.com/article/mid-sized-shipyards-consolidating-and-restructuring-due-to-downturn>>

8 *Analysis of the economic operation of the shipbuilding industry in 2021*, CANSI, 9<sup>th</sup> January 2022, viewed 11<sup>th</sup> April 2022, <<http://www.cansi.org.cn/cms/document/17230.html>>

9 *China Wins Number-One Rank in Annual Shipbuilding Orders for 2021*, *The Maritime Executive*, 3<sup>rd</sup> January 2022, viewed 11<sup>th</sup> April 2022, <<https://www.maritime-executive.com/article/china-wins-number-one-rank-in-annual-shipbuilding-orders-for-2021>>

10 *Fleet Forecast data basis September 2021 (100+ GT)*, *Orderbook data basis start 2022*, Clarksons Research, 10<sup>th</sup> February 2022, viewed 21<sup>st</sup> April 2022, <<https://www.clarksons.net/n/#/portal>>

11 *Analysis of the economic operation of the shipbuilding industry in 2021*, CANSI, 9<sup>th</sup> January 2022, viewed 11<sup>th</sup> April 2022, <<http://www.cansi.org.cn/cms/document/17230.html>>

12 Ibid.

13 *Powerful growth in the China-owned fleet*, *Hellenic Shipping News*, 16<sup>th</sup> June 2022, viewed 16<sup>th</sup> June 2022, <<https://www.hellenicshippingnews.com/powerful-growth-in-the-china-owned-fleet/>>

14 Daniel, Laurent; Lee, Changhoon & Spieth, Judith, *Shipbuilding policy and developments in selected economies*, OECD, 15<sup>th</sup> September 2021, viewed 8<sup>th</sup> April 2022, <[https://www.oecd-ilibrary.org/science-and-technology/shipbuilding-policy-and-market-developments-in-selected-economies\\_5872e0cf-en](https://www.oecd-ilibrary.org/science-and-technology/shipbuilding-policy-and-market-developments-in-selected-economies_5872e0cf-en)>

15 *Notification of the State Council on Printing and Distributing 2030 Carbon Peak Action Plans*, State Council, 26<sup>th</sup> October 2021, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2021-10/26/content\\_5644984.htm](http://www.gov.cn/zhengce/content/2021-10/26/content_5644984.htm)>

16 *14<sup>th</sup> Five-Year Plan for Green Development of Industry*, MIIT, 3<sup>rd</sup> December 2021, viewed 19<sup>th</sup> April 2022, <<http://www.gov.cn/zhengce/zhengceku/2021-12/03/5655701/files/4c8e11241e1046ee9159ab7dcad9ed44.pdf>>

17 China's vessel fleets include the inland waterway vessels, ships in coastal trade, short-sea shipping liners and ocean-going fleets.





total nitrogen oxide (NO<sub>x</sub>) emissions by seven per cent by 2025 (taking 2020 as the baseline).<sup>18</sup> It also states that ports and service areas within the Yangtze River Economic Zone should reach 100 per cent shore power capacity by 2025.<sup>19</sup>

While these plans are aimed at accelerating the decarbonisation of Chinese domestic inland shipping, it is unclear how they will be implemented. Targets laid out in the MOT's 14<sup>th</sup> Five-year Plan are moreover highly unambitious, as regulators have sought to control emissions emanating from shipping for quite some time. As the Asian Development Bank noted in a recent report on green shipping in China, "development has been uneven and largely uncoordinated because of insufficient integration, knowledge, and capacity to implement new energy applications in domestic river ships and ports."<sup>20</sup>

There are currently no policies or regulations geared toward integrating international technology into China's domestic shipping industry. In addition, China's failure to provide a clear indication of its current market—such as size, age and type of fleet—may lead to both foreign and domestic companies finding it difficult to accurately assess the business potential and identify the right technology mix.

## Key Recommendations

### 1. Provide a Comprehensive Roadmap Detailing How the Maritime Sector Will be Included in China's 2060 Carbon Neutrality Pledge

#### 1.1 Increase Foreign Companies' Access to Green Demonstration Projects and Pilot Projects

##### Concern

Decarbonisation of inland and coastal water transportation will be key in reaching China's 2060 carbon neutrality goal, yet European companies are largely prevented from participating in green maritime demonstration projects and other pilot projects because of unclear tendering processes and other relevant information.

18 Notice of the Ministry of Transport on printing and distributing the "14<sup>th</sup> Five-Year Plan for Development of Green Transportation", Ministry of Transport, 21<sup>st</sup> January 2022, viewed 18<sup>th</sup> April, <[https://xxgk.mot.gov.cn/2020/jjgou/zghs/202201/t20220121\\_3637584.html](https://xxgk.mot.gov.cn/2020/jjgou/zghs/202201/t20220121_3637584.html)>

19 Ibid.

20 People's Republic of China: Study on the Development of Green Ports and Shipping, Asia Development Bank (ADB), December 2021, viewed 8<sup>th</sup> April 2022, pp.2-3, <<https://www.adb.org/projects/55032-001/main>>

## Assessment

Marine equipment and energy-saving technologies are at the heart of the huge and critical process of decarbonising shipping. In the short-term, there is potential for the use of transition fuels such as fossil LNG in large ships, and batteries and hydrogen in smaller ships. Alternative carbon-neutral fuels such as green-anhydrous ammonia (NH<sub>3</sub>), green methanol, green LNG and green hydrogen, which take well-to-wake emissions—meaning emissions from fuel production, transportation, distribution and eventually combustion onboard—into account, may become more dominant fuels in the long-term. This approach is in line with proposals put forward by the European Commission and by China on approaches to decarbonisation.<sup>21&22</sup>

According to a mapping exercise on green demonstration projects carried out by the Getting to Zero Coalition, in 2021, China had 15 maritime zero-emission pilots and demonstration projects.<sup>23</sup> Of these, eight are targeted at domestic shipping. None of the projects identified include a foreign equipment or technology provider as a project partner.<sup>24</sup>

Most working group members note that they do not receive information directly from the Chinese authorities on green demonstration projects for domestic, inland shipping, but rather tend to hear of them when it is too late to get involved or when no foreign suppliers are being considered. Some recent examples include:

- A state-sponsored project for the *Yangtze River Three Gorges 1*, the world's largest electrical cruise ship, powered by a battery with a capacity of 7,500 kilowatt (kW) hours, allowing it to sail 100 kilometres on a single charge.<sup>25</sup>

21 Proposal for a Regulation of the European Parliament and of the Council on the Use of Renewable and Low-carbon Fuels in Maritime Transport and Amending Directive 2009/16/EC, European Union, 14<sup>th</sup> July 2021, viewed 9<sup>th</sup> May 2022, <<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0562>>

22 Notice on Releasing of the 14<sup>th</sup> Five-year Plan for Development of Green Transport Industry by the Ministry of Transport, State Council, 29<sup>th</sup> October 2021, viewed 20<sup>th</sup> June 2022, <[http://www.gov.cn/zhengce/zhengceku/2022-01/21/content\\_5669662.htm](http://www.gov.cn/zhengce/zhengceku/2022-01/21/content_5669662.htm)>

23 The Getting to Zero Coalition is a multi-stakeholder, multi-country, industry-led platform for collaboration that brings leading stakeholders from across the maritime and fuels value chains together with the financial sector and other stakeholders committed to making commercially viable zero-emission vessels a scalable reality by 2030: Kilemo, Heidi, Montgomery, Robert & Leitão, Ana Madalena, *Mapping of Zero Emission Pilots and Demonstration Projects Third Edition*, The Getting to Zero Coalition, 31<sup>st</sup> March 2022, viewed 12<sup>th</sup> April, <<https://www.globalmaritimeforum.org/publications/mapping-of-zero-emission-pilots-and-demonstration-projects>>

24 Data shared courtesy of the Getting to Zero Coalition.

25 Yangfei Zhang & Kun Liu, *Largest electric cruise ship makes debut, China*





- A 'Green Pearl River' project that includes the design and construction of 50 LNG-fuelled river vessels. As far as the working group is aware, foreign suppliers and Chinese suppliers with foreign sub-suppliers were not considered.<sup>26</sup>
- A project, under the banner 'Norway-China Hydrogen Initiative', to build up the hydrogen value chain deemed necessary to achieve zero-emission domestic shipping on the Yangtze River before 2040, funded by the Beijing-Tsinghua Industrial Research and Development (R&D) Institute (BTIRDI)<sup>27</sup> and the Three Gorges Corporation on the Chinese side.<sup>28</sup> Some working group members reached out to see if there are opportunities to join, as they have a strong interest in entering early into the zero-emission inland waterway transition, but without success.<sup>29</sup>

There also is a lack of clarity on processes for participation in demonstration projects and initiatives at the local level, as additional information on project details and bidding is not readily available. In 2021, Fujian Province issued its *Work Plan for Promoting the High-quality Development of Ship and Marine Engineering Equipment in Fujian Province (2021–2023)*,<sup>30</sup> which states that there will be at least 10 electric ship demonstration projects. Guangdong Province has also issued its *Inland Shipping Green Development Demonstration Project Implementation Plan*,<sup>31</sup> with a heavy emphasis on conversion of the

Daily, 30<sup>th</sup> March 2022, viewed 13<sup>th</sup> April, <[https://english.www.gov.cn/news/topnews/202203/30/content\\_WS6243ad1ac6d02e5335328724.html](https://english.www.gov.cn/news/topnews/202203/30/content_WS6243ad1ac6d02e5335328724.html)>

26 CSSC commences construction of 50 LNG-fuelled bulk carriers for 'Green Pearl River' project, *Manifold Times*, 5<sup>th</sup> April 2021, viewed 13<sup>th</sup> April 2022, <<https://www.manifoldtimes.com/news/cssc-commences-construction-of-50-lng-fuelled-bulk-carriers-for-green-pearl-river-project/>>

27 The BTIRDI is a public institution jointly established in 1998 and managed by the Beijing Municipal People's Government and Tsinghua University.

28 *China calls for Norwegian tech firms to take part in hydrogen growth industry*, BI Norwegian Business School, 4<sup>th</sup> October 2019, viewed 13<sup>th</sup> April 2022, <<https://www.bi.edu/about-bi/news/2019/09/China-Calls-for-Norwegian-tech-companies/>>

29 It is unclear whether this is due to being blocked or that there are no real activities in this field yet. Although the 2040-target timing is quite distant, to reach it the work needs start now, with studies, infrastructure and pilots.

30 The plan envisions Fujian becoming a leading R&D and manufacturing base for domestic electric ships and other high-technology ship products, such as deep-sea mining vessels, roll-on-roll-off (ro-ro) vessels, cruise ships, electric ships and new high-performance ocean-going fishing vessels, with a combined output value of Chinese yuan (CNY) 30 billion by 2023: *Notice on Printing and Distributing the Work Plan for Promoting the High-quality Development of Ship and Marine Engineering Equipment in Fujian Province (2021–2023)*, People's Government of Fujian Province, 17<sup>th</sup> August 2021, viewed 11<sup>th</sup> April 2022, <[http://gxt.fujian.gov.cn/gk/zfbxgk/zfbxgkml/gfxwj/202108/t20210819\\_5672794.htm](http://gxt.fujian.gov.cn/gk/zfbxgk/zfbxgkml/gfxwj/202108/t20210819_5672794.htm)>

31 *General Office of the People's Government of Guangdong Province issued the 'Guangdong Provincial Division of Labour Plan to Enhance Inland Navigation Capacity and Promote Green Development of Inland Shipping Overall', 'Guangdong Provincial Inland Shipping Capacity Improvement Implementation Plan' and the 'Guangdong Provincial Inland Shipping Green Development Demonstration Project Implementation Plan'*, People's Government of Guangdong Province, 19<sup>th</sup> August 2021, viewed 11<sup>th</sup> April 2022, <[https://www.gd.gov.cn/zwgk/wjkbqbwj/yfb/content/post\\_3491983.html](https://www.gd.gov.cn/zwgk/wjkbqbwj/yfb/content/post_3491983.html)>

existing fleet to LNG-fuelled vessels.<sup>32</sup> These and similar projects around the country would have been of great interest to European maritime companies. In the experience of the working group, the reasons for foreign companies being unable to join demonstration projects for domestic, inland shipping is threefold. First, for these kinds of projects, the provider must be certified by the China Classification Society (CCS), and foreign-made maritime equipment and technology destined for China-flagged vessels must have additional certification from the Maritime Safety Administration (MSA) (see Key Recommendation 1.2). Second, budgets and prices tend to be low, meaning that in most cases only low-end local manufacturers can meet the requirements – this sometimes also discourages mid-range and high-end Chinese suppliers. Finally, China's focus on developing self-sufficiency in the maritime industry means domestic manufacturers are to a certain degree still favoured. All these factors make it challenging for European companies to increase their market share.

However, the main issue is that demonstration projects for domestic, inland shipping are not visible upfront. While foreign companies are sometimes invited to provide training and workshops, and engage in consultancy for domestic shipping projects (most notably foreign classification societies), only domestic companies are invited to join as full-fledged project partners or technology providers. In some cases, Chinese shipyards that obtain government funding for R&D projects may subcontract to a foreign company.

For China to reach its emission reduction targets for domestic and inland shipping, it is imperative to upgrade its existing fleets with new technologies,<sup>33</sup> a task to which European companies could contribute. In view of potential future exports of vessels to Europe through these local projects, cooperation with European suppliers is also in the interests of Chinese shipbuilders, equipment manufacturers and other stakeholders.

The development and construction of the green infrastructure needed to successfully decarbonise

[gd.gov.cn/zwgk/wjkbqbwj/yfb/content/post\\_3491983.html](https://www.gd.gov.cn/zwgk/wjkbqbwj/yfb/content/post_3491983.html)>

32 The subsidy standards are as follows: for ships 300kW and below power, the maximum subsidy limit is CNY 900,000; for ships with power 300–600kW, the maximum subsidy limit is CNY 1.3 million; for ships with power 600–1,000kW, CNY 1.7 million; for ships with power 1,000–1,500kW, CNY 2.5 million; and for ships with power above 1,500kW, the maximum subsidy limit is CNY 3.8 million. The specific subsidy implementation plan shall be formulated separately by the Provincial Department of Finance and the Department of Transportation: *Ibid*.

33 *Ibid*.





domestic shipping could be accelerated if a transparent and open mechanism for project bidding and certification of marine equipment and technology destined for China-flagged vessels is established. Moreover, establishing a decarbonisation task force in shipping and maritime manufacturing involving policymakers and businesses, both Chinese and foreign, could ensure best-practice sharing and mutual benefits in the global fight against climate change.

### Recommendations

- Involve foreign companies in green demonstration projects and pilot projects by improving their access to such initiatives.
- Develop and implement a transparent and open mechanism that allows all companies—both Chinese and foreign—to contribute to the development and construction of the green infrastructure needed to successfully decarbonise domestic shipping in China.
- Establish a decarbonisation task force involving policymakers and businesses, both Chinese and foreign.

### 1.2 Support Decarbonisation of the Domestic Fleet by Clarifying the Application Process and Timeline for Certification of Maritime Equipment Imported from Abroad for Installation on China-flagged Vessels

#### Concern

The process of applying for and obtaining the MSA Type Approval Certificate (TAC), in order to have equipment installed on China-flagged vessels, is not transparent.

#### Assessment

Foreign-manufactured marine equipment destined for China-flagged vessels needs two TACs: first, a TAC for vessels classified by the CCS and flying a non-Chinese flag; and second, a TAC for vessels flying a China flag from the MSA. Based on the experience of working group members, while the process for obtaining the first TAC is relatively straightforward, that for obtaining an MSA-TAC is highly opaque and ambiguous. Among other issues, there is neither a clear point of contact to liaise with and submit relevant documentation, nor has any timeframe been stipulated for the process.

European manufacturers must obtain the MSA-TAC because China does not accept the European Union (EU) Marine Equipment Directive (MED) certification

procedure or ‘wheelmark’ for equipment, components, or materials destined for China-flagged ship classes, despite the CCS being authorised to perform the MED certification.<sup>34</sup> As a result, European equipment manufacturers are forced to apply for and obtain CCS certification, which often results in additional costs. This practice is unfair, as Chinese marine manufacturers can automatically obtain a MED certification from the CCS or another classification society approved by the EU, allowing them full access to the European market and vessels flying flags of any member state.

In addition, some European manufacturers are also subject to higher certification costs at the CCS than local manufacturers, even though their products are similar and have similar safety criticality or environmental performance. Likewise, it has in the past been unclear whether Chinese authorities will approve ballast water treatment systems (BWTS) manufactured by European or other foreign equipment manufacturers for installment on Chinese vessels, regardless of whether it has an IMO-TAC issued by the CCS or another classification society.

This TAC issue has been a long-term concern for working group members, as previously detailed in the *Shipbuilding Working Group Position Paper 2019/2020*.<sup>35</sup> One member company noted that although it first applied in 2015, it did not obtain TAC approval until 2018. In addition, the approval was granted as a ‘one-off’ by the CSS on behalf of the MSA, but did not include approval for China-flagged vessels. While it has since then become easier for foreign BWTS manufacturers to obtain both the CCS and the MSA-TAC-approval, the process for certifying other foreign-made energy efficiency technology and marine equipment is still unclear and complicated.

According to the Asian Development Bank, in 2020, more than 90 per cent of Chinese domestic, inland vessels operated on traditional diesel engines.<sup>36</sup> Depending on sources consulted, estimates of the

<sup>34</sup> The MED certification covers a limited number of types of marine equipment, such as life-saving and firefighting equipment and scrubbers, and does not cover ballast water devices. However, it is still considered essential certification for European maritime manufacturers.

<sup>35</sup> *Shipbuilding Working Group Position Paper 2019/2020*, European Union Chamber of Commerce in China, 24<sup>th</sup> September 2019, viewed 21<sup>st</sup> April, <[https://www.eurochamber.com.cn/en/publications-archive/711/Shipbuilding\\_Working\\_Group\\_Position\\_Paper\\_2019\\_2020](https://www.eurochamber.com.cn/en/publications-archive/711/Shipbuilding_Working_Group_Position_Paper_2019_2020)>

<sup>36</sup> *People's Republic of China: Study on the Development of Green Ports and Shipping*, ADB, December 2021, viewed 8<sup>th</sup> April 2022, <<https://www.adb.org/projects/55032-001/main>>





number domestic, inland river vessels in China range between 115,000 to 200,000, but all will need to be replaced or upgraded over the next 40 years.<sup>37&38</sup>

According to working group calculations, European suppliers would be able to take 25 per cent of this upgrading demand if barriers were lowered. Therefore, considering that the average price of a new inland ship is approximately euro (EUR) 1.5 million, with equipment representing about 70 per cent of the newbuilding cost, the yearly market potential for European suppliers would be between EUR 650 million and EUR 2 billion. Apart from the business opportunities, the decarbonisation of domestic shipping could be quickly accelerated if foreign-made marine equipment (with suitable technology) could be made readily available to Chinese vessels.

#### Recommendations

- Ensure that the MSA-TAC application process is transparent, and clearly designate a single point of contact to liaise with and to whom relevant documentation should be submitted.
- Issue official documentation once the application has been received.
- Stipulate the timeframe for reviewing an application from when it is received to when the permits will be issued.
- Create a mechanism that allows companies to track their applications.

## 2. Issue Guidance on the Transportation of LNG

### 2.1 Accelerate the Deployment of LNG Bunkering and Ship-to-Ship Regulations along Coastal Areas

#### Concern

The current lack of regulations on LNG ship-to-ship transfers and LNG bunkering services presents

refuelling challenges to both domestic and international ships bunkering at Chinese ports.

#### Assessment

Despite a national regulation on LNG ship-to-ship transfers and LNG bunkering services having been under development and discussion for many years,<sup>39</sup> it has yet to be officially promulgated.

In August 2021, the MSA issued the *Measure for the Safety Supervision and Administration of Water Liquefied Natural Gas Filling Operations*, which took effect as of 30<sup>th</sup> September 2021 and will be valid for five years.<sup>40</sup> The *Measure* covers safety regulations related to ship-to-ship and onshore storage-to-ship LNG filling operations. However, as detailed guidelines are yet to be released by local MSA authorities, ship-to-ship LNG transfer remains out of reach in most provincial ports.

To ensure the safety of bunkering operations, it is standard practice to conduct both a concept hazard identification analysis and a hazard and operability analysis of the intended gas system. Many European (as well as Singaporean) ports have solid experience in carrying out these studies in order to define dedicated regulations and, as a result, have conducted hundreds of LNG ship-to-ship transfers safely. The working group believes that establishing a cooperative framework between one of these ports and Chinese ports could help accelerate the implementation of the national rules at the provincial level.

#### Recommendations

- Issue relevant local guidelines for ship-to-ship transfers and LNG bunkering in Chinese coastal areas.
- Increase cooperation with European ports offering similar services, to better understand hazard identification analysis and hazard and operability analysis workshop results and the corrective actions that have been implemented.

<sup>37</sup> Information on the number of domestic ships is not precise and varies largely depending on the sources consulted. Both the ADB and the Chinese consultancy Zhi Yan estimate that there were 115,000 domestic inland vessels in 2020, but Statista estimates there were 126,800 vessels at the end of 2020: Ibid.; *Current Competition and Investment Outlook of Transport Vessel Industry in China 2021-2027*, Zhi Yan Consultancy, 3<sup>rd</sup> June 2021, viewed 13<sup>th</sup> April 2021, <<https://www.chyxx.com/industry/202106/954998.html>>; *Number of transport vessels in China from 2008 to 2021 (in 1,000s)*, Statista, 1<sup>st</sup> February 2022, viewed 13<sup>th</sup> April 2022, <<https://www.statista.com/statistics/258515/number-of-vessels-in-china/>>

<sup>38</sup> In 2021, the working group held a meeting with the China Transport Planning and Research Institute, which noted that there were approximately 200,000 inland river vessels in China.

<sup>39</sup> Bunkering LNG ship-to-ship can take place between two seagoing ships at anchorage or in port.

<sup>40</sup> *Notice of the Maritime Safety Administration of the People's Republic of China on Amending and Issuing the Measure for the Safety Supervision and Administration of Water Liquefied Natural Gas Filling Operations*, MSA, 27<sup>th</sup> August 2021, viewed 12<sup>th</sup> April 2022, <<https://www.msa.gov.cn/html/xgk/tzgg/wgfw/20210830/5C1201AF-E262-4207-91F1-2CD37127635F.html>>





## 2.2 Authorise LNG Transportation on Domestic Waterways at Both the National and Provincial Level

### Concern

Existing regulation on LNG transportation on main domestic waterways is insufficient due to a lack of alignment at local levels.

### Assessment

There is a clear guideline for the development of LNG transportation on domestic, inland waterways.<sup>41</sup> However, inner waterways such as the Yangtze River, Pearl River and the Yellow River flow through several provinces, and difficulties associated with coordination and varying safety concerns mean implementation at the local level (province and county) is evolving very slowly.

Following an expert assessment meeting in late 2020 between MOT officials and 50 LNG industry experts, approval was granted for LNG carriers to enter the Yangtze River. Provincial branches of the MSA were deemed responsible for overseeing implementation. In September 2021, the Jiangsu Province MSA issued detailed trial measures on safety measures for the navigation, operation and bunkering of LNG vessels in its local section of the Yangtze River.<sup>42</sup> However, as the proposal specifies many restrictions, as of mid-2022, no LNG carrier has sailed on the Yangtze River. To resolve this, the working group recommends working with both Chinese and foreign experts, especially on the industry side, to move forward on LNG carriers entering the Yangtze River.

### Recommendations

- Issue relevant local guidelines promoting safe transportation of LNG on domestic waterways, making the adoption of large-capacity LNG carriers and LNG storage under atmospheric conditions possible.
- Invite foreign-invested companies and foreign experts to share their insights and recommendations with regulators.

<sup>41</sup> *Guidance on Promoting the Application of LNG in the Water Transport Sector by the Ministry of Transport, MOT*, 23<sup>rd</sup> October 2013, viewed 16<sup>th</sup> June 2022, <[http://www.gov.cn/gongbao/content/2013/content\\_2547150.htm](http://www.gov.cn/gongbao/content/2013/content_2547150.htm)>

<sup>42</sup> *Notice on the Issuance of the 'Safety Measures for Navigation, Berthing and Operation of Bulk LNG Vessels Carriers Sailing on the Jiangsu Section of the Yangtze River (Trial)'*, General Office of Jiangsu Maritime Safety Administration, 20<sup>th</sup> September 2021, viewed 12<sup>th</sup> April 2022, <[https://www.js.msa.gov.cn/art/2021/9/20/art\\_11434\\_1274993.html](https://www.js.msa.gov.cn/art/2021/9/20/art_11434_1274993.html)>

## 3. Advance the Opening-up of the Cruise Market in China and Support the Restart of Business Operations 3

### Concern

China's cruise market is only partly open to foreign-invested cruise operators, which negatively impacts business sustainability as restrictions continue to slow business growth, while the lack of a timeline for cruise businesses to restart international operations is causing grave financial burdens and will substantially discourage the global cruise industry from investing in China.

### Assessment

On 14<sup>th</sup> March 2020, the global cruise market was shut down due to COVID-19 control measures, an unprecedented move that resulted in USD 32.7 billion total expenditures created by the cruise industry by the end of 2020.<sup>43</sup> All foreign-owned cruise ships operating in Shanghai had to dock offshore or on standby in other ports such as Singapore and Dubai. Most have since been re-assigned to serve other markets, primarily because China is yet to resume international ocean cruising.

Since the initial outbreak of COVID-19, the sanitation and epidemic prevention system of global cruise ships and ports has greatly improved. According to the Cruise Lines International Association (CLIA), the world's largest cruise industry trade association, the infection rate in mid-2022 is about eight per 10,000 passengers. By the end of 2021, 86 countries and regions had resumed international ocean cruise operations.<sup>44</sup> In June 2022, the CLIA estimated that the number of passengers in 2023 will exceed that of 2019.<sup>45</sup>

In other non-CLIA countries, effective communication platforms have been established between government, medical authorities and cruise operators to enable industry re-opening. Meanwhile, the Chinese Government has yet to lay out a roadmap for re-opening its international cruise market, which has left the industry in the dark as to how to prepare for business to restart.

<sup>43</sup> *Cruise Industry Shutdown Has Cost Billions of Dollars, Hundreds of Thousands Of Jobs, CLIA Says*, The Business Journals, 14<sup>th</sup> December 2020, viewed 16<sup>th</sup> June 2022, <<https://www.bizjournals.com/southflorida/news/2020/12/14/cruise-industry-shutdown-losses-to-surpass-32b.html>>

<sup>44</sup> *State of the Cruise Industry Outlook 2022*, Cruise Lines International Association, January 2022, viewed 12<sup>th</sup> April 2022, <<https://cruising.org/en/news-and-research/research/2022/january/state-of-the-cruise-industry-outlook-2022>>

<sup>45</sup> *CLIA Optimistic About Greece Cruise Travel in 2022 and Beyond*, GTP, 10<sup>th</sup> June 2022, viewed 16<sup>th</sup> June 2022, <<https://news.gtp.gr/2022/06/10/clia-optimistic-about-greece-cruise-travel-in-2022-and-beyond/>>





In contrast to the European and United States (US) cruise markets, only Chinese-flagged local cruise ships are allowed to offer packages off the coast of China, with no foreign-invested operators currently permitted to do so. Rules concerning cabotage and foreign-flagged vessels,<sup>46</sup> combined with the fact that foreign-invested travel agencies are not allowed to sell cruise tickets directly to Chinese customers (but are forced to sell via Chinese tour operators instead), have been a drag on market growth.

Prior to COVID-19, China had overtaken Germany to become the world's second largest cruise market after the US, and had seen a double-digit annual increase that would have allowed it to reach 10 million passengers by 2026. Therefore, despite the barriers they encountered, foreign cruise operators had been willing to increase investments in China. However, after two years of zero profits since the outbreak of COVID-19, and with other large markets opening up while China operations remain at a standstill, many foreign cruise operators are now considering whether to exit the China market.

However, if China opened up so-called 'cruises to nowhere' to international ocean cruise liners, it could help stimulate the growth of the Chinese travel market by bringing more revenues to local travel agencies. Regulators could grant special permission for international cruise lines as part of the central government's efforts to revitalise the domestic travel market. Piloting cruises to nowhere on a trial basis under the current circumstances considered safe enough by medical experts and other authorities as neither passengers nor crew members would have contact with other countries' citizens.

#### Recommendations

- Issue a plan with a clear timeline for cruise businesses in China to restart international operations.
- Allow foreign-invested cruise operators to offer 'cruises to nowhere' departing from Chinese ports.
- Allow foreign-invested travel agencies to sell tickets directly to Chinese customers.

<sup>46</sup> Cabotage is the right to operate sea, air or other transportation services within a particular territory. Maritime cabotage laws govern the transportation of goods and people between ports.

## 4. Ease Cross-border Movement of Foreign Experts, Managers and Specially-trained Maritime Engineers / Maintenance Workers

### Concern

China's current strict quarantine measures and visa restrictions make it difficult for foreign, specially-trained maritime experts and marine technicians to enter China to take up full-term employment, or to conduct specific, short-term activities related to installation, maintenance and repairs onboard ships, as well as the newbuilding of ships.

### Assessment

Prior to entering China, foreign companies' employees face complex application procedures for obtaining visas to travel to China, both for employment and to conduct specific, short-term activities related to installation, maintenance and repairs of equipment and ships, or newbuilding of ships. Upon arrival in China, strict quarantine requirements (up to a minimum of three weeks plus one week of self-observation) are imposed, and in some cases, foreign experts face an additional two weeks of quarantine when travelling between provinces.

While most working group members engaged in shipbuilding and maritime equipment report that they set up local teams over the last two years to handle maintenance—and in cases where specially-trained maritime experts and marine technicians from abroad were required, they managed to get by with the support of the shipyard—the story is completely different for classification societies and service providers.

The main reason is that the invitation letter (PU letter) verification became more complicated in 2021, with not only the officially listed documents required but also often *ad hoc* documentation requested on a case-by-case basis, on top of prior verification by the Chinese Foreign Affairs Office. Therefore, the working group is happy to see that, from the beginning of June 2022, foreigners no longer need to apply for a PU letter, or invitation letter, before applying for certain types of visas.<sup>47</sup> However, at time of writing, implementation remains to be observed.

<sup>47</sup> *Process to approve working visas to be simplified for entering China: AmCham China, Global Times*, 10<sup>th</sup> June 2022, viewed 23<sup>rd</sup> June 2022, <<https://www.globaltimes.cn/page/202206/1267811.shtml>>





Another issue is access to Chinese ports: to date, all have some sort of restrictions on entry by foreign crew and technicians.<sup>48&49</sup> In addition, COVID-19 containment measures have caused disruptions, with shipyards occasionally forced to temporarily shut down and—as during the Shanghai lockdown in spring 2022—declare *force majeure*.<sup>50</sup> These restrictions pose a challenge for the entire maritime industry, and discourage foreign investment and long-term partnerships in China.

#### Recommendation

- Ease COVID-related travel restrictions and implement a fast-track programme for foreign maritime experts, managers and specially-trained engineers, and facilitate foreign marine technicians' access to Chinese ports.

### 5. Amend Value-added Tax (VAT) Regulations on Imported Ship Components from Outside China for Assembly Onboard

#### Concern

In contrast to international industry norms, Chinese shipbuilders that acquire and import ship components and equipment from outside China to be assembled onboard an international China-flagged vessel must pay the VAT, which unfairly impacts the competitiveness of European maritime equipment manufacturers.

#### Assessment

According to international practice, no additional VAT is required on imported components being assembled onboard a seagoing vessel if it is operated for at least 70 per cent navigation on high seas and 100 per cent commercially. In China, the VAT is payable on all *renminbi* contracts for both domestic and imported products. However, local suppliers do not need to pay the import duty of 10 per cent if products are destined for international seagoing vessels flying a Chinese flag, but they must pay if the product or components are manufactured outside of China. It should however be noted that China does not impose VAT on components

and equipment destined for so-called 'export projects', which include a foreign shipowner and a foreign flag, conducted in foreign currency.

This practice affects the Chinese shipbuilding business when it comes to ship repair and conversion (especially for the cruise industry,). As a result, and combined with the COVID-19 restriction, many ship operators prefer to go to Singapore or elsewhere in Southeast Asia to repair and convert their ships. A direct consequence of this is that China's ship-repair-and-conversion business segment is not growing as it should be, and consequently Chinese shipyards are generating losses. Additionally, it is currently not possible to replace all ship components from overseas with local Chinese components, simply because neither the standards nor the quality assurance are compatible.

#### Recommendation

- Exempt imported ship components for assembly onboard from VAT payments, in line with international practice, in order to foster the domestic ship-repair-and-conversion business.

### Abbreviations

CANSI	China Association for National Shipbuilding Industry
CCS	China Classification Society
CGT	Compensated Gross Tonnage
CNY	Chinese Yuan
CO <sub>2</sub>	Carbon Dioxide
EUR	Euro
DWT	Dead Weight Tonnage
IMO	International Maritime Organization
LNG	Liquefied Natural Gas
MED	Marine Equipment Directive
MOT	Ministry of Transport
MSA	Maritime Safety Administration
NOx	Nitrogen Oxide
R&D	Research and Development
TAC	Type Approval Certificate
USD	United States Dollar
VAT	Value-added Tax

48 *Weekly Update on COVID-19 in China*, Ocean Favor Shipping (Shanghai) Ltd, 21<sup>st</sup> February 2022, viewed 8<sup>th</sup> April 2022, <<https://secureservercdn.net/160.153.138.163/w3t.a8c.myftpupload.com/wp-content/uploads/2022/02/Weekly-Update-on-COVID-19-in-China-8th-Week.pdf>>

49 *Live port quarantine requirements map for China*, Ocean Favor Shipping (Shanghai) Ltd, 2022, viewed 8<sup>th</sup> April 2022, <<https://www.oceanfavor.com/index2.html>>

50 *Shanghai Lockdown Shuttles Three State-Owned Shipyards*, *Maritime Executive*, 7<sup>th</sup> April 2022, viewed 13<sup>th</sup> April 2022, <<https://www.maritime-executive.com/article/shanghai-lockdown-shuttles-three-major-cssc-shipyards>>





# Petrochemicals, Chemicals and Refining Working Group

## Key Recommendations

### 1. Sustainability and Green Chemistry

#### 1.1 Promote Sustainability through Effective Communication, Best Practice Sharing, and Innovation on Safety and Environmental/Carbon Management

- Strengthen government-international businesses cooperation and encourage the central authorities to involve affected companies as key stakeholders, particularly regarding the emissions trading system (ETS), Responsible Care, and health, safety and environment management.
- Establish regular, formal and transparent communication channels to collect feedback from foreign enterprises and industrial associations on regulation drafting and implementation to avoid 'one-size-fits-all' measures, and a central platform on which standard answers to frequently-asked-questions can be published and relevant parties can raise queries.
- Clarify the distinction in standards between mandatory requirements and good practices and provide regulatory flexibility for industry evolution, including the incorporation of new technologies.
- Conduct regulatory training for authorities at every level (town, provincial and national) to align interpretations and enforcement.
- Accelerate the establishment and development of the national green electricity market, standardise the certification of carbon credit from the consumption of green electricity and issue green electricity consumption certificates on a regular basis.
- Encourage enterprises to purchase green electricity by differentiating purchased green electricity from grid electricity emissions in the ETS, and establishing a channel for electricity and carbon markets in line with international standards.
- Clarify the definition of 'two-high' projects and provide industry development guidelines on local project approvals.

#### 1.2 Improve Policies for Promotion of the Circular Economy Within the Chemical Industry

- Foster value chain cooperation as well as regulatory, financial and tax support to promote the implementation of circular economy principles, for example, re-use of chemical waste as a raw material and energy co-generation.
- Encourage energy/resource sharing and collaboration within chemical parks.
- Simplify the certification and approval requirement to encourage waste recycling and utilisation projects while offering the possibility of case-by-case exemptions.
- Grant tax incentives that promote plastic recycling processes and improve urban waste infrastructure, and speed up the construction of a green standard system for recycled plastics.
- Standardise chemical recycling of plastic waste requirements, particularly regarding onsite pre-treatment and transportation to industrial parks for recycling.

#### 1.3 Boost the Green Development of Chemical Parks by Providing More Efficient and Integrated Public Utility Services

- Consider specific industrial characteristics when establishing plans and layouts for chemical



parks.

- Strengthen unified planning for the construction and management of industrial gas, public pipelines, heating, hazardous chemical (HC) waste disposal facilities and other public utilities at chemical parks.
- Speed up the deployment of measures to improve energy consumption intensity and efficiency in chemical parks under the 30/60 Goals through building, optimising and sharing common utilities such as steam, waste water treatment and hazardous waste facilities.
- Encourage renewable energy investment by establishing mechanisms such as a fast-track approval procedure for on-site photovoltaics installations in chemical parks.

## 2. Investment and Manufacturing Costs

### 2.1 Guarantee Fair and Reasonable Treatment by Local Authorities with Respect to Relocations and Temporary Closures of Enterprises and Chemical Parks 6

- Ensure that any criteria provided and actions undertaken to have businesses relocate or temporarily close are based on law and regulations, transparent and published well in advance.
- Use a 'case-by-case' approach to address suggestions for plant relocations, with significant lead-time and lenient timelines to avoid disrupting chemical supply chains.
- Reach mutual agreement with companies on relocation timelines and fair compensation to decrease their associated costs.
- Factor in secondary risks on overall shutdown policies, including COVID-19-related closures and particularly in relation to measures given at short notice, to avoid disruptions to chemical plant operations that may increase risks of explosions.
- Establish a direct communication channel for companies to submit suggestions to the authorities on the relocation or shutdown of chemical plants.

### 2.2 Facilitate the Diversity and Competitiveness of the Oil and Gas Sectors

#### a) Continue Deregulation of the Retail Fuel Market 4

- Fully remove oil product price ceilings to deliver a competitive retail fuel market in China, and establish a clear time schedule for market deregulation.

#### b) Deregulate the Liquefied Petroleum Gas (LPG) Market on a National Level 3

- Fully deregulate limitations on the new energy market on a national level, including cylinder LPG prices for domestic use, particularly where local governments set the retail price.

### 2.3 Simplify the Regulatory Process to Support New Market and Technology Innovation in Fine Chemical Manufacturing 2

- Simplify the permit allocation process for minor recipe changes within the same product category to promote quick market responses and encourage innovation.
- Simplify the permit allocation process for plant debottlenecking projects that aim to increase production capacity and optimise the workflow without changing the main production process or increasing emissions.
- Establish a standardised permit approval process and provide measures to correct permit applications during the approval procedure.
- Streamline, and involve industrial experts with relevant expertise, in the permit approval review process.





### 3. Chemicals Management

#### 3.1 Develop a Well-argued and Practical Legislation Framework for Chemical Risk Management



- Remove local barriers to HC transportation and enhance capacity building for HC transportation, import and export.
- Adopt risk management option analysis guidance by ensuring key stakeholders are involved and all factors (for example, exposure scenarios, socio-economic analyses, alternative availability) are considered in the decision-making process for chemicals prioritisation and risk management measures selection.
- Exempt low volume notification for new chemicals and HC registration from notification requirements.
- Simplify and improve the registration system for HC and new chemicals.
- Minimise the scope of HC control under the 'one enterprise, one product and one code' policy and prohibit the downloading of product labels to protect confidential information.
- Include chemical manufacturers in the risk assessment process to determine the chemicals listed under Priority Assessment Chemicals and Priority Control Chemicals, taking the entire chemical supply chain into consideration.

## Introduction to the Working Group

The Petrochemicals, Chemicals and Refining (PCR) Working Group represents the leading European companies in the petroleum and chemical industry in China, many of which are Fortune Global 500 companies. The aim of the working group is to improve the operating conditions for PCR companies in China by facilitating communication between member companies, the government and Chinese industrial associations. The working group provides up-to-date information on pressing issues related to the chemical industry and the effects of various locally enacted regulations.

The Petrochemicals, Chemicals and Refining Working Group maintains an ongoing strategic dialogue with the Ministry of Ecology and Environment (MEE), the Ministry of Emergency Management (MEM), the Ministry of Commerce, the Ministry of Transportation, the State Administration for Market Regulation, the Ministry of Industry and Information Technology (MIIT), the National Development and Reform Commission (NDRC), as well as counterparts from the Delegation of the European Union (EU) to China and the European Commission. The working group also has a close relationship with several chemical industry associations, including the

China Petroleum and Chemical Industry Federation (CPCIF) and the Association of International Chemical Manufacturers (AICM), which share the aim of facilitating the Chinese manufacturing industry in becoming more sustainable and innovative.

## Recent Developments

China's chemical market has contributed half of the total global growth of the industry over the past two decades,<sup>1</sup> yet it is still in the midst of a profound transition; reflecting consumer-demand trends and navigating stricter environmental regulations. The working group greatly appreciates the constructive exchanges that have taken place between European stakeholders and Chinese officials, as well as the market-driven approach taken by much of the new domestic legislation regulating the PCR industry in recent years.

### Sustainability and Green Chemistry

In the lead-up to the 26<sup>th</sup> UN Climate Change Conference of the Parties (COP26) in November 2021, China released its long-awaited *Action Plan for*

<sup>1</sup> Hong, Sheng and Jie, Yifan and Liu, Nathan, *China's Chemical Industry: New Strategies For a New Era*, McKinsey, 20<sup>th</sup> March 2019, viewed 8<sup>th</sup> June 2022, <<https://www.mckinsey.com/industries/chemicals/our-insights/chinas-chemical-industry-new-strategies-for-a-new-era>>



*Reaching Carbon Dioxide Peak Before 2030* and the *Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality*, which form the basis of the policy framework for reaching its two key carbon reduction targets – to peak carbon emissions by 2030 and reach carbon neutrality by 2060 (30/60 Goals).<sup>2</sup> At the forefront is transitioning to a low-carbon economy by curbing ‘two high’ projects (high energy consumption, high pollution including carbon emissions),<sup>3</sup> which focusses on carbon-intensive industries such as steel manufacturing, non-ferrous metals and petrochemicals. Realising the 30/60 Goals will require a rapid green transformation amongst industries and significant drops in pollutants and emissions intensity, with initiatives such as the national emissions trading system (ETS) launched on 1<sup>st</sup> February 2021 under the jurisdiction of the MEE, and online trading commencing in July 2021.<sup>4</sup> Forecasts in early 2022 predicted China’s emission trading market to see a 70 per cent expansion that year, due to plans to add heavy industry and manufacturing, with carbon prices potentially reaching Chinese yuan (CNY) 65 per tonne, up from the CNY 54.22 seen at the end of 2021.<sup>5</sup> However, due to the poor quality of reported data, plans to expand the ETS market to include aluminium and cement will be delayed to 2023 at the earliest, hindering China’s progress towards decarbonisation.<sup>6</sup>

As the world’s largest greenhouse gas emitter, the success of China’s ETS will be critical in peaking carbon emissions by 2030. The European Chamber’s *Carbon Neutrality: The Role of European Business in China’s Race to 2060* outlined that although China’s overarching 14<sup>th</sup> Five-year Plan (14FYP) provides some general guidance towards 2030, the specific mechanisms for achieving the 30/60 Goals are not adequately defined, nor are sufficient details provided for the national-level

roadmap from 2025–2030.<sup>7</sup> The working group hopes there will be further roadmaps clarifying requirements for the chemical industry in order to facilitate its expansion under the 30/60 Goals.

Certain sustainability regulations on sustainability of relevance to the industry are already in place. On 22<sup>nd</sup> February 2021, the State Council released a plan for the development of a circular economy, which includes the creation of a formal scrap-recycling system and a focus on Extended Producer Responsibility.<sup>8</sup> The legal framework of the national pollutant discharge permit system, which obliges manufacturers to apply for permits before discharging pollutants through the *Regulations on Management of Pollutant Discharge Permits*, has been in effect since 1<sup>st</sup> March 2021.<sup>9</sup> In addition, on 3<sup>rd</sup> February 2022, the NDRC, MIIT, MEE and the National Energy Administration (NEA) jointly issued the *Implementation Guidelines for Energy Conservation and Carbon Reduction Renovation and Upgrading in Key Areas of Energy-consuming Industries (2022 Edition)*,<sup>10</sup> modifying key areas of high energy-consuming industries across the supply chains of industries such as oil refining, cement, iron, steel and chemicals. The guidelines aim to improve energy efficiency levels across 17 different industries while giving full play to their advantages in capital, talent and technology.

### Investment and Manufacturing Costs

The Yangtze River Protection Law, which entered into force in March 2021, prohibits the construction or expansion of chemical parks and projects within one kilometre of the river, with no nuance for projects intended to upgrade plants’ safety and ecological protection.<sup>11</sup> Several working group members report local authorities ordered them to shut down within unreasonably short timeframes. Many also received

2 *Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of the New Development Philosophy*, NDRC, 24<sup>th</sup> October 2021, viewed 23<sup>rd</sup> April 2022, <[https://en.ndrc.gov.cn/policies/202110/t20211024\\_1300725.html](https://en.ndrc.gov.cn/policies/202110/t20211024_1300725.html)>

3 Huld, Arendse, *Understanding China’s Action Plan for Reaching Peak Carbon Emissions by 2030*, China Briefing, 11<sup>th</sup> November 2021, viewed 24<sup>th</sup> April 2022, <<https://www.china-briefing.com/news/china-carbon-emissions-understanding-peak-emissions-action-plan/>>

4 *China’s National Carbon Market is About to Launch*, China Dialogue, 29<sup>th</sup> January 2021, viewed 23<sup>rd</sup> April 2022, <<https://chinadialogue.net/en/climate/chinas-national-carbon-market-is-about-to-launch/>>

5 Xue, Yujie, *China’s Emissions Trading Market Likely To See Expansion, Rising Carbon Price in 2022 Say Analysts*, SCMP, 9<sup>th</sup> January 2022, viewed 25<sup>th</sup> April 2022, <<https://www.scmp.com/business/china-business/article/3162702/chinas-emissions-trading-market-likely-see-expansion-rising>>

6 *National Carbon Market Expansion May Be Delayed to 2023*, China Dialogue, 19<sup>th</sup> May 2022, viewed 28<sup>th</sup> June 2022, <<https://chinadialogue.net/en/digest/national-carbon-market-expansion-may-be-delayed-to-2023/>>

7 *Carbon Neutrality: The Role of European Business in China’s Race to 2060*, European Union Chamber of Commerce in China, 25<sup>th</sup> May 2022, viewed 12<sup>th</sup> June 2022, p. 9, <<https://www.eurochamber.com.cn/en/publications-carbon-neutrality-report>>

8 *Guiding Opinions of the State Council on Accelerating the Establishment and Improvement of a Green and Low-Carbon Circular Development Economic System*, State Council, 22<sup>nd</sup> February 2021, viewed 23<sup>rd</sup> April 2022, <[http://www.gov.cn/zhengce/content/2021-02/22/content\\_5588274.htm](http://www.gov.cn/zhengce/content/2021-02/22/content_5588274.htm)>

9 *Order No. 736 of the State Council of the People’s Republic of China*, State Council, 29<sup>th</sup> January 2021, viewed 24<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2021-01/29/content\\_5583525.htm](http://www.gov.cn/zhengce/content/2021-01/29/content_5583525.htm)>

10 *Implementation Guide for Energy Conservation and Carbon Reduction Transformation and Upgrading in Key Areas of High Energy Consuming Industries*, NDRC, 3<sup>rd</sup> February 2022, viewed 15<sup>th</sup> April 2022, <[https://www.ndrc.gov.cn/xwd/tzgg/202202/t20220211\\_1315447.html?code=&state=123](https://www.ndrc.gov.cn/xwd/tzgg/202202/t20220211_1315447.html?code=&state=123)>

11 *Yangtze River Protection Law of the People’s Republic of China*, National People’s Congress, 26<sup>th</sup> December 2020, viewed 25<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202012/1626d0bc5284485588222995e712c434.shtml>>





conflicting information from different government departments and encountered difficulties in establishing direct negotiation channels with the relevant authorities. This situation, in addition to further mandatory shutdowns related to localised COVID-19 containment measures and local energy curbs, has presented a triple whammy to the chemical industry. The government should avoid a 'one-size-fits-all' approach to closures, and provide transparent and fair criteria, and adequate timeframes, for plant shutdowns to mitigate business disruption.

In 2022, due to the severity of COVID-19-induced lockdown measures in Shanghai from March to the end of May,<sup>12</sup> the chemical industry has been significantly impacted by supply chain disruptions and intermittent chemical parks closures. Many chemical manufacturers encountered logistics bottlenecks, including shortages of raw materials, interprovincial border restrictions and a general lack of transportation.<sup>13</sup> These challenges pose safety risks for hazardous chemicals (HC), as well as severely disrupting production for crucial sectors such as semiconductors and healthcare, which will in turn lead to repercussions for international supply chains, and both the domestic and global economy. The secondary risks of transporting HC should also be taken into consideration when implementing COVID-related curbs, to ensure stability for the chemical manufacturing industry.<sup>14</sup>

### Chemicals Management

The MEE's *Measures for Environmental Management Registration of New Chemical Substances (Order No. 12)* went into effect at the beginning of 2021.<sup>15</sup> Although the legislation eases new substance reporting requirements, the lack of reporting exemptions for low-quantity chemicals used in research will likely hamper innovation capacity and add to manufacturers' administrative burdens. The MEM's draft Hazardous Chemicals Safety Law similarly creates a standardised legislative

framework for HC management,<sup>16</sup> but enforcement of other chemical-related regulations by local authorities remains inconsistent.

On 7<sup>th</sup> April 2021, the MEE published the *Guiding Opinions on Strengthening the Positive List Management of Ecological Environment Supervision and Law Enforcement and Promoting Differentiated Law Enforcement and Supervision*.<sup>17</sup> The working group is pleased that the central authorities adopted its suggestion to avoid 'one-size-fits-all' solutions when enforcing compliance, considering the different levels of maturity of operational practices in the chemical industry. Further measures have been implemented to encourage the safe production of HC, including oil and gas. Issued by the MEM on 21<sup>st</sup> March 2022,<sup>18</sup> the 14<sup>th</sup> Five-year Plan for the Safe Production of Hazardous Chemicals aims to prevent major workplace accidents caused by HC, and implement a system for screening, prevention and control of hidden dangers by 2025. However, it is vital that risk assessment be undertaken with a scientific approach rather than a zero-risk approach that leads to the over-management of chemical safety—particularly for new chemical registration—which has proved to hinder innovation.

## Key Recommendations

### 1. Sustainability and Green Chemistry

#### 1.1 Promote Sustainability through Effective Communication, Best Practice Sharing, and Innovation on Safety and Environmental/Carbon Management

#### Concern

Recent government policies reinforced negative views concerning the chemical industry in China and ignored its significant contributions to promoting the responsible, green and innovative economy necessary to realise the 30/60 Goals.

#### Assessment

The chemical industry is a key stakeholder in developing

<sup>12</sup> Zheng, Xin, *Chemical Firms Coping With Lockdown*, *China Daily*, 29<sup>th</sup> April 2022, viewed 1<sup>st</sup> May 2022, <<https://global.chinadaily.com.cn/a/202204/29/WS626b3748a310fd2b29e5a0cd.html>>

<sup>13</sup> *Analysis: China's Widening COVID Curbs Threaten Global Supply Chain Paralysis*, *Reuters*, 13<sup>th</sup> April 2022, viewed 15<sup>th</sup> April 2022, <<https://www.reuters.com/world/china/chinas-widening-covid-curbs-threaten-global-supply-chain-paralysis-2022-04-13>>

<sup>14</sup> *Guangzhou Emergency Management Bureau: Chemical Enterprises Need to Pay Attention to Six Types of Secondary Safety Risks of the Epidemic*, People's Government of Guangzhou Municipality, 13<sup>th</sup> April 2022, viewed 15<sup>th</sup> April 2022, <[http://www.gz.gov.cn/zttzzyyzq/bmdt/content/post\\_8182915.html](http://www.gz.gov.cn/zttzzyyzq/bmdt/content/post_8182915.html)>

<sup>15</sup> *Measures for Environmental Management Registration of New Chemical Substances (Order No. 12)*, MEE, 29<sup>th</sup> April 2020, viewed 24<sup>th</sup> April 2022, <[http://www.mee.gov.cn/xxgk/xxgk02/202005/t20200507\\_777913.html](http://www.mee.gov.cn/xxgk/xxgk02/202005/t20200507_777913.html)>

<sup>16</sup> People's Republic of China Hazardous Chemicals Safety Law (Draft for Comments), MEM, 2<sup>nd</sup> October 2020, viewed 24<sup>th</sup> April 2022, <[https://www.mem.gov.cn/gk/tzgg/tz/202010/t20201002\\_368140.shtml](https://www.mem.gov.cn/gk/tzgg/tz/202010/t20201002_368140.shtml)>

<sup>17</sup> *Guiding Opinions on Strengthening the Positive List Management of Ecological Environment Supervision and Law Enforcement and Promoting Differentiated Law Enforcement and Supervision*, MEE, 7<sup>th</sup> April 2021, viewed 21<sup>st</sup> May 2021, <[http://www.mee.gov.cn/xxgk/xxgk05/202104/t20210423\\_830095.html](http://www.mee.gov.cn/xxgk/xxgk05/202104/t20210423_830095.html)>

<sup>18</sup> *China Unveils Plan to Strengthen Safe Production of Hazardous Chemicals*, *China Daily*, 21<sup>st</sup> March 2022, viewed 15<sup>th</sup> April 2022, <<https://www.chinadaily.com.cn/a/202203/21/WS62382915a310fd2b29e52484.html>>



a clear and comprehensive strategy on building a sustainable green economy and in helping China reach its ambitious 30/60 Goals — with the launch of the national ETS constituting a vital step. Now that the ETS is poised to deeply transform the power generation industry, the working group urges the MEE and corresponding provincial authorities to maintain communication with all chemical industry stakeholders, as their operations will be included in or impacted by the scheme. When the ETS is expanded, it should be on a product-by-product basis, to ensure necessary lead time and opportunities for stakeholder engagement. Furthermore, the ETS should incentivise the adoption of advanced technologies and allocate emission credits based on industry benchmarks and sector goals, rather than providing more credits based on 'historical emissions', which puts early adopters of energy efficient measures at a disadvantage.

Many accidents in the chemicals industry stem from a lack of risk awareness and knowledge about best practices. Multinational chemical companies' maturity on health, safety and environment (HSE) matters is not recognised by the Chinese authorities, which still insist on a 'one-size-fits-all' approach to the industry, such as bans affecting compliant and non-compliant companies alike.<sup>19</sup> Therefore, a formal channel of communication and cooperation between chemical companies and government officials is necessary to promote responsible and sustainable practices, and improve preventative measures. This collaboration should include chemical parks or associations such as the AICM, CPCIF and Together for Sustainability. Practical steps like providing English-language versions of policies, and more opportunities for comments and discussion, could also facilitate communication.

Vaguely-written regulations lead to difficulties in interpreting laws and regulations, and thereby result in major inconsistencies in enforcement. For example, if a new regulation is not clear enough, local government departments may stop issuing permits until they receive more specific guidelines from a higher department. This has occurred frequently in the past few years in relation to HSE management, and is currently a concern for classifying projects under the 'two-high'

requirement.<sup>20</sup> Interpretation should therefore be clarified and aligned among local and central authorities before new regulations go into force. However, even when clarifications are provided, policies might still not be adequately enforced locally, as in the case of the pollutant discharge permit (PDP). Although the MEE clarified in multiple policy documents that the PDP will be the only management tool for site-specific supervision, this is still not adequately enforced, despite being in place since 2018.<sup>21&22</sup>

Although the authorities have ambitious plans for greening the economy and promoting innovation, the mechanisms for facilitating cooperation between companies and institutions are often lacking, and plans also may not distinguish between mandatory requirements and good practices. The standard for volatile organic compounds (VOCs), for example, requires manufacturers to remove 90 per cent of VOCs even if emissions are already limited. This comes at a high cost in terms of both investment and energy efficiency. Meanwhile, in the *Guiding Opinions on Promoting the Development of the Petrochemical and Chemical Industry in the 14<sup>th</sup> Five-year Plan Period*,<sup>23</sup> jointly issued by the MIIT and five other departments, requirements include significantly reducing energy consumption and carbon emission per unit of bulk products, and reducing total VOC emissions by more than 10 per cent compared to the 13FYP period.

Despite establishing the national green electricity trading pilot in September 2021,<sup>24</sup> and getting trials of several provincial-level green electricity markets underway,<sup>25</sup> the market is far from active, and the carbon emission certification process has not yet

20 *Plan for Improving the Dual Control System of Energy Consumption Intensity and Total Amount*, State Council, 11<sup>th</sup> September 2021, viewed 22<sup>nd</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-09/17/content\\_5637960.htm](http://www.gov.cn/zhengce/zhengceku/2021-09/17/content_5637960.htm)>

21 *MEE Answers Reporter's Questions on the Technical Specifications for the Application and Issuance of Pollutant Discharge Permit and Industrial Solid Waste*, MEE, 15<sup>th</sup> November 2021, viewed 22<sup>nd</sup> April 2022, <[https://www.mee.gov.cn/ywdt/zbf/202111/t20211115\\_960421.shtml](https://www.mee.gov.cn/ywdt/zbf/202111/t20211115_960421.shtml)>

22 *Suggestions on Comprehensively Promoting Post Pollution Permit Management*, Guangmingwang News, 24<sup>th</sup> April 2020, viewed 22<sup>nd</sup> April 2022, <[https://theory.gmw.cn/2020-04/24/content\\_33766478.htm](https://theory.gmw.cn/2020-04/24/content_33766478.htm)>

23 *Six Departments Jointly Issue Guidance on the "14<sup>th</sup> Five-year Plan" to Promote the High-quality Development of the Petrochemical and Chemical Industry*, MIIT, 7<sup>th</sup> April 2022, viewed 28<sup>th</sup> June 2022, <[https://www.miit.gov.cn/zwgk/zcwj/wjfb/yj/art/2022/art\\_4ef438217a4548cb98c2d7f4f091d72e.html](https://www.miit.gov.cn/zwgk/zcwj/wjfb/yj/art/2022/art_4ef438217a4548cb98c2d7f4f091d72e.html)>

24 *China's Green Power Trading Pilot Was Officially Launched - There Is a 'China Plan' for Green Power Consumption*, State Council, 9<sup>th</sup> September 2021, viewed 24<sup>th</sup> April 2022 <[http://www.gov.cn/xinwen/2021-09/09/content\\_5636363.htm](http://www.gov.cn/xinwen/2021-09/09/content_5636363.htm)>

25 *Green Electricity Trading Featured By 'Integration of Certificate and Power'*, Dentons, 27<sup>th</sup> May 2022, viewed 30<sup>th</sup> June 2022, <<https://www.dentons.com/en/insights/articles/2022/may/27/green-electricity-trading-featured-by-integration-of-certificate-and-power>>

19 *AICM Points Out Barriers to Responsible Care in China*, Chemical Watch, 28<sup>th</sup> July 2016, viewed 22<sup>nd</sup> April 2022, <<https://chemicalwatch.com/48853/aicmpoints-outbarriers-to-responsible-care-in-china>>





been fully clarified. Furthermore, a systematic carbon emissions for purchased energy mechanism has yet to materialise, which leads to inconsistencies in carbon dioxide (CO<sub>2</sub>) reporting. To accelerate establishment of the national green electricity market and encourage greater enterprise engagement, the certification of carbon credits from consumption of green electricity should be standardised and issued regularly, while green electricity purchases should be differentiated from grid electricity emissions in the ETS. The working group believes focussing on overall energy consumption and environmental protection would be more conducive to greening operations than an arbitrary emissions standard. The government should also establish sound and practical communication platforms that encourage industries to reduce their environmental impact and fully utilise existing resources in an innovative manner, for example, in hazardous waste management.

#### Recommendations

- Strengthen government-international businesses cooperation and encourage the central authorities to involve affected companies as key stakeholders, particularly regarding the ETS, Responsible Care and HSE management.
- Establish regular, formal and transparent communication channels to collect feedback from foreign enterprises and industrial associations on regulation drafting and implementation to avoid 'one-size-fits-all' measures, and a central platform on which standard answers to frequently-asked-questions can be published and relevant parties can raise queries.
- Clarify the distinction in standards between mandatory requirements and good practices and provide regulatory flexibility for industry evolution, including the incorporation of new technologies.
- Conduct regulatory training for authorities at every level (town, provincial and national) to align interpretations and enforcement.
- Accelerate the establishment and development of the national green electricity market, standardise the certification of carbon credit from the consumption of green electricity and issue green electricity consumption certificates on a regular basis.
- Encourage enterprises to purchase green electricity by differentiating purchased green electricity from grid electricity emissions in the ETS, and establishing a channel for electricity and carbon markets in line with international standards.
- Clarify the definition of 'two-high' projects and provide

industry development guidelines on local project approvals.

## 1.2 Improve Policies for Promotion of the Circular Economy Within the Chemical Industry

### Concern

China needs stronger institutional management and flexible enforcement to promote circular innovation within the chemical industry, and to establish a complete plastic and chemical waste recycling system.

### Assessment

Around half of global CO<sub>2</sub> emissions come from the extraction and processing of materials that underpin a 'take-make-dispose' economy. In contrast, a circular economy aims to close industrial loops by turning outputs from one manufacturer, including waste, into inputs for another. China recognised the importance of this issue by enacting the Circular Economy Promotion Law (CEPL) in 2008.<sup>26</sup> In addition, in July 2018, the EU and China signed a Memorandum of Understanding on Circular Economy Cooperation.<sup>27</sup> As the circular economy is an emerging model, it still faces economic challenges, including financing research and development (R&D), building a circular value chain, and fostering acceptance of new methods such as the use of recycled materials, which many view as low-quality.<sup>28</sup> Although the State Council issued guiding opinions in February 2021 outlining an overall system for circular economy development,<sup>29</sup> progress in adopting suggestions has been relatively slow, despite industry players submitting comments on the amendment of the CEPL in September 2021.<sup>30</sup> The *Guiding Opinions* should be followed up with a clearly defined mid- and long-term legislation framework, including targets and roadmaps, that involves both Chinese and EU companies to encourage innovation and draw upon the EU's circular economy framework.

26 Circular Economy Promotion Law, MEE, 29<sup>th</sup> August 2008, viewed 17<sup>th</sup> May 2022, <[https://english.mee.gov.cn/Resources/laws/envir\\_elatedlaws/201712/t20171212\\_427823.shtml](https://english.mee.gov.cn/Resources/laws/envir_elatedlaws/201712/t20171212_427823.shtml)>

27 *China and EU Sign Memorandum of Understanding on Circular Economy*, Resource, 17<sup>th</sup> July 2018, viewed 22<sup>nd</sup> April 2022, <<https://resource.co/article/china-and-eu-sign-memorandum-understanding-circular-economy-12744>>

28 *Circular Economy and Material Value Chains*, World Economic Forum, n.d., viewed 21<sup>st</sup> April 2022, <<https://www.weforum.org/projects/circular-economy/>>

29 *Guiding Opinions on Accelerating the Establishment and Improvement of a Green and Low-Carbon Circular Development Economic System*, State Council, 2<sup>nd</sup> February 2021, viewed 28<sup>th</sup> June 2022, <[http://www.gov.cn/zhengce/content/2021-02/22/content\\_5588274.htm](http://www.gov.cn/zhengce/content/2021-02/22/content_5588274.htm)>

30 *CBCGDF Welcome Public Suggestions for the Revision of Circular Economy Promotion Law of the People's Republic of China by National Development and Reform Commission*, China Biodiversity Conservation and Green Development Foundation, 15<sup>th</sup> September 2021, viewed 25<sup>th</sup> April 2022, <<http://www.cbcdgf.org/English/NewsShow/5004/17261.html>>



As chemicals are essential for many industries, chemical manufacturers are key players in the midstream of many supply chains.<sup>31</sup> Foreign chemical companies operating in China already have a strong focus on whole life cycle sustainability, as well as on developing products that are recyclable by design at the end of their lifespan. In China, incomplete physical and policy infrastructures hinder the mass adoption of chemical recycling of waste plastics, which is generally sourced from the 'dry waste' category of urban waste. However, it is often difficult to separate waste plastics that are of sufficient high quality to be used as raw materials from other dry waste. Advancements in urban domestic waste infrastructure are therefore necessary to improve recycling processes. A cross-provincial disposal system that can combine capacity and facilities for all types of waste should also be established.

Meanwhile, the authorities and industry can collaborate to create green standards for the whole plastic recycling supply chain, particularly regarding necessary onsite pre-treatment and transportation to industrial parks for recycling. In addition, tax reforms that exempt green products/services from consumption tax, and moving tax collection to the end of retail consumption, would facilitate the development of the chemical recycling industry. Furthermore, full value-added tax refunds, and extending or expanding various existing preferential tax treatments (for example, the catalogues of preferential corporate income tax treatments for specialised environmental protection, water conservation or energy usage reduction equipment),<sup>32</sup> could likewise offset the costs of investing in the sophisticated equipment and technology required by chemical recycling enterprises.<sup>33</sup>

In general, the authorities should ensure that the applicability of regulations and standards to specific cases or overall environmental footprint is considered. For example, *GB 18484 Pollution Control Standard for Hazardous Wastes Incineration* requires online monitoring for all incineration projects, even if no dangerous pollutants are emitted.<sup>34</sup> Overly detailed requirements like this ignore a project's overall

environmental footprint. Simplifying the permit allocation process for projects with favourable impacts on the circular economy, and applying a flexible approach based on individual circumstances, would encourage plants and chemical parks to carry out innovative pilot projects.

### Recommendations

- Foster value chain cooperation as well as regulatory, financial and tax support to promote the implementation of circular economy principles, for example, re-use of chemical waste as a raw material and energy co-generation.
- Encourage energy/resource sharing and collaboration within chemical parks.
- Simplify the certification and approval requirement to encourage waste recycling and utilisation projects while offering the possibility of case-by-case exemptions.
- Grant tax incentives that promote plastic recycling processes and improve urban waste infrastructure, and speed up the construction of a green standard system for recycled plastics.
- Standardise chemical recycling of plastic waste requirements, particularly regarding onsite pre-treatment and transportation to industrial parks for recycling.

### 1.3 Boost the Green Development of Chemical Parks by Providing More Efficient and Integrated Public Utility Services

#### Concern

As the most significant platform and incubator of the chemical industry, chemical parks play a key role in ensuring the supply of reliable, efficient, and low-carbon public utilities, yet efficient and integrated access to clean electricity, water and industrial gas have not been taken into consideration in their design.

#### Assessment

In 2020, there were 616 chemical parks and industrial parks focussed on the petrochemical industry across China, considered a crucial pillar supporting China's economic development.<sup>35</sup> The petrochemical industry is characterised by long industrial chains, complex products and high energy consumption. In 2020, carbon emissions from the industry contributed 20 per cent of overall

31 2019 AICM Sustainable Development Report, AICM, 4<sup>th</sup> June 2019, viewed 21<sup>st</sup> April 2022, <<http://aicm.cn/upload/files/20190604/1559634731364010712.pdf>>

32 A Summary of China's Corporate Income Tax Incentives, Jones Day, July 2008, viewed 22<sup>nd</sup> April 2022, <<https://www.jonesday.com/en/insights/2008/07/a-summary-of-chinas-corporate-income-tax-incentives>>

33 For more information, please see the *Finance and Taxation Working Group Position Paper 2022/2023*

34 *Pollution Control Standard for Hazardous Wastes Incineration*, MEE, 1<sup>st</sup> January 2002, viewed 22<sup>nd</sup> April 2022, <<http://www.mee.gov.cn/image20010518/1533.pdf>>

35 *Ecological Thinking Should Be Established in the Development of the Park*, CCIN, 1<sup>st</sup> March 2022, viewed 22<sup>nd</sup> April 2022, <<http://www.ccin.com.cn/detail/e5f6d0a0c4a0d1b4751567221e464023/news>>





industrial emissions,<sup>36</sup> while in 2019, the total energy consumption of petrochemical exceeded 600 million tonnes of standard coal for the first time.<sup>37</sup> The industry's high energy consumption is exacerbated by the intrinsic nature of the chemical parks, which mainly rely on traditional fossil fuels and consume more energy than similar industrial parks focussed on different industries, such as electronics. Chemical parks therefore face additional challenges in realising the green development transition. To encourage investment in renewable energy in these industrial parks—for example, installing on-site photovoltaics—the authorities should implement initiatives to streamline the investment process, such as establishing fast-track approval procedures.

Although the MIIT released the *Guiding Opinion for Promoting Standardised Development of Chemical Parks* in 2015,<sup>38</sup> there is still insufficient infrastructure and utilities to enable the transition process, while energy curbs are increasingly imposed on energy-intensive industries. The lack of facilities is mainly due to the pressure on park management to attract further economic investment, leading to the neglect of planning issues such as public utilities, electricity supplies, heating and industry gas. In order to reach the 30/60 Goals, chemical parks should optimise industrial waste treatment and other public utilities.

### Recommendations

- Consider specific industrial characteristics when establishing plans and layouts for chemical parks.
- Strengthen unified planning for the construction and management of industrial gas, public pipelines, heating, HC waste disposal facilities and other public utilities at chemical parks.
- Speed up the deployment of measures to improve energy consumption intensity and efficiency in chemical parks under the 30/60 Goals through building, optimising and sharing common utilities such as steam, waste water treatment and hazardous waste facilities.
- Encourage renewable energy investment by establishing mechanisms such as a fast-track approval procedure for on-site photovoltaics installations in chemical parks.

36 *The Task of Green and Low-carbon Development of Chemical Industry Park is Urgent*, CCIN, 22<sup>nd</sup> June 2021, viewed 22<sup>nd</sup> April 2022, <<http://www.ccin.com.cn/detail/c3c24d73e8afe54e80a314278bc3cb76>>

37 *China's Crude Oil Production Has Reversed the Downward Trend for Three Consecutive Years*, CNPC, 15<sup>th</sup> January 2020, viewed 22<sup>nd</sup> April 2022, <<http://news.cnpc.com.cn/system/2020/01/15/001759872.shtml>>

38 *Guiding Opinion to Promote the Standardized Development of Chemical Industry Parks*, MIIT, 25<sup>th</sup> November 2015, viewed 22<sup>nd</sup> April 2022, <[https://www.miit.gov.cn/zwgk/zcwj/wjfb/qt/art/2020/art\\_568c1587f2af497192c10290a277c2cc.html](https://www.miit.gov.cn/zwgk/zcwj/wjfb/qt/art/2020/art_568c1587f2af497192c10290a277c2cc.html)>

## 2. Investment and Manufacturing Costs

### 2.1 Guarantee Fair and Reasonable Treatment by Local Authorities with Respect to Relocations and Temporary Closures of Enterprises and Chemical Parks 6

#### Concern

Despite progress in national legislation to ensure that the shutdown or relocation of chemical facilities do not unfairly target companies that comply with HSE regulations, implementation—particularly on the local level—has yet to reassure compliant companies that they will receive consistent and fair treatment.

#### Assessment

The chemical industry has played a significant role in the economic development of China through its high production value and tax rates, and is regarded by many local governments as one of their main pillars of finance and taxation revenue. However, due to a number of significant accidents in recent years, EHS regulations for the industry are getting increasingly stricter. As a result, 2021 saw a drop in incidents, with 122 PCR-related accidents and 150 deaths, a decrease of 124 deaths and 42 accidents compared to 2019.<sup>39</sup>

Provincial and local government bureaus are enforcing tighter regulations and increasing plant inspections, which place additional administrative burdens on companies, like preparing excessive documentation at the request of the authorities. Furthermore, many provinces such as Jiangsu, Shandong and Shanxi abruptly mandated the relocation of PCR-related plants into chemical parks, thereby disrupting operations severely.

The working group welcomes the checks and inspections necessary to ensure the safety of workers and the general public, as well as to protect the environment. However, one-size-fits-all enforcement focusses on quotas rather than performance, which can damage the chemical supply chain and have negative industrial repercussions. Closure or relocation initiatives should involve continuous communication between authorities and enterprises, employing a 'one enterprise, one policy' customised approach, especially in light of recent

39 *Ministry of Emergency Management: In 2021, There Were 122 Chemical Accidents in the Country, Killing 150 People*, Chem Vogel, 22<sup>nd</sup> February 2022, viewed 25<sup>th</sup> April 2022, <<https://chem.vogel.com.cn/c1160843.shtml?msclid=1f7540ddc05911ec94d13f8b35913293>>



COVID-19 outbreaks and containment measures. In addition, the time allowed for relocation is often also unrealistic in terms of the requirements involved in moving entire operations and workforces. Furthermore, provincial safety and environmental offices advise municipal governments on which plants should be closed or relocated. Enterprises are unable to communicate directly with these offices and therefore rely on information from local government industry and information bureaus, which take the advice of the offices as orders rather than suggestions, even if there is no evidence that a plant's operations cause environmental hazards. Furthermore, foreign-invested enterprises requested to relocate should be treated equally to local companies, and should receive clear information and relocation criteria, be able to discuss relocation timelines with local authorities to minimise the associated costs, and receive fair compensation after relocation.

### Recommendations

- Ensure that any criteria provided and actions undertaken to have businesses relocate or temporarily close are based on law and regulations, transparent and published well in advance.
- Use a 'case-by-case' approach to address suggestions for plant relocations, with significant lead-time and lenient timelines to avoid disrupting chemical supply chains.
- Reach mutual agreement with companies on relocation timelines and fair compensation to decrease their associated costs.
- Factor in secondary risks on overall shutdown policies, including COVID-19-related closures and particularly in relation to measures given at short notice, to avoid disruptions to chemical plant operations that may increase risks of explosions.
- Establish a direct communication channel for companies to submit suggestions to the authorities on the relocation or shutdowns of chemical plants.

## 2.2 Facilitate the Diversity and Competitiveness of the Oil and Gas Sectors

### a) Continue Deregulation of the Retail Fuel Market



#### Concern

Despite signals of opening the retail fuel sector, regulations and price ceilings continue to hinder foreign

investment and progress towards a competitive retail market.

#### Assessment

China's oil market prices are currently regulated through a system of price caps by the central government and only tenuously linked to international oil prices.<sup>40</sup> There have been several positive signals in recent years that suggest the government intends to deregulate the retail fuel sector. For instance, the *Several Opinions on Deepening Oil and Gas Sector Reform (Opinions)*, released by the State Council in 2017,<sup>41</sup> advocated a central role for the market in guiding oil prices. However, the actions encouraged by the *Opinions* have not been forthcoming. Furthermore, the *Measures on the Supervision and Administration of Fair Opening of Oil and Gas Pipeline Facilities* were published in May 2019, but also do not mention how oil prices are to be determined.<sup>42</sup>

Deregulating oil prices would bring several key benefits, such as supporting China's commitment to continue its economic reform. A fully functioning retail fuel market would also boost service and product quality by offering consumers greater choices between high and low-quality fuel.<sup>43</sup> Retail fuel market opening has also led to price decreases because it attracts international oil companies and investment, and therefore increases competition.

#### Recommendation

- Fully remove oil product price ceilings to deliver a competitive retail fuel market, and establish a clear time schedule for market deregulation.

### b) Deregulate the Liquefied Petroleum Gas (LPG) Market on a National Level

#### Concern

Despite deregulation of the LPG market across most of

40 *Review of China's Oil Pricing Mechanism*, Sina Finance, 7<sup>th</sup> March 2022, viewed 22<sup>nd</sup> April 2022, <<https://finance.sina.com.cn/money/future/fmnews/2022-03-07/doc-imcwiwss4603517.shtml>>

41 *Several Opinions on Deepening Oil and Gas Sector Reform*, State Council, 21<sup>st</sup> May 2017, viewed 22<sup>nd</sup> April 2022, <[http://www.gov.cn/zhengce/2017-05/21/content\\_5195683.htm](http://www.gov.cn/zhengce/2017-05/21/content_5195683.htm)>

42 Lian, Jing; Du, Lijing; Luo, Ce & Tu, Haoxue, *A Milestone in the Reform of Oil and Gas Sector – Preliminary Comments on the Measures on the Supervision and Administration of Fair Opening of Oil and Gas Pipeline Facilities*, Junhe, 25<sup>th</sup> June 2019, viewed 28<sup>th</sup> June 2022, <<http://www.junhe.com/legal-updates/960?locale=en>>

43 *China Gasoline Retailing Development Trends Report 2019*, Deloitte, May 2019, viewed 16<sup>th</sup> May 2022, <<https://www2.deloitte.com/cn/en/pages/about-deloitte/articles/pr-china-gasoline-retailing-development-trends-report-2019.html>>





the country, LPG for domestic use is still regulated in several provinces, preventing market competition and giving retailers little room to make profit.

#### Assessment

The biggest proportion of LPG usage goes toward heating and cooking at the household level, yet while industrial and commercial LPG is fully deregulated, certain provinces and municipalities such as Shanghai still regulate cylinder LPG prices for household use. For example, for standard cylinders of 14.5 kilograms (kg), the Shanghai Government sets the maximum retail price as the local refineries' price plus CNY 25 to cover labour, cylinder, production and transportation costs, as well as depreciation, safety management fees, sales and management costs, and tax, among other external expenses. Although changes in the maximum retail price are announced periodically, the CNY 25 price differential has not been adjusted for five years. Since 10<sup>th</sup> April 2022, the maximum retail price has been adjusted to CNY 126 per standard cylinder, in comparison to the March 2021 price of CNY 84 per cylinder.<sup>44</sup>

#### Recommendation

- Fully deregulate limitations on the new energy market on a national level, including cylinder LPG prices for domestic use, particularly where local governments set the retail price.

### 2.3 Simplify the Regulatory Process to Support New Market and Technology Innovation in Fine Chemical Manufacturing

#### Concern

Strict permit allocation requirements for increasing production capacity or making minor changes to product recipes hinder fine chemical manufacturers from quickly adapting to market conditions.

#### Assessment

The permit allocation process for fine chemicals manufacturing is very stringent, and includes requirements for safety, environmental impact and occupational health assessments, as well as capital expenditure thresholds. To adapt to market changes, downstream fine chemical

manufacturers sometimes need to adjust recipes or technologies. If these adjustments involve raw materials that are not on the plant's list of registered chemicals, the new materials must undergo an entirely new permit allocation process, even if they are replacing a listed ingredient with similar properties and do not bring any additional operational risk or pollution.

The same constraint is true for production increases. Permit allocation processes stipulate maximum production capacities; therefore, to increase manufacturing capacity—for instance, when debottlenecking<sup>45</sup> is required—manufacturers must relaunch the permit process, which usually takes six months to one year. Creating a simplified permit allocation process for minor replacements of fine chemical ingredients or slight capacity increases would reduce administrative burdens and allow manufacturers to respond more competitively to market advancements. Since the HSE-related regulatory system was introduced in 2011,<sup>46</sup> many companies have faced challenges in closing the gaps between their existing facilities and new requirements. This is partly due to the lack of mechanisms to support companies on both compliance as well as safety training. As each chemical producer handles thousands of different products, professional expertise including sufficient industrial knowledge is required to conduct risk-based permit reviews. Therefore, streamlining permit approval procedures would prevent unreasonable delays and onerous requirements.

#### Recommendations

- Simplify the permit allocation process for minor recipe changes within the same product category to promote quick market responses and encourage innovation.
- Simplify the permit allocation process for plant debottlenecking projects that aim to increase production capacity and optimise the workflow without changing the main production process or increasing emissions.
- Establish a standardised permit approval process, and provide measures to correct applications during the approval procedure.
- Streamline, and involve industrial experts with relevant expertise, in the permit approval review process.

<sup>44</sup> Notice of Shanghai Development and Reform Commission on Adjusting The Maximum Retail Price of Civil Cylinder Liquefied Petroleum Gas, People's Government of Shanghai, 9<sup>th</sup> April 2022, viewed 22<sup>nd</sup> April 2022, <<https://www.shanghai.gov.cn/gwk/search/content/6e5306f106f54706ac832741181df1ac>>

<sup>45</sup> What is Debottlenecking?, Simplicable, 7<sup>th</sup> February 2015, viewed 22<sup>nd</sup> April 2022, <<https://simplicable.com/new/debottlenecking>>

<sup>46</sup> What is HSE?, China Safety, 13<sup>th</sup> April 2011, viewed 22<sup>nd</sup> April 2022, <[https://www.china-safety.org.cn/caws/Contents/Channel\\_21048/2012/1107/185627/content\\_185627.htm](https://www.china-safety.org.cn/caws/Contents/Channel_21048/2012/1107/185627/content_185627.htm)>



### 3. Chemicals Management

#### 3.1 Develop a Well-argued and Practical Legislation Framework for Chemical Risk Management 9

##### Concern

Although the legislative framework for chemical management has become more streamlined, specific legislation for classification and labelling of new chemicals, priority chemicals and HC fail to capture the principle of proportionality for risk assessment and management.

##### Assessment

Regulators attach great importance to preventing HC accidents, and the resulting overcautious management has increased the compliance burden for the whole value chain. During the Shanghai lockdowns from March to May 2022, complicated interprovincial border checkpoint procedures, and stringent requirements for travel permits, health code and 48-hour nucleic acid reports, severely impacted the efficiency of HC transportation, thereby posing major health and safety risks.<sup>47</sup>

Restrictions on HC continue to tighten both within China as well as in the EU. However, the EU's risk management option analysis (RMOA)<sup>48</sup> has proven to be an effective process for chemical industry players to provide input on management measures for certain substances, such as the hazard profile, potential exposure scenarios, the availability of alternative solutions and how chemical legislation interacts with other legislation. The EU's RMOA could likewise serve as an example of appropriate risk management, under which chemicals listed for priority assessment are not automatically subject to priority control without additional analysis and public consultation.

The MEE's *Guidelines for the Environmental Management Registration of New Chemical Substances* (Order No. 12) went into effect on 1<sup>st</sup> January 2021, replacing the Order No. 7 legislative framework.<sup>49</sup>

<sup>47</sup> Chinese Truckers Left Stranded for Days at Highway Exit by Hardline COVID Curbs, Reuters, 15<sup>th</sup> April 2022, viewed 22<sup>nd</sup> April 2022, <<https://www.reuters.com/world/china/chinese-truckers-left-stranded-days-highway-exit-by-hardline-covid-curbs-2022-04-15/>>

<sup>48</sup> Risk Management Option Analysis Conclusion Document, Swedish Chemicals Agency, 20<sup>th</sup> December 2017, viewed 22<sup>nd</sup> April 2022, <<https://www.echa.europa.eu/documents/10162/0bb59072-df52-49b7-9434-5631b4bc9b89>>

<sup>49</sup> Announcement on the Issuance of the 'Guidelines for the Environmental Management Registration of New Chemical Substances' and Related Supporting Forms and Filing Instructions, MEE, 16<sup>th</sup> November 2020, viewed 22<sup>nd</sup> April 2022, <[http://www.mee.gov.cn/xxgk/2018/xxgk/xxgk01/202011/20201119\\_808843.html](http://www.mee.gov.cn/xxgk/2018/xxgk/xxgk01/202011/20201119_808843.html)>

Unlike in early drafts, the final version of Order No. 12 does not exempt new chemical substances under 0.1 metric tonnes per year that undergo reasonable risk assessment. Reporting substances of such small volume would be overly burdensome for chemical enterprises. For example, manufacturers often provide reagents in dosages of several milligrams, or even micrograms, to thousands of downstream users. It is not feasible to track management of these substances after registration. Moreover, the environmental exposure risk of such small amounts of new chemical substances used for laboratory research is extremely low. The draft Hazardous Chemicals Safety Law, released in a call for comments by the MEM on 2<sup>nd</sup> October 2020,<sup>50</sup> exempts HC used for R&D, trial production and marketing, as well products containing low volumes of HC. Low volumes of new chemicals under the same conditions should also be exempted from notification and registration requirements.

The MEE has developed an online registration system for new chemical substances,<sup>51</sup> and the updated HC registration system was officially launched in February 2022, with a more streamlined and easier to navigate interface. The working group hopes the online platform can be further improved to make the registration process smoother and more efficient. For instance, as some data required—such as storage, transportation, usage and emergency measures—is already provided in products' safety data sheets, authorities should avoid the need to duplicate information and thereby reduce the administrative burden. Furthermore, the system should also allow for corrections, such as removing substances, rather requiring re-registration each time.

On 5<sup>th</sup> June 2021, Guangdong Province piloted a 'one enterprise, one product, one code' policy ([Quick Response] QR Code Policy). Over 85 per cent of Guangdong Province's producers and importers have since registered hazardous products and generated QR codes under the new platform,<sup>52</sup> doubling registration rates. The QR Code Policy is expected to

<sup>50</sup> People's Republic of China Hazardous Chemicals Safety Law (Draft for Comments), MEE, 2<sup>nd</sup> October 2020, viewed 22<sup>nd</sup> April 2022, <[https://www.mem.gov.cn/gk/tzgg/tz/202010/t20201002\\_368140.shtml](https://www.mem.gov.cn/gk/tzgg/tz/202010/t20201002_368140.shtml)>

<sup>51</sup> Measures for Environmental Management Registration of New Chemical Substances, MEE, 29<sup>th</sup> April 2020, viewed 22<sup>nd</sup> April 2022, <[https://www.mee.gov.cn/xxgk/2018/xxgk/xxgk02/202005/t20200507\\_777913.html](https://www.mee.gov.cn/xxgk/2018/xxgk/xxgk02/202005/t20200507_777913.html)>

<sup>52</sup> More Than 1,000 Enterprises Applied for "One Enterprise, One Product and One Code" in Guangdong, China News, 1<sup>st</sup> September 2021, viewed 22<sup>nd</sup> April 2022, <<https://www.chinanews.com.cn/cj/2021/09-01/9555945.shtml>>





be implemented nationwide in the near future.<sup>53</sup> The plan also proposes enhancing the digital management of hazardous products to allow HC data be transferred efficiently throughout the whole product life cycle. The working group hopes that the control scope of HC can be minimised to reduce administrative burdens. For example, considering the current catalogue and classification principles for HC, the number of QR codes needed are beyond what is reasonable, and may lead to excessive enterprise compliance and government supervision pressure. Furthermore, under the current system, product labels can be easily downloaded by scanning the QR code, which poses risks to intellectual property. Preventing such downloads or permitting enterprises to use their self-generated QR codes would reduce the administrative burden on both the authorities and enterprises.

On 1<sup>st</sup> January 2022, the MEE released the *Guidelines for Screening of Priority Assessment Substances*,<sup>54</sup> outlining the related principles, procedures and technical requirements. This demonstrates that China's chemicals management system is increasingly evolving to resemble the EU Registration, Evaluation, Authorisation and Restriction of Chemicals (REACH) approach,<sup>55</sup> which was adopted to improve HSE protection against chemical risks while also enhancing the competitiveness of the EU chemicals industry. Similarly, the MEE is to expand its list of priority control chemicals (PCCs), with preparation of the third batch underway at the time of writing.<sup>56</sup> However, chemicals listed under these 'priority lists' (firstly as priority assessment chemicals (PACs) before PCCs) are considered inherently hazardous to environmental and human health, leading to further restrictions in their production, usage, and import and export, and increasing administrative burdens. The working group hopes to increase engagement with the MEE to ensure European industry players are involved in the risk assessment process for chemical substances included in the expanded PACs and PCCs lists.

## Recommendations

- Remove local barriers to HC transportation and enhance capacity building for HC transportation, import and export.
- Adopt RMOA guidance by ensuring key stakeholders are involved and all factors (for example, exposure scenarios, socio-economic analyses, alternative availability) are considered in the decision-making process for chemicals prioritisation and risk management measures selection.
- Exempt low volume notification for new chemicals and HC registration from notification requirements.
- Simplify and improve the registration system for HC and new chemicals.
- Minimise the scope of HC control under the 'one enterprise, one product and one code' policy and prohibit the downloading of product labels to protect confidential information.
- Include chemical manufacturers in the risk assessment process to determine the chemicals listed under PAC and PCC, taking the entire chemical supply chain into consideration.

53 "One Enterprise, One Product and One Code" to Open the Era of Code Scanning of Hazardous Chemicals, CIRS, 12<sup>th</sup> January 2022, viewed 22<sup>nd</sup> April 2022, <<https://www.cirs-group.com/reg/news/hazchem/14360.html>>

54 *Guidelines for Screening of Priority Assessment Chemical Substances*, MEE, 1<sup>st</sup> January 2022, viewed 22<sup>nd</sup> April 2022, <[https://www.mee.gov.cn/ywgz/fgbz/bz/bzwb/gthw/qtxgbz/202112/t20211227\\_965407.shtml](https://www.mee.gov.cn/ywgz/fgbz/bz/bzwb/gthw/qtxgbz/202112/t20211227_965407.shtml)>

55 *Understanding REACH*, ECHA, viewed 22<sup>nd</sup> April 2022, <<https://echa.europa.eu/regulations/reach/understanding-reach>>

56 *List of Chemicals for Priority Control (Second Batch)*, MEE, 2<sup>nd</sup> November 2020, viewed 17<sup>th</sup> May 2022, <[https://www.mee.gov.cn/xxgk/xxgk01/202011/t20201102\\_805937.html](https://www.mee.gov.cn/xxgk/xxgk01/202011/t20201102_805937.html)>



## Abbreviations

AICM	Association of International Chemical Manufacturers
CEPL	Circular Economy Promotion Law
CNY	Chinese Yuan
CO <sub>2</sub>	Carbon Dioxide
CPCIF	China Petroleum and Chemical Industry Federation
ETS	Emissions Trading System
EU	European Union
HC	Hazardous Chemicals
HSE	Health, Safety and Environment
kg	Kilogram
LPG	Liquefied Petroleum Gas
MEE	Ministry of Ecology and Environment
MEM	Ministry of Emergency Management
MIIT	Ministry of Industry and Information Technology
NDRC	National Development and Reform Commission
PAC	Priority Assessment Chemicals
PCC	Priority Control Chemicals
PCR	Petrochemicals, Chemicals and Refining
PDP	Pollutant Discharge Permit
REACH	Registration, Evaluation, Authorisation and Restriction of Chemicals (EU)
R&D	Research and Development
RMOA	Risk Management Option Analysis
VOC	Volatile Organic Compounds



# Pharmaceutical Working Group

## Key Recommendations

### 1. Further Advance Regulatory Harmonisation and Convergence with International Standards 3

- Encourage greater harmonisation of the Chinese regulatory and quality system with international standards from the International Council for Harmonisation of Technical Requirements for Pharmaceuticals for Human Use (ICH) and the Pharmaceutical Inspection Co-operation Scheme (PIC/S), and more active participation in the International Coalition of Medicines Regulatory Authorities (ICMRA) in order to contribute to global alignment.
- Reduce barriers in the drug review and approval process, notably in the clinical trial assessment review and approval process, by aligning with major regulatory agencies and World Health Organization standards.
- Implement more effective and efficient post-approval change management to ensure continuity of supply.
- Support the National Medical Products Administration (NMPA) to introduce e-labelling to ensure sustainable labelling updates in the long run and to resolve the grace period issue.

### 2. Ensure Clear Interpretations and Consistent Implementation of Intellectual Property (IP) Laws and Policies to Better Foster Pharmaceutical Innovations for Chinese Patients

- Implement an effective patent term extension (PTE) mechanism that will encourage and protect innovation, including: 1) a clear definition of 'new drug', which should include any drug which has firstly obtained marketing authorisation from the NMPA and provided a thorough set of efficacy and safety data in support of its application; 2) clarified protection scope during the extended patent term; and 3) transparent and clear calculation for PTE.
- Improve the patent linkage mechanism to balance the interest of originators and generics, and to provide more clarity on the linkage rules, including: 1) extended stay period (more than nine months) for both chemical and biological products; 2) remedy if a generic or biosimilar manufacturer submits an erroneous/inconsistent declaration; and 3) clear guidance on patent linkage rules for biologics.
- Enforce the six-year regulatory data protection (RDP) rule under the existing *Regulations for Implementing the Drug Administration Law*.
- Provide clear guidance for RDP in the draft amendment of the *Regulations for Implementing the Drug Administration Law*, including clarification of the drugs eligible for RDP and a clear timetable for implementation of a comprehensive RDP regime.
- Eliminate the mandatory patent-sharing requirements under the Human Genetic Resources regime and resort to the pertinent legal requirements, such as those provided in the Patent Law.

### 3. Establish a National/Provincial Funding Pool for Rare Diseases, with a Higher National Negotiation Price Threshold for High-value Rare Disease Drugs, and Encourage Local Governments to Continue Provincial-level Coverage for Rare Diseases

- Build a dedicated, national, multi-party, innovative access review and payment model that works





seamlessly with basic medical insurance (BMI) in exploring additional funding for rare disease drugs, including commercial health insurance (CHI) and charity funds, to keep rare disease patients' co-pay at reasonable levels.

- Eliminate the Chinese yuan (CNY) 300,000 annual price threshold for National Reimbursement Drug List (NRDL) negotiations for rare disease drugs.
- Adopt a fit-for-purpose value assessment framework that meets the unique characteristics of rare diseases and considers all relevant elements of product value in a multi-dimensional framework, including patient benefit and social value.
- Exempt the cost-effective analysis model or increase the incremental cost-effective ratio threshold when conducting value assessment for rare disease drugs, especially for breakthrough therapies.
- Encourage local governments to continue provincial-level coverage for rare diseases, leveraging CHI and charity funds, and exempt rare disease drugs from provincial reimbursement drug lists (PRDL) delisting.
- Accelerate CHI development, include more rare disease drugs in city CHI special drug lists, increase the reimbursement ratio, and develop special CHI for rare disease drugs.
- Implement a quality control waiver (for both registration testing and commercial testing) for rare disease drug imports provided they are uninterruptedly controlled according to globally harmonised manufacturing, distribution, and storage standards (for example, good manufacturing practice, good distribution practice and good storage practice).

#### **4. Improve the Dynamic Update Mechanism in the NRDL to Promote the Medical Insurance System Reform, as Well as Hospital Access for NRDL Drugs, and Introduce a Value-based Evaluation Mechanism for Innovative Drugs Inclusion**

- Reward innovation adequately, include value-based assessments in the NRDL process, and determine pricing and reimbursement in line with fund affordability.
- Explore a new co-payment model with reimbursement for certain high-value innovative drugs, partially shared by both the BMI and CHI, to reduce pressure on the BMI and create development space for CHI.
- Simplify the hospital access process by holding, in the short-term, special Drug Committee Meetings (DCMs) for negotiated drugs within a set time-range, referencing Shanghai's policy where local authorities mandate hospitals to host DCM, and apply this model nationwide.
- Consider more options to improve hospital access in the long-term, including a joint National Healthcare Security Administration (NHSA)-National Health Commission (NHC) mechanism to grant access to newly listed NRDL drugs.
- Exclude negotiated drugs when evaluating increases of medical expenses in performance appraisals of medical insurance designated institutions, and ensure their usage is not affected by hospitals' annual budget caps.
- Establish a linkage mechanism to allow inclusion of qualified national volume-based procurement (VBP) drugs in the NRDL.
- Include the single pill combination in the NRDL to improve patients' compliance and expand their access to drugs with safe and better clinical efficacy, particularly for chronic diseases such as hypertension and diabetes.
- Include biomarker testing costs in the medical insurance fund for precision tumour treatment.





## 5. Further Improve Implementation of Volume-based Procurement (VBP) and Establish a Follow-up Evaluation Mechanism to Ensure Market Competition as well as Patients' and Doctors' Access to High-quality, Safe and Efficacious Drugs

- Develop a long-term follow-up evaluation mechanism on the medical expenses and quality of all VBP products, and fully respect the opinions of doctors and patients based on the actual situation of clinical treatment practice, to accumulate and supply evidence for VBP policy improvement.
- Improve competition rules, avoid awarding bids quoting extremely low prices, and assess the supply capacity of bidding entrants.
- Ensure provincial drugstores also provide brand drugs that are not VBP winners to secure patients and doctors' access to brand drugs.
- Extend the grace period of reimbursement payment standards (RPS) implementation of VBP drugs to mitigate patients' treatment costs.
- Improve the regulatory framework on biosimilars to ensure safety, efficacy and interchangeability before expanding the scope of biologics VBP.
- Prevent regional authorities from piloting VBP on biologics, considering the high risks of treatment replacement to patient safety.
- Exclude patented medicines (including but not limited to patents on compounds) in VBP, which abrogates innovators' IP rights and, in regard to therapeutic class tendering, treats as interchangeable products with very different clinical characteristics and performance.

## 6. Harmonise the Vaccine Policy Environment with International Standards to Improve and Accelerate Access to Innovative Vaccines for the Chinese Population 2

- Increase the availability of innovative vaccines and immunisation to the Chinese population through harmonising the regulatory environment with international standards, including but not limited to international multi-centre trial blood samples requirements, technical guidance and pharmacopeia.
- Promote the reform of China's procurement criteria and process to include all NMPA-approved vaccines, both imported and locally manufactured, on the National Immunisation Programme to enable access for more innovative vaccines and build a more sufficient and sustainable supply to address public health needs.
- Promote routine vaccination and vaccination strategy for respiratory diseases, such as influenza, to avoid dual infection with COVID-19, and expand influenza immunisation programmes in provinces and cities.
- Implement a vaccine pilot launch in the coming year in qualifying pilot zone areas to provide the Chinese population faster access to and more choices on disease prevention.
- Prioritise prevention and realise healthy ageing through promoting the construction of adult vaccine infrastructure to improve public awareness of adult disease prevention.
- Update the current categorisation and regulatory approach for prophylactic bio-products to properly categorise and guide their usage, boost innovation and enhance the diversity and accessibility of advanced measures for disease prevention.



## 7. Clearly Define the Projects and Scope of Prohibited Investment in the Development and Application of Human Stem Cells, Genetic Diagnosis and Treatment Technologies in the Foreign Investment Negative List, and Ease Restrictions on Foreign Investment in this Area Through Regular Government-Industry Meetings

- Issue unified and consistent guidelines by all relevant authorities to define the scope of “prohibited investment” and “development and application” to facilitate investment and R&D planning by foreign companies.
- Allow pilot projects in selected areas, for example, the ‘two zones’ of Beijing, the Pudong New Area of Shanghai, Tianjin Free Trade Zone, the Greater Bay Area and Hainan Free Trade Port, to gradually ease foreign investment restrictions before applying successful outcomes nationwide.
- Solicit advice from enterprises, industry associations and chambers of commerce on amendments to the *Negative List* and hold regular meetings with industry to explore ways to ease restrictions on foreign investment.
- Strengthen the supervision capacity and mechanisms of relevant departments, such as the NMPA, the Human Genetic Resources Administration of China and the NHC, to support post market surveillance once *Negative List* restrictions are lifted.

## Introduction to the Working Group

The Pharmaceutical Working Group represents nearly 40 international pharmaceutical manufacturing companies operating in China. The working group engages in a constructive dialogue with Chinese central and local authorities to support the development of a sustainable pharmaceutical ecosystem, and government policies that foster innovation and patients’ access to affordable, innovative and high-quality healthcare solutions. In particular, the working group has established a sound communication channel with the Chinese healthcare and regulatory authorities, with whom it shares its expertise and policy recommendations based on international best practices and members’ experiences accumulated during decades of healthcare reform in European countries.

## Recent Developments

China’s healthcare system reform continues to deepen, with the key objectives of further providing innovative healthcare solutions for the Chinese population and fostering innovation, in line with the 14<sup>th</sup> Five-

year Plan (14FYP)<sup>1</sup> and the Healthy China 2030 blueprint.<sup>2</sup> In January 2022, China released its sector-specific *14<sup>th</sup> Five-year Plan on the Development of the Pharmaceutical Industry*, which also focusses on innovation, alongside supply chain security.<sup>3</sup> This strong commitment to pharmaceutical innovation is supported by China’s rapidly evolving regulatory landscape, as well as major legislative steps in intellectual property (IP) protection, and special access policies in various parts of China (such as the Guangdong-Macau-Hong Kong Greater Bay Area,<sup>4</sup> Shanghai Pudong Zhangjiang,<sup>5</sup> and

1 *14<sup>th</sup> Five-year Plan for National Economic and Social Development of the People’s Republic of China and the Long-term Goals for 2035*, State Council, 13<sup>th</sup> March 2021, viewed 24<sup>th</sup> June 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592681.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm)>

2 *Healthy China 2030 Blueprint*, Chinese Communist Party Central Committee and State Council, 25<sup>th</sup> October 2016, viewed 24<sup>th</sup> June 2022, <[http://www.gov.cn/zhengce/2016-10/25/content\\_5124174.htm](http://www.gov.cn/zhengce/2016-10/25/content_5124174.htm)>

3 *14<sup>th</sup> Five-Year Plan on the Development of the Pharmaceutical Industry*, Ministry of Industry and Information Technology, 31<sup>st</sup> January 2022, viewed 27<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2022-01/31/content\\_5671480.htm](http://www.gov.cn/zhengce/zhengceku/2022-01/31/content_5671480.htm)>

4 *‘Hong Kong-Macau Drug and Medical Device Pass’ Policy Landed in Nine Cities in the Greater Bay Area*, Guangming Net, 28<sup>th</sup> August 2021, viewed 27<sup>th</sup> April 2022, <[https://news.gmw.cn/2021-08/28/content\\_35119407.htm](https://news.gmw.cn/2021-08/28/content_35119407.htm)>

5 *Announcement on Passing the Regulations of Shanghai Pudong New Area on Promoting Zhangjiang Biomedical Industry Innovation*, Shanghai Municipal People’s Congress, 30<sup>th</sup> December 2021, viewed 27<sup>th</sup> April 2022, <<http://www.spcc.sh.cn/n8347/n8467/u1ai241152.html>>





Shenzhen<sup>6</sup>) for pharmaceutical companies.

Regarding market access policies, cost control remains at the centre of China's reimbursement and pricing regimes for pharmaceuticals, as volume-based procurement (VBP) schemes and National Reimbursement Drug List (NRDL) negotiations mature.

The working group commends the Chinese authorities on the major reform efforts they have undertaken. However, major challenges, such as finding the right balance between cost control and innovation, as well as implementing laws and policies, lie ahead. The working group is committed to working alongside Chinese authorities and policymakers in their efforts to improve Chinese patients' access to innovative healthcare solutions.

Several important regulations and public consultations relating to the pharmaceutical industry have been published since mid-2021, including:

- On 1<sup>st</sup> June 2021, the China National Intellectual Property Administration enacted the new Patent Law.<sup>7</sup>
- On 15<sup>th</sup> June 2021, the National Healthcare Security Administration (NHSA) called for public consultation on the Healthcare Security Law.<sup>8</sup>
- On 15<sup>th</sup> November 2021, the National Health Commission (NHC) called for public consultation on the *Administrative Measures for the National Essential Medicines Catalogue*.<sup>9</sup>
- On 19<sup>th</sup> November 2021, the State Council published the *Opinions on Improving the Medical Insurance and Assistance System for Critical and Serious Diseases*.<sup>10</sup>
- On 22<sup>nd</sup> March 2022, the Ministry of Science and

Technology (MOST) called for public consultation on the *Implementation Rules for the Regulation on Human Genetic Resources Management*.<sup>11</sup>

- On 9<sup>th</sup> May 2022, the National Medical Products Administration (NMPA) called for public consultation on the *Implementation Regulations of the Drug Administration Law*.<sup>12</sup>

The Pharmaceutical Working Group encourages the Chinese Government to continue taking steps toward a sustainable healthcare system that ensures faster and broader access to best-in-class medicines and vaccines, while also continuously incentivising innovation and fair competition.

## Key Recommendations

### 1. Further Advance Regulatory Harmonisation and Convergence with International Standards

#### Concern

Gaps in the harmonisation and convergence of China's regulatory framework with international standards, in particular in the Chinese Pharmacopoeia (ChP), remain a key concern of the industry.

#### Assessment

Since 2015, the NMPA has taken important steps to align China's regulatory environment with international standards, and encourage pharmaceutical innovation and simultaneous research and development (R&D), as well as registration of innovative drugs in China and overseas. Since joining the International Council for Harmonisation of Technical Requirements for Pharmaceuticals for Human Use (ICH) in 2017, China has implemented over 40 ICH guidelines.<sup>13</sup>

The NMPA has established a regulatory framework providing more regulatory efficiency and transparency through greater alignment with international practices. The 2019 Drug Administration Law (DAL) and the 2020

6 *Opinions on the Several Special Measures for Relaxing Market Access in Building Shenzhen into a Pilot Demonstration Area of Socialism with Chinese Characteristics*, National Development and Reform Commission and Ministry of Commerce, 26<sup>th</sup> January 2022, viewed 27<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2022-01/26/content\\_5670555.htm](http://www.gov.cn/zhengce/zhengceku/2022-01/26/content_5670555.htm)>

7 Patent Law of the People's Republic of China, CNIPA, 23<sup>rd</sup> November 2021, viewed 18<sup>th</sup> April 2022, <[https://www.cnipa.gov.cn/art/2020/11/23/art\\_97\\_155167.html](https://www.cnipa.gov.cn/art/2020/11/23/art_97_155167.html)>

8 *Call for Public Consultation on the Healthcare Security Law*, NHSA, 25<sup>th</sup> June 2021, viewed 18<sup>th</sup> April 2022, <[http://www.nhsa.gov.cn/art/2021/6/15/art\\_48\\_5268.html](http://www.nhsa.gov.cn/art/2021/6/15/art_48_5268.html)>

9 *Call for Public Consultation on the Administrative Measures for the National Essential Medicines Catalogue*, NHC, 15<sup>th</sup> November 2021, viewed 18<sup>th</sup> April 2022, <<http://www.nhc.gov.cn/yaoz/s7656/202111/068c31b85cb7486b9f77057b3e358aae.shtml>>

10 *Opinions on Improving the Medical Insurance and Assistance System for Critical and Serious Diseases*, State Council, 19<sup>th</sup> November 2021, viewed 18<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2021-11/19/content\\_5651446.htm](http://www.gov.cn/zhengce/content/2021-11/19/content_5651446.htm)>

11 *Call for Public Consultation on Implementation Rules for the Regulation on Human Genetic Resources Management*, MOST, 22<sup>nd</sup> March 2022, viewed 18<sup>th</sup> April 2022, <[http://www.most.gov.cn/tztg/202203/t20220322\\_179904.html](http://www.most.gov.cn/tztg/202203/t20220322_179904.html)>

12 *Call for Public Consultation on the Implementation Regulations of the Drug Administration Law*, NMPA, 9<sup>th</sup> May 2022, viewed 24<sup>th</sup> May 2022, <<https://www.nmpa.gov.cn/xxgk/zhqyj/zhqyjyp/20220509222233134.html>>

13 *NMPA holds a symposium on the process and prospects of ICH in China*, NMPA, 10<sup>th</sup> April 2021, viewed 27<sup>th</sup> April 2022, <[http://english.nmpa.gov.cn/2021-04/10/c\\_610224.htm](http://english.nmpa.gov.cn/2021-04/10/c_610224.htm)>





*Drug Registration Regulation* (DRR)<sup>14</sup> have significantly streamlined and speeded up the drug approval process.<sup>15</sup> Accelerated pathways have also been created to allow faster approval for innovative drugs, and multiple efforts are ongoing to improve the quality and efficiency of the review and approval system. In parallel, the NMPA is also actively encouraging multinational companies (MNCs) to further integrate China into global R&D of innovative drugs with clinical value.

The continuous harmonisation of China's regulatory framework would enable MNCs to introduce innovative medicines in China in a timely manner to the benefit of Chinese patients. First, the further harmonisation of Chinese quality standards and ChP requirements with international standards is crucial for pharmaceutical companies that develop and manufacture drug products globally, independent of whether located in China or overseas. However, there are still gaps in ChP general monographs that have already been harmonised by the Pharmacopoeial Discussion Group (PDG),<sup>16</sup> and differences in requirements compared to some ICH guidelines.

In addition, the clinical trial applications process in China requires substantial testing and related manufacturing information, including biologics upstream construction information and batch records, that are only requested at the marketing authorisation application (MAA) stage by other regulatory agencies, like the European Medicines Agency (EMA) and the United States (US) Food and Drug Administration. Such requests hinder Chinese companies and MNCs' China affiliates from participating in multi-regional clinical trials in China, which is not in alignment with the government spirit to encourage domestic simultaneous drug development.

Moreover, issues linked to post-approval variation management impact the industry's ability to launch new

products in a timely manner and ensure the continuous supply of marketed products. The definition of the 'implementation date' in particular has implications linked to chemistry manufacturing and control (CMC) variation, labelling updates and Marketing Authorisation Holder (MAH) transition.

For CMC variation, Chinese regulations do not permit applications for review and approval of post-marketing CMC changes to be submitted simultaneously in China and overseas, and the drug may only be manufactured after the changes are approved. This means the time lag between the implementation of such changes outside China and the supply of the post-change drugs to the Chinese market can take an average of 19 months. Of those, the time lag attributable to the 'manufacturing upon approval' requirement can account for an average of almost nine months. As a result, companies have no other choice but to store in advance manufacturing materials, sometimes valued at up to hundreds of millions of US dollars (USD), to ensure supply to the Chinese market during this period. However, such reserves only maintain supply for an average of nine months, bearing a high risk of supply failure.

For labelling updates, as no grace period has been mentioned in the regulations, the manufacturer has to implement the new labelling immediately upon approval. This is not practical and may lead to out-of-stock and/or resource wasting for the old-materials write-off. In regard to the ongoing MAH transition, if no grace period is provided, the supply, bidding and listing will be impacted. One solution is to introduce e-labelling: the MAH would simply need to upload the newly approved e-labelling onto the database linked to the e-code provided on product packaging and patients can access the updated e-labelling information by rescanning the e-code, even from older packs/cartons.

Lastly, China's 'new drug' definition, including in the recently revised DAL and DRR, remains misaligned with international standards. China defines a new drug as one that has not yet been marketed anywhere in the world, and not simply new to China,<sup>17</sup> This exposes drugs manufactured and approved abroad to potential different treatment from those manufactured

<sup>14</sup> *Drug Registration Regulation*, State Administration for Market Regulation, 22<sup>nd</sup> January 2020, viewed 24<sup>th</sup> June 2022, <[https://gkml.samr.gov.cn/nsjg/fgs/202003/t20200330\\_313670.html](https://gkml.samr.gov.cn/nsjg/fgs/202003/t20200330_313670.html)>

<sup>15</sup> *Newly Revised Drug Administration Law Adopted After Deliberation — To Comprehensively Implement the Four Strictest Requirements and Effectively Protect Drug Safety for the Public*, NMPA, 26<sup>th</sup> August 2019, viewed 27<sup>th</sup> April 2022, <[http://english.nmpa.gov.cn/2019-08/26/c\\_411183.htm](http://english.nmpa.gov.cn/2019-08/26/c_411183.htm)>

<sup>16</sup> The PDG was formed in 1989 with representatives from the European, Japanese and the US Pharmacopoeia. In May 2001, the PDG welcomed the World Health Organization as an observer. The PDG generally meets twice a year and holds monthly status and technical teleconferences to advance harmonisation work. See: *Pharmacopoeial Discussion Group (PDG)*, Usp.org, viewed 4<sup>th</sup> July, <<https://www.usp.org/harmonized-standards/pdg>>

<sup>17</sup> *Circular on the Publication of Chemical Drug Registration Classification and Declaration Requirements*, NMPA, 30<sup>th</sup> June 2020, viewed 27<sup>th</sup> April 2022, <<https://www.nmpa.gov.cn/xxgk/gtg/qtggtg/20200630180301525.html>>



domestically, and may result in them losing key benefits. This misalignment will also reduce domestic and foreign companies' flexibility to include the Chinese market in their long-term global drug development plans.

### Recommendations

- Encourage greater harmonisation of the Chinese regulatory and quality system with international standards from the ICH and the Pharmaceutical Inspection Co-operation Scheme (PIC/S) and more active participation in the International Coalition of Medicines Regulatory Authorities (ICMRA) in order to contribute to global alignment.
- Reduce barriers in the drug review and approval process, notably in the clinical trial assessment review and approval process, by aligning with major regulatory agencies and World Health Organization standards.
- Implement more effective and efficient post-approval change management to ensure continuity of supply.
- Support the NMPA to introduce e-labelling to ensure sustainable labelling updates in the long run and to resolve the grace period issue.

## 2. Ensure Clear Interpretations and Consistent Implementation of Intellectual Property (IP) Laws and Policies to Better Foster Pharmaceutical Innovations for Chinese Patients

### Concern

The protection of pharmaceutical IP in China is hindered by ineffective, unequal and unpredictable implementation, especially regarding regulatory data protection (RDP), patent term extension (PTE), the definition of 'new drug', and patent linkage (PTL) system.

### Assessment

As global experience and practice have shown, IP rights are fundamental for investment in R&D that leads to new medicines, as well as in facilitating access to medicines. The Chinese economy—now the second largest in the world—is on the path to innovation in all sectors, including healthcare and pharmaceuticals. Hence, establishing a multi-dimensional IP protection mechanism in China that encompasses patents and regulatory data protection will facilitate innovation in pharmaceuticals and accelerate patient access to

innovative medicines from both global and domestic players.

In recent years, China has enacted several laws and policies to advance important IP reforms. However, further work is still required to ensure that implementation effectively advances innovation and patient access.

### Patent term extension (PTE)

China has provided both patent term adjustment (PTA) and PTE, as outlined in the recently amended Patent Law,<sup>18</sup> the draft *Implementing Rules of the Patent Law* and the draft *Patent Examination Guidelines*. However, detailed rules for PTA and PTE are still pending. With regard to PTE, the type of drugs and patents eligible for PTE, the definition of 'new drug', the scope of protection provided during PTE, as well as PTE calculation need to be further clarified in finalised rules and guidelines as soon as practical.

### Patent linkage (PTL)

Despite the implementation of the PTL system, drug innovators are concerned about the short stay period provided for chemical drugs (nine months only), which may not be sufficient for resolving patent disputes; the lack of a stay period for biological drugs; and the lack of remedy if a generic or biosimilar manufacturer submits an erroneous/inconsistent declaration. Furthermore, the prevailing linkage-related legislation lacks clarity, which has caused uncertainties over implementation.

### Regulatory data protection (RDP)

As part of its accession to the World Trade Organisation, China committed to providing RDP. The *Implementation Regulations of the Drug Administration Law* anticipate a six-year protection period for test data of products containing new chemical ingredients. However, in practice, there is no enforcement mechanism to prevent the unfair commercial use of safety and efficacy data generated by innovative pharmaceutical companies. As the *Regulations* are under amendment, the working group strongly recommends retaining and clarifying the RDP clause, and setting up a clear timetable for RDP implementation.

<sup>18</sup> Patent Law of the People's Republic of China, NPC, 19<sup>th</sup> November 2021, viewed 24<sup>th</sup> June 2022, <<http://www.npc.gov.cn/npc/c30834/202011/82354d98e70947c09db c5e4eeb78bdf3.shtml>>



### Mandatory IP-sharing related to human genetic resources (HGR) requirements

In 2019, the State Council released the *Regulations on Management of Human Genetic Resources of China*, addressing mandatory patent-sharing requirements between foreign companies and local partners (such as hospitals) where the collaboration (including pre-clinical and clinical trials) utilises China's HGR. While the pertinent laws, such as the Patent Law, already provide rules on patent co-ownership and interest-sharing in respect to agreements between contracting parties in general,<sup>19</sup> the mandatory patent-sharing requirement under the HGR regime forms a significant hurdle and creates uncertainty for foreign companies conducting clinical research in China. The working group recommends eliminating such mandatory patent-sharing requirements.

#### Recommendations

- Implement an effective PTE mechanism that will encourage and protect innovation, including: 1) a clear definition of 'new drug', which should include any drug that has firstly obtained marketing authorisation by the NMPA and provided a thorough set of efficacy and safety data in support of its MAA; 2) clarified protection scope during the extended patent term; and 3) transparent and clear calculation for PTE.
- Improve the patent linkage mechanism to balance the interest of originators and generics, and to provide more clarity on the linkage rules, including: 1) extended stay period (more than nine months) for both chemical and biological products; 2) remedy if a generic or biosimilar manufacturer submits an erroneous/inconsistent declaration; and 3) clear guidance on patent linkage rules for biologics.
- Enforce the six-year RDP rule under the existing *Regulations for Implementing the Drug Administration Law*.
- Provide clear guidance for RDP in the draft amendment to the *Regulations for Implementing the Drug Administration Law*, including clarification of the drugs eligible for RDP, and a clear timetable for implementation of a comprehensive RDP regime.
- Eliminate the mandatory patent-sharing requirements under the HGR regime and resort to the pertinent legal requirements, such as those provided in the Patent Law.

<sup>19</sup> *Regulations on Management of Human Genetic Resources in China*, State Council, 10<sup>th</sup> June 2019, viewed 24<sup>th</sup> June 2022, <[http://www.gov.cn/zhengce/content/2019-06/10/content\\_5398829.htm](http://www.gov.cn/zhengce/content/2019-06/10/content_5398829.htm)>

### 3. Establish a National/Provincial Funding Pool for Rare Diseases, with a Higher National Negotiation Price Threshold for High-value Rare Disease Drugs, and Encourage Local Governments to Continue Provincial Level Coverage for Rare Diseases

#### Concern

Insufficient funding of rare disease drugs in China continues to hinder patients' sustainable access to treatment, and the national negotiation mechanism and value assessment framework is not optimised for innovative rare disease treatments, while rare disease drugs risk removal from provincial reimbursement drug lists (PRDL).

#### Assessment

The Chinese authorities have undertaken significant reform efforts to allow greater access to innovative treatment for rare diseases patients in China. In 2018, the NMPA Center for Drug Evaluation (CDE) published the *First List of Clinically Urgently-needed Drugs Launched Abroad*, which includes 40 drugs.<sup>20</sup> In 2019, a second list with an additional 26 drugs was released, including 17 rare disease drugs.<sup>21</sup> Inclusion on these lists resulted in 15 out of the 66 drugs—of which four were rare disease drugs—receiving regulatory approval in less than 10 months. In addition, the *Drug Registration Administrative Measures* made innovative and rare disease drugs eligible for priority review and approval, effective from 1<sup>st</sup> July 2020.<sup>22</sup> As of December 2021, more than 60 rare disease drugs have been approved for marketing in China, and more than 40 have entered the NRDL, including seven rare disease drugs added to the list in 2021.<sup>23</sup>

The working group commends these efforts by the Chinese authorities and encourages continued reform

<sup>20</sup> *CDE Solicitation on the List of Urgently Needed Drugs*, Lexology, 3<sup>rd</sup> September 2018, viewed 4<sup>th</sup> July 2022, <<https://www.lexology.com/library/detail.aspx?g=6f8c9add-dd48-45bd-911d-182faf5fdaab>>

<sup>21</sup> *CDE releases the List of the Second Batch of Overseas New Drugs Urgently Needed in Clinical Settings*, *China Daily*, 29<sup>th</sup> May 2019, viewed 4<sup>th</sup> July 2022, <<https://govt.chinadaily.com.cn/s/201905/29/WS5dd1fca1498e7df3800ef678/cde-releases-the-list-of-the-second-batch-of-overseas-new-drugs-urgently-needed-in-clinical-settings.html>>

<sup>22</sup> *Administrative Measures of Drug Registration*, State Administration for Market Regulation, 30<sup>th</sup> March 2020, viewed 3<sup>rd</sup> April 2021, <[http://gkml.samr.gov.cn/nsjg/fgs/202003/t20200330\\_313670.html](http://gkml.samr.gov.cn/nsjg/fgs/202003/t20200330_313670.html)>.

<sup>23</sup> *Over 60 rare disease drugs approved for the Chinese market*, *Xinhua*, 19<sup>th</sup> December 2021, viewed 27<sup>th</sup> April 2022. <[http://english.www.gov.cn/statecouncil/ministries/202112/19/content\\_WS61be7078c6d09c94e48a26d9.html](http://english.www.gov.cn/statecouncil/ministries/202112/19/content_WS61be7078c6d09c94e48a26d9.html)>.



to further improve patients' access to rare disease drugs. However, insufficient funding remains a critical obstacle to the sustainable treatment of rare diseases in China. At the national level, the current reimbursement system is inadequate to provide sustainable coverage for rare disease patients, who still need to pay around 20 to 30 per cent for NRDL-listed drugs and even higher for prescriptions in outpatient settings. This results in a significant economic burden for such patients, as treatment costs are relatively high.

Moreover, the national negotiation mechanism and value assessment framework used for most drugs is not optimised for the most innovative rare disease treatments. NRDL negotiation sets a Chinese yuan (CNY) 300,000 annual price threshold for all drugs, which hinders the entry of high-value rare complex disease drugs. Current economic evaluation is also a big challenge for the pricing of rare disease drugs in NRDL negotiations, such as the cost-effectiveness modelling and incremental cost-effective ratio threshold. Furthermore, commercial health insurance (CHI) and charity funds do not often provide supplemental coverage for rare disease patients' co-pay fees.

At the regional level, several provinces (including Ningxia, Zhejiang, Jiangsu and Shandong) have successfully piloted innovative models to cover rare disease treatment costs, benefitting from more agility at the local level. However, the NHSA has mandated provinces to strictly follow the NRDL and remove by the end of 2022 all drugs from PRDL that are not listed on the NRDL.<sup>24</sup> De-listing rare disease drugs that are not listed on the NRDL may lead to forced treatment switches that could jeopardise patients' treatment continuity and expose them to life-threatening risks. Provinces have up until now been leading the exploration of innovative ways to leverage CHI and charity to build a multi-layer reimbursement for rare disease patients. Ceasing PRDL updates may discourage regional authorities from further exploring innovative and sustainable payment models for rare diseases.

Finally, China's quality control (QC) testing requirements for all imported biological drugs have material impacts on the accessibility of rare disease drugs for Chinese patients. Up to 45 per cent of each imported batch is lost to QC testing, while the testing process further delays delivery.

### Recommendations

- Build a dedicated, national, multi-party innovative access review and payment model that works seamlessly with basic medical insurance (BMI) exploring additional funding for rare disease drugs, including CHI and charity funds, to keep rare disease patients' co-pay at a reasonable level.
- Eliminate the CNY 300,000 annual price threshold for NRDL negotiation for rare disease drugs.
- Adopt a fit-for-purpose value assessment framework that meets the unique characteristics of rare diseases and considers all relevant elements of product value in a multi-dimensional framework, including patient benefit and social value.
- Exempt the cost-effective analysis model or increase the incremental cost-effective ratio threshold when conducting value assessment for rare diseases drugs, especially for breakthrough therapies.
- Encourage local governments to continue provincial-level coverage for rare diseases, leveraging CHI and charity funds, and exempt rare disease drugs from PRDL delisting.
- Accelerate CHI development, include more rare disease drugs in city CHI special drug lists, increase the reimbursement ratio, and develop special CHI for rare disease drugs
- Implement a quality control waiver (for both registration testing and commercial testing) for rare disease imports, provided that they are uninterruptedly controlled according to globally harmonised manufacturing, distribution, and storage standards (for example, good manufacturing practice, good distribution practice and good storage practice).

<sup>24</sup> In 2022, the State Council's *Government Work Report* stated that "the reimbursement drug scope to be unified" as a policy goal for the year. Also in 2022, the State Council issued the *2022 Priority Tasks in Deepening Healthcare Reform*, which stated "the reimbursement drug scope to be unified": *2022 Government Work Report*, State Council, 12<sup>th</sup> March 2022, viewed 4<sup>th</sup> July 2022, <[http://www.gov.cn/premier/2022-03/12/content\\_5678750.htm](http://www.gov.cn/premier/2022-03/12/content_5678750.htm)>; *2022 Priority Tasks in Deepening Healthcare Reform*, State Council, 25<sup>th</sup> May 2022, viewed 4<sup>th</sup> July 2022, <[http://www.gov.cn/xinwen/2022-05/25/content\\_5692276.htm](http://www.gov.cn/xinwen/2022-05/25/content_5692276.htm)>



#### 4. Improve the Dynamic Update Mechanism in the NRDL to Promote the Medical Insurance System Reform, as Well as Hospital Access for NRDL Drugs, and Introduce a Value-based Evaluation Mechanism for Innovative Drugs Inclusion

##### Concern

Steep price cuts and barriers to NRDL implementation at hospital-level remain problematic and hinder the development of the biomedical industry and patient access to innovative medicines.

##### Assessment

China reached a new stage of its medical insurance system reform in June 2021, when the NHSA released the draft Healthcare Security Law as an overarching framework.<sup>25</sup>

China's health security system has adopted many strategic procurement mechanisms to provide high-quality and affordable medical services. For instance, China has updated the NRDL annually since 2017. However, Chinese patients still have limited access to many innovative medicines that may not be included in the NRDL, as the negotiation process remains primarily driven by price. This process should instead balance and recognise the value of innovative medications to patients, the healthcare system and society. To improve patients' adherence and expand their access to drugs that are safer and have higher clinical efficacy, particularly for common chronic diseases such as hypertension and diabetes, the NHSA should also expand the NRDL to include single pill combination as clinical guidelines recommend.<sup>26&27</sup>

The 14FYP proposes that 1) biomedicines be included as a "national mega-innovation field"; 2) appropriate incentives for corporate innovation be made available within the health security system, and 3) that CHI be

leveraged as a supplementary element to partly cover innovative treatments and technologies that may not be affordable under the BMI alone.<sup>28</sup>

The common issue of certain NRDL products not being included in hospital formularies, the 'last kilometre' problem, caught the attention of the government, which issued several polices to improve the situation.<sup>29,30&31</sup> In Shanghai, local authorities mandate hospitals to host Drug Committee Meetings (DCMs), from whom hospitals need approval to grant drugs access to their formulary. However, as most hospitals do not host DCMs regularly, the latest NRDL-listed drugs cannot get access to hospitals in a timely manner.

At present, China's NRDL and VBP systems have been normalised and institutionalised. Some exclusive patented products have entered the NRDL negotiation list over several consecutive years, and had their clinical effectiveness, safety, innovation and fairness fully acknowledged by the experts. However, they fail to be listed in the NRDL simply because of disagreement over the sharp reduction in price required. These products often later end up being included in the VBP when their patent expiration dates approach, with the price determined by the government through the VBP mechanism. A linkage mechanism that allows these types of VBP products to be included in the NRDL could help Chinese patients benefit from them quicker, ease government administrative processes and save administrative costs.

In recent years, Chinese regulators have actively promoted the development of personalised precision medicines, and encouraged the simultaneous development of anti-tumour drugs and corresponding diagnostic reagents. However, biomarker testing, which is the cornerstone of precision treatment, still follows

25 Announcement of National Healthcare Security Administration on Public Opinions on Healthcare Security Law (draft for comments), NHSA, 15<sup>th</sup> June 2021, viewed 12<sup>th</sup> April 2022, <[http://www.nhsa.gov.cn/art/2021/6/15/art\\_48\\_5268.html](http://www.nhsa.gov.cn/art/2021/6/15/art_48_5268.html)>

26 Guidelines for Hypertension Prevention and Treatment in China (2018 revision), Chinese Journal of Cardiovascular Diseases, vol. 24, no. 1, February 2019, viewed 18<sup>th</sup> April 2022, <<https://www.cnki.com.cn/Article/CJFDTOTAL-XIXG201901003.htm>>

27 National Guidelines on Hypertension Prevention and Management Guidelines at Grassroots Level (2020 version), National Centre of Cardiovascular Diseases, December 2021, viewed 18<sup>th</sup> April 2022, <<https://hbp-office.nccd.org.cn/download.html>>

28 Outline of the 14<sup>th</sup> Five-Year Plan (2021-2025) for National Economic and Social Development and the Long-Range Objectives Through the Year 2035, State Council, 13<sup>th</sup> March 2021, viewed 12<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592681.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm)>

29 NHSA, NHC Guidance on establishing and improving the 'dual channel' management mechanism of NRDL negotiation drugs, NHSA and NHC, 10<sup>th</sup> May 2021, viewed 13<sup>th</sup> April 2022, <[http://www.nhsa.gov.cn/art/2021/5/10/art\\_37\\_5023.html](http://www.nhsa.gov.cn/art/2021/5/10/art_37_5023.html)>

30 NHSA, NHC Notice on adapting to normalisation of national medical insurance negotiation and continuing to guarantee NRDL negotiated drugs landing, NHSA and NHC, 10<sup>th</sup> September 2021, viewed 13<sup>th</sup> April 2022, <[http://www.nhsa.gov.cn/art/2021/9/10/art\\_37\\_5939.html](http://www.nhsa.gov.cn/art/2021/9/10/art_37_5939.html)>

31 Notice on the performance appraisal operation manual of national tertiary public hospitals (2022 Edition), NHC, 30<sup>th</sup> March 2022, viewed 14<sup>th</sup> April 2022, <<http://www.nhc.gov.cn/yzygj/ylyxjg/202204/d61b7201a56643d1a876e103340e5897.shtml>>





the model of independent pricing by medical institutions or third-party testing institutions, and is not yet included in the medical insurance fund. To a certain extent, the high costs of biomarker testing limits patients' choices of drugs listed in the NRDL and impacts treatment. Therefore, the working group recommends taking NHTSA COVID-19 testing proposals as an example,<sup>32</sup> and explore setting government-guided price standards for biomarker testing in medical institutions, while gradually including testing expenses for precision tumour treatment in the medical insurance fund.

#### Recommendations

- Reward innovation adequately, include value-based assessments in the NRDL process, and determine pricing and reimbursement in line with fund affordability.
- Explore a new co-payment model with reimbursement for certain high-value innovative drugs, partially shared by both BMI and CHI, to reduce pressure on the BMI and create development space for CHI.
- Simplify the hospital access process by holding, in the short-term, special DCMs for negotiated drugs within a set time-range, referencing Shanghai's policy where local authorities mandate hospitals to host DCM, and apply this model nationwide.
- Consider more options to improve hospital access in the long-term, including a joint NHTSA-NHC mechanism to grant access to new NRDL drugs.
- Exclude negotiated drugs when evaluating increases of medical expenses in performance appraisals of medical insurance designated institutions, and ensure their usage is not affected by hospitals' annual budget caps.
- Establish a linkage mechanism to allow qualified national VBP drugs to be included in the NRDL.
- Include the single pill combination in the NRDL to improve patients' compliance and expand their access to safe drugs with better clinical efficacy, particularly for chronic diseases such as hypertension and diabetes.
- Include biomarker testing costs in the medical insurance fund for precision tumour treatment.

<sup>32</sup> On 19<sup>th</sup> June 2020, the NHTSA issued the *Notice on Further Improving the COVID-19 Detection Capability*, which proposes including nucleic acid testing and related consumables in the provincial medical insurance reimbursement scheme. On 21<sup>st</sup> March 2022, the NHTSA again requested the temporary inclusion of COVID-19 antigen detection reagents and corresponding detection items in the provincial BMI and medical service catalogue.

## 5. Further Improve Implementation of Volume-based Procurement (VBP) and Establish a Follow-up Evaluation Mechanism, to Ensure Market Competition as well as Patients' and Doctors' Access to High-quality, Safe and Efficacious Drugs

#### Concern

While China's VBP policy has significantly reduced drug prices, problems in drug selection, procurement, supply and quality supervision have impacted both patients' and doctors' access to drugs, and there have not been follow-up evaluations of these impacts.

#### Assessment

On 23<sup>rd</sup> September 2021, the State Council published the *Notice on the National Medical Security Plan in the 14<sup>th</sup> Five-Year Plan*, setting a clear target for universal medical VBP to cover 500 drugs by 2025, thereby "continuously improving the people's sense of acquisition, happiness, and security".<sup>33</sup> The 2022 National Medical Security Work Conference reported that the cost burden of drugs and consumables was significantly reduced, with savings in the first five batches of drugs VBP and coronary stents VBP in 2021 reaching nearly CNY 170 billion.<sup>34</sup>

The working group fully supports the government's goal of reducing patients' financial burden. However, it also notes that low price is still the key factor in winning bids while enterprises' supply capacity is not fully considered, and there is no clear and scientific price competition mechanism. A mature and scientific-effectiveness evaluation system on VBP is also lacking. The working group has noticed that some VBP drugs have low reimbursement payment standards (RPS) – some as low as CNY 0.5 per day. Such low VBP RPS affects patients' access to brand drugs, especially patients with chronic diseases who may depend on branded drugs for treatment continuity.

According to the NHTSA, since the release of the *Guideline on Establishing Credit Evaluation System*

<sup>33</sup> *Notice on the 14<sup>th</sup> Five-year Plan for National Medical Security*, State Council, 23<sup>rd</sup> September 2021, viewed 20<sup>th</sup> April 2022. <[http://www.gov.cn/gongbao/content/2021/content\\_5643264.htm](http://www.gov.cn/gongbao/content/2021/content_5643264.htm)>

<sup>34</sup> *National Conference on Medical Security Held in Beijing*, NHTSA, 14<sup>th</sup> January 2022, viewed 20<sup>th</sup> April 2022, <[http://www.nhsa.gov.cn/art/2022/1/14/art\\_14\\_7780.html](http://www.nhsa.gov.cn/art/2022/1/14/art_14_7780.html)>





for Drug Prices and Bidding in 2020,<sup>35</sup> by September 2021, a total of 69 enterprises had been rated, including five with 'seriously' discreditable behaviour. Most discreditable acts are cited as "failure to supply according to agreement, cut off supply".

In 2021, the NHTA began to expand VBP to biologics. Several regional VBPs involve generic medicines that have not passed the Generic Quality Consistency Evaluation. Without a sound framework that ensures the quality, efficacy, safety, interchangeability and traceability of biologic and biosimilar products, such VBP and other 'forced-switch' policies can put patient safety and therapeutic continuity at risk, due to the high complexity of biologics and the conditions that they treat.

Lastly, new concerns with the national VBP programme have emerged with respect to the protection of IP rights. Members of the working group noted that the list of products for the fourth national VBP had included a compound for which the patent was still valid and for which an administrative lawsuit was in progress. Additionally, the announced procurement for the sixth national VBP (insulin) group included patented and off-patent products in the same class for competitive lowest price bidding.

### Recommendations

- Develop a long-term follow-up evaluation mechanism on the medical expenses and quality of all VBP products, and fully respect the opinions of doctors and patients based on the actual situation of clinical treatment practice, to accumulate and supply evidence for VBP policy improvement.
- Improve competition rules, avoid awarding bids quoting extremely low prices, and assess the supply capacity of bidding entrants.
- Ensure provincial drugstores also provide brand drugs that are not VBP winners to secure patients and doctors' access to brand drugs.
- Extend the grace period of RPS implementation of VBP drugs to mitigate patients' treatment costs.
- Improve the regulatory framework on biosimilar to ensure safety, efficacy and interchangeability before expanding the scope of biologics VBP.
- Prevent regional authorities from piloting VBP on

biologics, considering the high risk of treatment replacement to patient safety.

- Exclude patented medicines (including but not limited to patents on compounds) in VBP, which abrogate innovators' IP rights and, in regard to therapeutic class tendering, treats as interchangeable products with very different clinical characteristics and performance.

## 6. Harmonise the Vaccine Policy Environment with International Standards to Improve and Accelerate Access to Innovative Vaccines for the Chinese Population 2

### Concern

The current vaccine policy environment in China (in particular, the registration process and ChP) is not harmonised with international standards, impeding the Chinese population's timely access to innovative vaccines, and there are no dynamic adjustment mechanisms for vaccines to be included in the National Immunisation Programme (NIP).

### Assessment

'Prevention first' serves as one of the core strategies of national Healthy China initiatives. With COVID-19 remaining a global health concern, the Chinese Government has prioritised reforming the national disease control system and strengthening vaccine R&D capabilities. These priorities were also highlighted in the 14FYP, as well as during the 2021 and 2022 plenary sessions of the National People's Congress (NPC) and the Chinese People's Political Consultative Conference, also known as the 'Two Sessions'.

On 13<sup>th</sup> May 2021, China announced the establishment of the National Disease Prevention and Control Bureau, and on 16<sup>th</sup> February 2022, details on its overall structure, detailed roles and responsibilities were released.<sup>36</sup> This reinforces the role assigned to disease prevention and control on the national political agenda. In addition, progress has been made on legislation to reinforce pandemic prevention and response capabilities, and enhance technology innovation capacity. The Public Health Emergency Response Law, listed in the NPC Standing Committee 2021 Legislative

<sup>35</sup> *Guideline on Establishing Credit Evaluation System for Drug Prices and Bidding*, NHTA, September 2020, viewed 24<sup>th</sup> June 2022, <[http://www.nhta.gov.cn/art/2020/9/16/art\\_104\\_6497.html](http://www.nhta.gov.cn/art/2020/9/16/art_104_6497.html)>

<sup>36</sup> *Chinese Centre for Disease Control and Prevention's Measures on Functional Configuration, Internal Organisation, and Staff Management*, State Council, 16<sup>th</sup> February 2022, viewed 24<sup>th</sup> June 2022, <[http://www.gov.cn/zhengce/2022-02/16/content\\_5674041.htm](http://www.gov.cn/zhengce/2022-02/16/content_5674041.htm)>





Work Plan, is under drafting,<sup>37</sup> and the Infectious Disease Prevention and Control Law is under revision by the NHC at the time of writing.<sup>38</sup>

While the working group commends these developments, it expects to see further regulatory reforms to foster the building of an innovative domestic vaccine ecosystem. China has actively participated in global initiatives on fighting COVID-19, especially in contributing to vaccine development and supply. In this context, the harmonisation of China's vaccine regulatory framework with international standards will not only help Chinese people get quicker access to more innovative vaccines, but also support the expansion of China-manufactured vaccines into global markets.

Despite efforts to speed up the registration and approval process for vaccines, the time required remains challenging, and affects the simultaneous global development of vaccines. There is also a lack of clarity regarding requirements on international multi-centre trial blood samples, technical guidance and pharmacopeia. Although pilot zone policies on the fast launch of innovative drugs have greatly benefitted Hainan and the Guangdong-Hong Kong-Macau Greater Bay Area, vaccines—categorised as drugs in China—do not qualify, despite their growing importance in the public health system.

Considering China's fast-ageing population, it is also important to reinforce vaccine awareness among the general public, for vaccines—alongside their high social economic value—are a key public health solution for improving people's health and life expectancy. Furthermore, prophylactic agents, such as monoclonal antibodies/insulin, have emerged that can protect populations from infectious diseases, yet Chinese regulations do not include categories for such innovative prophylaxes. In addition, procurement of NIP vaccines is open to domestically-produced products only. Imported vaccines that are safe, urgently needed and affordable should be included in the NIP – thereby improving access and sustainable supply of innovative vaccines.

Lastly, in the evolving COVID-19 reality, it is even more critical to strengthen routine vaccination for the Chinese population to avoid unnecessary crowding out of medical resources. Promoting vaccination against other respiratory diseases, such as influenza, and expanding immunisation programmes to more Chinese provinces and cities would be in line with international best practices, and will help avoid dual infection with COVID-19.

### Recommendations

- Increase the availability of innovative vaccines and immunisation to the Chinese population by harmonising the regulatory environment with international standards, including but not limited to international multi-centre trial blood samples requirements, technical guidance and pharmacopeia.
- Promote the reform of procurement criteria and processes to include all NMPA-approved vaccines, both imported and locally manufactured, on the NIP to enable access for more innovative vaccines and build a more sufficient and sustainable supply to address public health needs.
- Promote routine vaccination and vaccination strategy in respiratory diseases, such as influenza, to avoid dual infection with COVID-19, and expand influenza immunisation programmes in provinces and cities.
- Implement vaccine pilot launches this coming year in qualifying pilot zone areas to provide the Chinese population with faster access to and more choices on disease prevention.
- Prioritise prevention and realise healthy ageing through promoting the construction of adult vaccine infrastructure to improve public awareness of adult disease prevention.
- Update the current categorisation and regulatory approach for prophylactic bio-products to properly categorise and guide their usage, boost innovation and enhance the diversity and accessibility of advanced measures for disease prevention.

<sup>37</sup> National People's Congress Standing Committee's 2021 Legislative Work Plan, National People's Congress, 21<sup>st</sup> April 2021, viewed 30<sup>th</sup> June 2022, <<http://www.npc.gov.cn/npc/c30834/202104/1968af4c85c246069ef3e8ab36f58d0c.shtml>>

<sup>38</sup> Notice on Public Consultation on the Infectious Diseases Prevention and Control (Revised Draft for Comments), NHC, 2<sup>nd</sup> October 2020, viewed 8<sup>th</sup> May 2021, <<http://www.nhc.gov.cn/wjw/yjzj/202010/330ecbd72c3940408c3e5a49e8651343.shtml>>





## 7. Clearly Define the Projects and Scope of Prohibited Investment in the Development and Application of Human Stem Cells, Genetic Diagnosis and Treatment Technologies in the Foreign Investment Negative List, and Ease Restrictions on Foreign Investment in this Area through Regular Government-Industry Meetings

### Concern

Article 19 of China's *Foreign Investment Negative List (2021 Edition)* may obstruct China's harmonisation with global frontier biotechnology R&D development trends, hinder sustainable foreign investment, and delay access of patients in China to new innovative therapies.

### Assessment

Cell and gene therapy (CGT) has transformed the way genetic and other challenging diseases are being treated globally. CGT is recognised as the third revolution of the bio-pharmaceutical industry, following the invention of small molecular drugs and antibody drugs.

The financing of R&D of CGT products reached euro (EUR) 20.1 billion globally in 2021, up 16 per cent compared with EUR 17.3 billion in 2020.<sup>39</sup> By the third quarter of 2021, there were 1,386 CGT products on clinical trials around the world, 175 of which were in the third phase.<sup>40</sup> In addition, by 2021, 30 CGT products had been approved in Europe and the US.<sup>41</sup> As of mid-2022, producers of 17 CGT products or therapies have submitted or indicated plans to submit biologic license applications or MAA.<sup>42</sup> By the end of 2022, the number of EMA-approved gene therapies for rare diseases is expected to double from a year earlier.<sup>43</sup>

39 Smith, Jonathon, *Europe Trailed US Despite Record Gene and Cell Therapy Funding in 2021*, Labiotech, 14<sup>th</sup> January 2022, viewed 14<sup>th</sup> April 2022, <<https://www.labiotech.eu/trends-news/gene-therapy-cell-arm/>>

40 *Cell and Gene State of the Industry Briefing*, Alliance for Regenerative Medicine, 10<sup>th</sup> January 2022, viewed 14<sup>th</sup> April 2022, <<https://alliancerm.org/arm-event/sotibriefing/>>

41 *China Cell and Gene Therapy Industry Development White Paper*, Frost & Sullivan, June 2021, pp. 37-39, viewed 22<sup>nd</sup> August 2022, <<http://www.frostchina.com/wp-content/uploads/2021/06/1-3.pdf>>

42 *Cell and Gene State of the Industry Briefing*, Alliance for Regenerative Medicine, 10<sup>th</sup> January 2022, viewed 14<sup>th</sup> April 2022, <<https://alliancerm.org/arm-event/sotibriefing/>>

43 Smith, Jonathon, *Europe Trailed US Despite Record Gene and Cell Therapy Funding in 2021*, Labiotech, 14<sup>th</sup> January 2022, viewed 14<sup>th</sup> April 2022, <<https://www.labiotech.eu/trends-news/gene-therapy-cell-arm/>>

While CGT is developing rapidly in Europe and the US, the Chinese CGT ecosystem has numerous barriers, including limitations on foreign investment, localisation of technology and IP, varying levels of capabilities among medical organisations and inconsistent reimbursement periods. This is extremely challenging for the commercialisation of CGT products, which in turn significantly delays patient access to innovative therapies. In regard to investment access, although R&D and production of cell therapy products are encouraged in the *Catalogue of Industries for Encouraged Foreign Investment (2020)*, the current *Negative List for Foreign Investment* still states China will “prohibit investment in the development and application of human stem cells, genetic diagnosis and treatment technologies”.<sup>44</sup> As the *Negative List* does not provide a detailed interpretation of “prohibited investment” or define “development and application”, it causes confusion and uncertainty for foreign companies in regard to CGT clinical trials, new drug application and investment planning, to name just a few areas.

### Recommendations

- Issue unified and consistent guidelines by all relevant authorities to define the scope of “prohibited investment” and “development and application” to facilitate investment and R&D planning by foreign companies.
- Allow pilot projects in selected areas, for example, the ‘two zones’ of Beijing, the Pudong New Area of Shanghai, Tianjin Free Trade Zone, the GBA and Hainan Free Trade Port, to gradually ease foreign investment restrictions before applying successful outcomes nationwide.
- Solicit advice from enterprises, industry associations and chambers of commerce on amendments to the *Negative List* and hold regular meetings with industry to explore ways to ease restrictions on foreign investment.
- Strengthen the supervision capacity and mechanisms of relevant departments, such as the NMPA, the Human Genetic Resources Administration of China and the NHC, to support post-market surveillance once *Negative List* restrictions are lifted.<sup>45</sup>

44 *Foreign Investment Negative List 2021 Edition*, 27<sup>th</sup> December 2021, viewed 4<sup>th</sup> July 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-12/28/content\\_5664886.htm](http://www.gov.cn/zhengce/zhengceku/2021-12/28/content_5664886.htm)>

45 While most developed markets do not prohibit foreign investment in CGT, comprehensive supervision mechanisms to monitor the manufacture of CGT related products is a standard practice.





## Abbreviations

BMI	Basic Medical Insurance
CDE	Center for Drug Evaluation
CGT	Cell and Gene Therapy
CHI	Commercial Health Insurance
ChP	Chinese Pharmacopeia
CMC	Chemistry Manufacturing Control
CNY	Chinese Yuan
DAL	Drug Administration Law
DCM	Drug Committee Meetings
DRR	Drug Registration Regulation
EMA	European Medicines Agency
EUR	Euro
FYP	Five-year Plan
HGR	Human Genetic Resources
ICH	International Council for Harmonisation of Technical Requirements for Pharmaceuticals for Human Use
ICMRA	International Coalition of Medicines Regulatory Authorities
IP	Intellectual Property
MAA	Marketing Authorisation Application
MAH	Marketing Authorisation Holder
MNC	Multinational Company
MOST	Ministry of Science and Technology
NHC	National Health Commission
NHSA	National Healthcare Security Administration
NIP	National Immunisation Programme
NMPA	National Medical Products Administration
NPC	National People's Congress
NRDL	National Reimbursement Drug List
PDG	Pharmacopeial Discussion Group
PIC/S	Pharmaceutical Inspection Co- operation Scheme
PRDL	Provincial Reimbursement Drug List
PTA	Patent Term Adjustment
PTE	Patent Term Extension
PTL	Patent Linkage
QC	Quality Control
R&D	Research and Development
RDP	Regulatory Data Protection
RPS	Reimbursement Payment Standards
US	United States
USD	United States Dollar
VBP	Volume-based Procurement





# Rail Working Group

## Key Recommendations

### 1. Continue to Expand Market Access and Improve Fair Competition in the Rail Industry

- Recognise that foreign-invested enterprises' (FIEs') and joint ventures' (JVs') technologies meet 'autonomous and controllable' requirements under certain circumstances pursuant to the principle of treating all company entities equally in the Foreign Investment Law.
- Ensure the full participation of FIEs and JVs in construction and after-sales services projects to China's 'large rail' and 'urban rail' markets.
- Eliminate the 'one-point scoring system' for subway projects and treat domestic and foreign companies equally.
- Encourage innovation of different market entities to continuously improve product quality, service, technology and safety in the rail industry.
- Remove barriers in the field of bidding, and treat all market entities fairly.

### 2. Increase the Participation of FIEs and Utilise Their Advantages in National Initiatives and Projects in Order to Boost the Economy

- Establish a dialogue mechanism to take into account the views of FIEs in China when formulating and implementing national initiatives such as 'new infrastructure' and the Belt and Road Initiative, and when implementing plans.
- Provide more support on innovation and research and development support for FIEs.
- Facilitate the exchange of leading global industrial practices, innovations and technologies for rail tracks, adjacent property assets, and systems operation and maintenance, through collaborative European Union-China infrastructure projects, both within China and overseas.

### 3. Promote the Adoption and Absorption of FIEs' Advanced Technologies in the Rail Industry to Help the Formulation of Domestic Standards and Technical Specifications, and Improve the Participation of FIEs and JVs in, and Transparency of, the Formulation Process

- Provide equal access to all companies legally registered in China to participate in the standardisation activities of relevant technical committees or working groups, and give them the right to vote.
- Ensure that FIEs equally participate in the formulation of national standards, industry standards, social organisation standards and enterprise standards, and encourage close and non-discriminatory coordination between standard-setting bodies and FIEs.
- Encourage the adoption of advanced technologies in Chinese standards, and their convergence with international standards.
- Accelerate the modernisation of the rail standards system, to make it fair, reasonable, inclusive, and transparent, and make the extensive participation of stakeholders in the standard-setting process in the important evaluation indicator.
- Regulate the standardisation activities of associations and recognise standards of associations





as national standards or industry standards before applying them to the product certification system.

- Establish a mechanism for regular exchanges between key stakeholders in Europe and China, in particular with major Chinese state-owned enterprises, to promote understanding of the direction of technology and standards development.

#### 4. Improve the Rail Industry Supply Chain through Further Improved Protection of Intellectual Property Rights (IPR)

- Improve IPR enforcement in order to encourage increased investment in the rail industry and to foster the participation of small and medium-sized enterprises in the supply chain.

## Introduction to the Working Group

The Rail Working Group consists of manufacturers of vehicles, infrastructure, and signal, traction and braking systems, as well as service providers, in the rail industry. It represents the common interests of the European rail transport industry, promoting market access and fair competition, as well as participation in national and third-country infrastructure projects and standardisation activities.

## Recent Developments

China's rail industry has grown rapidly in the last few years. According to the Ministry of Transport (MOT), during the 13<sup>th</sup> Five-year Plan (FYP) period from 2016 to 2020, China's total operating railway network reached 146,000 kilometres (km), covering 99 per cent of cities with a population of more than 200,000 people. The total length of high-speed rail is about 38,000 km, ranking first in the world and covering 95 per cent of China's cities with a population of one million or above.<sup>1</sup> The total length of urban rail in operation in 50 major cities in Mainland China reached nearly 9,200 km as of 31<sup>st</sup> December 2021, including more than 7,250 km of subways accounting for 78.9 per cent of total urban rail. In 2021 alone, a total of more than 1,200 km of new urban rail transit lines were added, with 39 new lines coming into operation.<sup>2</sup> However, compared with developed countries, China's rail industry still has a lot of room for development.

The Chinese Government attaches great importance to the development of its rail industry, and has issued a series of national guiding policies and documents to develop "a country with a strong transportation network".<sup>3</sup> On 11<sup>th</sup> March 2021, the National People's Congress (NPC) adopted the *Outline of the 14<sup>th</sup> Five-year Plan for National Economic and Social Development and the Long-range Objectives Through the Year 2035 (14FYP)*,<sup>4</sup> which, among other things, states China's intention to "speed up the construction of a country with a strong transportation network, by building a modern and comprehensive transportation system, and promote the integrated development of various modes of transportation, and improving the network effect and operational efficiency". The 14FYP includes the planning of strategic backbone channels,<sup>5</sup> high-speed railway, ordinary railway, urban agglomeration, and urban rail transportation. At the 2022 'Two Sessions', many rail transportation proposals were raised, including that national industrial authorities should coordinate on and promulgate a dedicated fifth generation mobile network (5G) frequency for the rail industry as soon as possible.

<sup>1</sup> *Press Conference Held by the State Council Information Office on Transport Development Achievements in the Period of the 13<sup>th</sup> Five-Year Plan*, MOT, 22<sup>nd</sup> October 2020, viewed 23<sup>rd</sup> May 2022, <<https://www.mot.gov.cn/2020wangshangzhibo/shisanwufzcj/>>

<sup>2</sup> *Association Express: Overview of Urban Rail Transit Routes in Mainland China in 2021*, China Association of Metros, 31<sup>st</sup> December 2021, viewed 14<sup>th</sup> March 2022, <<https://www.camet.org.cn/xhfb/9269>>

<sup>3</sup> *The CPC Central Committee and the State Council Issued the Programme of Building National Strength in Transportation*, Central People's Government of the People's Republic of China (PRC), 19<sup>th</sup> September 2019, viewed 23<sup>rd</sup> May 2022, <[http://www.gov.cn/zhengce/2019-09/19/content\\_5431432.htm](http://www.gov.cn/zhengce/2019-09/19/content_5431432.htm)>

<sup>4</sup> *The Outline of the 14<sup>th</sup> Five-Year Plan for National Economic and Social Development and the Long-Range Objectives Through the Year 2035 of the People's Republic of China*, Central People's Government of the PRC, 13<sup>th</sup> March 2021, 23<sup>rd</sup> May 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592681.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm)>

<sup>5</sup> China's strategic backbone channels include comprehensive transportation corridors, exit and entry channels of Xinjiang and Tibet, central and western region channels, and river and coastal channels: *The draft outline of the 14FYP and the long-range objectives through the year 2035 proposed the acceleration of the construction of a country with a strong transportation network and to improve the network effect and operational efficiency*, MOT, 8<sup>th</sup> March 2021, viewed 23<sup>rd</sup> May 2022, <[https://www.mot.gov.cn/jiaotongyaowen/202103/t20210308\\_3529817.html](https://www.mot.gov.cn/jiaotongyaowen/202103/t20210308_3529817.html)>





At the Fifth Plenary Session of the 19<sup>th</sup> Central Committee of the Communist Party of China (CPC) in October 2020, President Xi Jinping emphasised the need to "coordinate the advancement of infrastructure construction and accelerate China's construction towards a transportation powerhouse".<sup>6</sup> In August 2020, the China State Railway Group Co. Ltd (China Railway) released the *Outline of Advanced Railway Planning Towards Becoming a Transport Powerhouse in the New Era*, which described the two main goals for 2035 and 2050:<sup>7</sup>

- building a strong and modernised transportation system that is advanced by international standards by 2035; and
- becoming an important player in global railway development and an important participant in the formulation of global railway standards by 2050.

Despite the promising rail transportation market, the working group noticed that tighter national restrictions on approving urban rail and subway projects have been imposed in recent years, based on a series of policy documents such as the *Opinions on Further Improving Railway Planning and Construction Work* issued by the National Development and Reform Commission (NDRC) in 2021,<sup>8&9</sup> which emphasises preventing and addressing debt risks. During the 14FYP period, local governments are urged to strictly manage the risks incurred by taking on debt in order to invest in urban rail. The first round of construction planning from cities that do not have the basic conditions required for urban rail construction and ordinary prefecture-level cities will not be accepted; for cities that have not met the passenger flow targets for three years of operation, a new round of construction planning cannot be submitted.

State-owned enterprises (SOEs) have played an

important role in recent years, serving as the backbone of China's rail transportation industry. The Chinese Government has put forward new requirements for SOEs, as part of a three-year reform plan for the public sector. One of the stated goals is for SOEs to further strengthen overseas outreach and cross-border acquisitions, with a focus on the integration and development of enterprises.<sup>10</sup> With these supportive policies, the working group believes foreign-invested enterprises (FIEs) and SOEs will be able to cooperate better and create a mutually beneficial situation.

In recent years, the rail industry has been rapidly digitalising and becoming more environmentally friendly. On 23<sup>rd</sup> December 2021, the National Railway Administration (NRA) issued the *14<sup>th</sup> Five-year Plan for Railway Science and Technology Innovation*, which emphasise that the rail industry should "focus on promoting the deep integration of cutting-edge technologies with the railway sector, strengthen the research and application of intelligent railway technologies, and promote the sharing of transport big data."<sup>11</sup> FIEs possess rich experience in, and cutting-edge technologies for, industrial digitalisation and interconnection of the rail transportation system, which can benefit the development of all parts of the rail industrial chain, and ultimately achieve an intelligent and digitalised industry.

Compared with other modes of transportation, rail has always led efforts to save energy and reduce carbon emissions; greening is an integral part of high-quality development of the industry. On 22<sup>nd</sup> September 2020, Chinese President Xi Jinping made a pledge that China will peak carbon emissions by 2030 and achieve carbon neutrality by 2060. On 21<sup>st</sup> January 2022, the MOT issued the *14<sup>th</sup> Five-year Plan for Green Transportation*, which focusses on accelerating energy saving and carbon reduction efforts for the whole transportation industry, and establishing more international exchanges and collaboration on green transportation.<sup>12</sup> The working group strongly supports efforts to save energy and reduce carbon emissions in the rail industry, and its members have already established decarbonisation targets and plans. Some member companies have

6 *Accelerating the Building of a Strong Transportation Country (In-depth Study and Implementation of the Spirit of the Fifth Plenary Session of the 19<sup>th</sup> CPC Central Committee)*, Huanqiu Net, 17<sup>th</sup> December 2020, viewed 23<sup>rd</sup> May 2022, <<https://baijiahao.baidu.com/s?id=1686284011216770493&wfr=spider&for=pc>>

7 *The 'Outline of Advanced Railway Planning Towards Becoming a Transport Powerhouse in the New Era' was introduced*, China Railway, 13<sup>th</sup> August 2020, viewed on 23<sup>rd</sup> May 2022, <[http://www.china-railway.com.cn/xwzx/rdzt/ghgy/mtbd/202008/t20200813\\_107702.html](http://www.china-railway.com.cn/xwzx/rdzt/ghgy/mtbd/202008/t20200813_107702.html)>

8 *General Office of the State Council Notification on the Opinions of the National Development and Reform Commission and Other Units on Further Improving Railway Planning and Construction Work*, General Office of the State Council, 29<sup>th</sup> March 2021, viewed 14<sup>th</sup> March 2022, <[http://www.gov.cn/zhengce/content/2021-03/29/content\\_5596585.htm](http://www.gov.cn/zhengce/content/2021-03/29/content_5596585.htm)>

9 *Focusing on Science and Technology Innovation, Three-Year Action Campaign to Reform State-Owned Enterprises Begins*, Central People's Government of the PRC, 12<sup>th</sup> March 2021, viewed 8<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-03/12/content\\_5592630.htm](http://www.gov.cn/xinwen/2021-03/12/content_5592630.htm)>

10 Ibid.

11 *14<sup>th</sup> Five-Year Plan for Railway Science and Technology Innovation*, NRA, 23<sup>rd</sup> December 2021, viewed 8<sup>th</sup> March 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-12/24/content\\_5664357.htm](http://www.gov.cn/zhengce/zhengceku/2021-12/24/content_5664357.htm)>

12 *14<sup>th</sup> Five-Year Plan for Green Transportation*, MOT, 21<sup>st</sup> January 2022, viewed on 8<sup>th</sup> March 2022, <[https://xxgk.mot.gov.cn/2020/jigou/zhghs/202201/t20220121\\_3637584.html](https://xxgk.mot.gov.cn/2020/jigou/zhghs/202201/t20220121_3637584.html)>





taken the lead in taking actions to achieve carbon neutrality, and are actively promoting the measurement and analysis of carbon emissions for all parts of the industrial chain.

## Key Recommendations

### 1. Continue to Expand Market Access and Improve Fair Competition in the Rail Industry

#### Concern

Wholly foreign-owned enterprises (WFOEs) and joint ventures (JVs) controlled by foreign investors are at a disadvantage to domestic enterprises under the requirement for 'autonomous and controllable' technology in the Chinese rail industry.

#### Assessment

Market access restrictions are still a major problem for FIEs wanting to invest in China's rail industry. The European Chamber's *Business Confidence Survey 2022* found that 42 per cent of respondents missed out on business opportunities due to market access restrictions, a figure that has stayed much the same for the past seven years.<sup>13</sup> In addition, in recent years, the concept for technology in China to be 'autonomous and controllable' has been mentioned frequently in important industry documents. In November 2017, the NDRC stated in the *Three-year Action Plan on Enhancing Core Competitiveness in the Manufacturing Sector (2018–2020)* that it is necessary to "develop products that are internationally advanced and that have independent intellectual property rights" to realise the "industrialisation of key rail equipment technologies".<sup>14</sup> One of the development goals stipulated in the *Outline of Advanced Railway Planning Towards Becoming a Transport Powerhouse in the New Era (Outline)*, issued by China Railway on 12<sup>th</sup> August 2020, is to "develop advanced and independent technology through innovation"; that is, to "improve the independent innovation capacity and the level of industry chain modernisation of railways, improve the science and technology innovation systems of railways, and ensure that the key core technology and

equipment is autonomous and controllable, advanced, suitable, safe and efficient."<sup>15</sup> Furthermore, the Central Economic Work Conference, held in Beijing from 16<sup>th</sup> to 18<sup>th</sup> December 2020, identified the government's priorities for 2021, with "enhancing the autonomous and controllable ability of industrial and supply chains" being the second item on the list.<sup>16</sup> On 26<sup>th</sup> August 2021, the MOT and the Ministry of Science and Technology stated in the *Opinions on Speeding up the Building of National Strength in Transportation with Scientific and Technological Innovation* that the "basic research and original innovation capabilities in the transport sector shall be comprehensively enhanced, core technologies shall become autonomous and controllable, leading technologies shall be fully integrated into the transport sector, and a basic science and technology innovation system shall be created to meet the needs to build a transportation powerhouse by 2035."<sup>17</sup>

The working group fully understands China's determination to enhance the security of industrial and supply chains, particularly in an increasingly complex global environment, and FIEs are willing to support this policy by utilising their own technological advantages and localisation strategies. However, the process of formulating and implementing specific policies in the rail industry often follows a 'one-size-fits-all' approach, which excludes FIEs and JVs controlled by foreign investors on the grounds of upholding the 'autonomous and controllable' policy. This puts FIEs at a distinct disadvantage, whereby they are unable to compete fairly with domestic enterprises. This happens particularly frequently in new construction and after-sales projects for railways, urban rail and subways. For example, when participating in the bidding of rail projects in recent years, in the scoring system, WFOEs and JVs controlled by foreign investors often receive no points in the category of 'localisation', JVs in which both Chinese and foreign stakeholders account for 50 per cent of the shares can receive half a point, while

<sup>13</sup> *The Outline of Advanced Railway Planning Towards Becoming a Transport Powerhouse in the New Era*, China Railway, 12<sup>th</sup> August 2020, viewed 23<sup>rd</sup> May 2022, <[http://www.china-railway.com.cn/xwzx/rdzt/ghgy/gdqw/202008/t20200812\\_107636.html](http://www.china-railway.com.cn/xwzx/rdzt/ghgy/gdqw/202008/t20200812_107636.html)>

<sup>14</sup> *Central Economic Work Conference Held in Beijing, Xi Jinping and Li Keqiang Made Important Speeches, Li Zhanshu, Wang Yang, Wang Huning, Zhao Leji, and Han Zheng Attended the Meeting*, *Xinhuanet*, 18<sup>th</sup> December 2020, viewed 23<sup>rd</sup> May 2022, <[http://www.xinhuanet.com/politics/leaders/2020-12/18/c\\_1126879325.htm](http://www.xinhuanet.com/politics/leaders/2020-12/18/c_1126879325.htm)>

<sup>17</sup> *Opinions of the Ministry of Transport and the Ministry of Science and Technology on Speeding up the Building of National Strength in Transportation with Scientific and Technological Innovation*, Ministry of Transport, 26<sup>th</sup> August 2021, viewed 14<sup>th</sup> March 2022, <[https://xxgk.mot.gov.cn/2020/jigou/kjs/202108/t20210826\\_3616711.html](https://xxgk.mot.gov.cn/2020/jigou/kjs/202108/t20210826_3616711.html)>

<sup>13</sup> *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 20<sup>th</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

<sup>14</sup> *Notice by the National Development and Reform Commission on the Three-year Action Plan on Enhancing Core Competitiveness in the Manufacturing Sector*, Central People's Government of the PRC, 29<sup>th</sup> November 2017, viewed 23<sup>rd</sup> May 2022, <[http://www.gov.cn/xinwen/2017-11/29/content\\_5243125.htm](http://www.gov.cn/xinwen/2017-11/29/content_5243125.htm)>



Chinese domestic enterprises or JVs controlled by Chinese investors receive a full point. This differential treatment between domestic and foreign investors is referred to as the 'one-point scoring system'. The working group has been informed that such differential treatment was still happening in some local subway bidding projects in early 2022. With the current fierce market competition in the sector, whether an original equipment manufacturer (OEM) wins a bid may be determined by a single point during the evaluation process. Therefore, in order to win bids, OEMs tend to play it safe and no longer choose foreign equipment suppliers. This unfair one-point scoring system impedes FIEs that could potentially provide competitive pricing, technologies and services, thus undermining their confidence in long-term development and investment in China. The working group notes that some FIEs have already had internal discussions on adjusting their long-term development strategies in the Chinese market.

The working group believes that the one-point scoring system seriously contradicts the Foreign Investment Law, which "encourage[s] further open[ing] up, actively promote[s] foreign investment, and protect[s] the legal rights and interests of foreign investment".<sup>18</sup> At the same time, the system prevents WFOEs and JVs controlled by foreign investors from better integrating into China's 'dual circulation' strategy. The working group recommends the authorities rescind the one-point scoring system and other differential treatment imposed on foreign or domestic enterprises.

For many years FIEs and JVs have made important contributions to China's economy, especially to the railway transportation industry, through their technological advantages, innovation, international vision and localisation of operations. Premier Li Keqiang mentioned during the Two Sessions in 2022 that China would be steadfast in expanding reform and opening up, make full use of international and domestic markets and resources, continue to expand international economic collaboration and trade, and encourage deep reforms and high-quality development by opening up to the world at a higher level. He also said that China will take multiple measures to stabilise foreign trade and make greater use of foreign investments, and will ensure that the *Negative List for Foreign Investment* is fully

<sup>18</sup> *Foreign Investment Law*, NPC, 15<sup>th</sup> March 2019, viewed 30<sup>th</sup> April 2022, <[http://www.npc.gov.cn/zgrdw/npc/xinwen/2019-03/15/content\\_2083532.htm](http://www.npc.gov.cn/zgrdw/npc/xinwen/2019-03/15/content_2083532.htm)>

observed and that FIEs will enjoy national treatment.<sup>19</sup> The working group supports this sentiment very much and will following related developments closely.

The working group also noted that, in September 2020, the NDRC mentioned in the *Notice on Further Standardising Business Qualification Review in the Bidding Process (Notice)* that the authorities should "remove hidden barriers and unreasonable thresholds in bidding to maintain a fair and competitive bidding environment [...] all types of market entities should be treated fairly."<sup>20</sup> In addition, on 13<sup>th</sup> October 2021, the Ministry of Finance (MOF) stated in the *Notice on Implementing the Policies on Equal Treatment of Domestic and Foreign-invested Companies in Government Procurement Activities (Notice 1)* that it is necessary to "ensure that domestic and foreign companies participate equally in government procurement", "treat domestic and foreign companies equally in government procurement activities" and "equally protect the rights of domestic and foreign companies in order to build an integrated, open, competitive and orderly government procurement market system and encourage fair competition in government procurement".<sup>21</sup> The working group hopes that the matters mentioned in the *Notice* and *Notice 1* can be implemented to further ensure the government's equal treatment of domestic and foreign enterprises in the procurement process.

### Recommendations

- Recognise that FIEs' and JVs' technologies meet 'autonomous and controllable' requirements under certain circumstances pursuant to the principle of treating all company entities equally under the Foreign Investment Law.
- Ensure the full participation of FIEs and JVs in construction and after-sales services projects to China's 'large rail' and 'urban rail' markets.
- Eliminate the 'one-point scoring system' for subway projects and treat domestic and foreign companies equally.

<sup>19</sup> *Government Work Report by Premier Li Keqiang (Text Abstract)*, Central People's Government of the PRC, 5<sup>th</sup> March 2022, viewed 14<sup>th</sup> March 2022, <[http://www.gov.cn/premier/2022-03/05/content\\_5677248.htm](http://www.gov.cn/premier/2022-03/05/content_5677248.htm)>

<sup>20</sup> *Notice of National Development and Reform Commission General Office and State Administration for Market Regulation General Office on Further Standardising Business Qualification Review in the Bidding Process*, NDRC & SAMR, 22<sup>nd</sup> September 2020, viewed 23<sup>rd</sup> May 2022, <[https://www.ndrc.gov.cn/xxgk/zcxfb/tz/202009/t20200928\\_1239758.html?code=&state=123](https://www.ndrc.gov.cn/xxgk/zcxfb/tz/202009/t20200928_1239758.html?code=&state=123) https>

<sup>21</sup> *Notice on Implementing the Policies on Equal Treatment of Domestic and Foreign-invested Companies in Government Procurement Activities*, Central People's Government of the PRC, 13<sup>th</sup> October 2021, viewed 14<sup>th</sup> March 2022, <[http://gks.mof.gov.cn/guizhangzhidu/202110/t20211020\\_3759590.htm](http://gks.mof.gov.cn/guizhangzhidu/202110/t20211020_3759590.htm)>





- Encourage innovation of different market entities to continuously improve product quality, services, technology and safety in the rail industry.
- Remove barriers in the field of bidding and treat all market entities fairly.

## 2. Increase the Participation of FIEs and Utilise Their Advantages in National Initiatives and Projects in Order to Boost the Economy

### Concern

FIEs' participation in national initiatives and projects will greatly encourage their long-term investment and bolster their confidence in the Chinese market, but FIEs' advantages are not being fully utilised and levels of foreign investment are currently relatively low.

### Assessment

Since its announcement, the Belt and Road Initiative (BRI) has introduced new opportunities across the Eurasian continent. It provides more regional opportunities for FIEs to invest and develop in China, and has the potential to enhance the scope of and opportunities for cooperation between FIEs and Chinese enterprises, which is conducive to the formation of complementary advantages and increasing economic benefits. The *2022 Government Work Report* mentions that China will continue to “encourage high-quality collaboration pursuant to the BRI, steadily develop infrastructure connectivity, and improve collaboration on major projects”.<sup>22</sup> According to a report by the European Union Chamber of Commerce in China on the BRI, a small number of European companies in China are involved in construction for the initiative. Of those that are taking part, “nearly 40% of (surveyed) companies believe that procurement systems for BRI projects are not transparent enough”.<sup>23</sup>

Rail transport has significant advantages over other modes of transport in terms of cost effectiveness and carbon emissions,<sup>24</sup> and many European rail companies have built up a strong presence in the international markets in BRI regions, having established stable, solid

and well-recognised local service and operation teams. However, to maintain a stable market there is a need for sharing, reciprocity and mutual assistance with regard to investment opportunities. Therefore, the underlying logic of the European companies seeking to expand their market share has been to maintain an equal distribution of benefits. The working group believes that allowing more European companies to participate in the BRI and other national strategies will help to raise the quality, feasibility and sustainability of rail projects through increased competition and the introduction of world-class technologies and services. In addition, the expertise of European equipment manufacturers and service providers can help to develop the international competitiveness of Chinese OEMs.

Since 2018, ‘new infrastructure’ construction has been one of the most significant aspects of China's domestic development, in which rail transportation plays an essential part. The experience of many developed countries shows that the planned urban agglomerations and metropolitan areas can help to improve productivity and save land and energy, which is a priority for China's development, with rail transportation being the ‘bloodline’ for the integration of urban areas.<sup>25</sup> The Central Economic Work Conference in December 2021 and the *2022 Government Work Report* reiterated the government's intent to “accelerate the construction of new types of infrastructure and carry out planning for major infrastructure construction in an appropriately advanced manner.” China also vigorously promotes the development and integration of key regions such as Beijing-Tianjin-Hebei, the Yangtze River Delta and the Greater Bay Area.<sup>26&27</sup> Members of the working group welcome these national policies and are willing to deepen their presence in the Chinese market, share their technology and experience, and increase their investment. However, the participation of FIEs in the rail industry is relatively low, and only a few are still participating in large rail projects, with many excluded due to ‘autonomous and controllable’ policies.

Many European companies are very advanced in

22 *2022 Government Work Report*, NDRC, 5<sup>th</sup> March 2022, viewed 11<sup>th</sup> March 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592786.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592786.htm)>

23 *The Road Less Travelled: European Involvement in China's Belt and Road Initiative*, European Union Chamber of Commerce in China, 16<sup>th</sup> January 2020, viewed 24<sup>th</sup> May 2022, <[http://europeanunionchamber.com.cn/en/publications-archive/762/The\\_Road\\_Less\\_Travelled\\_European\\_Involvement\\_in\\_China\\_s\\_Belt\\_and\\_Road\\_Initiative](http://europeanunionchamber.com.cn/en/publications-archive/762/The_Road_Less_Travelled_European_Involvement_in_China_s_Belt_and_Road_Initiative)>

24 *Ibid.*

25 *2022 Research Report on China's New Infrastructure Construction*, Zeping Hongguan, 28<sup>th</sup> February 2022, viewed 12<sup>th</sup> March 2022, <<http://baijiahao.baidu.com/s?id=1725968577005626648&wfr=spider&for=pc>>

26 *Central Economic Work Conference Held in Beijing, Xi Jinping and Li Keqiang Made Important Speeches, Li Zhanshu, Wang Yang, Wang Huning, Zhao Leji, and Han Zheng Attended the Meeting*, Xinhuanet, 10<sup>th</sup> December 2021, viewed 16<sup>th</sup> March 2022, <[http://www.news.cn/politics/leaders/2021-12/10/c\\_1128152219.htm](http://www.news.cn/politics/leaders/2021-12/10/c_1128152219.htm)>

27 *2022 Government Work Report*, NDRC, 5<sup>th</sup> March 2022, viewed 12<sup>th</sup> March 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592786.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592786.htm)>



upgrading and digitalising rail products and generating innovations. They also have advantages in running cross-cultural operations and a solid track record of implementing complex infrastructure projects in other countries. The working group believes that, if provided equal treatment and equal access to research and development (R&D) funding, European companies could further accelerate the development of China's rail industry, which is in line with the government's long-term sustainability goals.

#### Recommendations

- Establish a dialogue mechanism to take into account the views of FIEs in China when formulating and implementing national initiatives such as 'new infrastructure' and the Belt and Road Initiative, and when implementing plans.
- Provide more support on innovation and R&D support for FIEs.
- Facilitate the exchange of leading global industrial practices, innovations and technologies for rail tracks, adjacent property assets, and systems operation and maintenance, through collaborative European Union-China infrastructure projects, both within China and overseas.

### 3. Promote the Adoption and Absorption of FIEs' Advanced Technologies in the Rail Industry to Assist in Formulation of Domestic Standards and Technical Specifications, and Improve the Participation of FIEs and JVs in, and Transparency of, the Formulation Process



#### Concern

FIEs in the rail industry generally do not have the same opportunities to participate in the formulation of standards and specifications in the same way that local enterprises do, and they also have very limited opportunities to put forward opinions and suggestions, which may create market entry barriers and result in unfair competition.

#### Assessment

FIEs in the rail industry face four key issues when trying to participate in standards setting. First, they are usually unable to participate equally in the formulation of standards and regulations as local enterprises, and

encounter difficulties providing input on the decision-making process. Second, as a result of standardisation reform in China, social organisations have been endowed with the legal status to formulate social organisation standards for themselves. Meanwhile, such standards are often applied in product certification systems that are *de facto* mandatory. However, FIEs do not have equal rights to participate in the development of social organisation standards nor are they given the opportunity to make suggestions in practice. Third, large domestic SOEs have been pressuring external suppliers to adopt their internal standards in recent years. Due to the lack of involvement of stakeholders along the industry chain in their formulation, these internal standards often lack sophistication and have low applicability and universality. This has affected the application of advanced technologies in China to an extent, and it has become a significant hidden barrier to FIEs trying to enter the market. Last but not least, Chinese rail sector standards lack both information and transparency, some are only available to certain selected FIEs and updates to the content of standards are normally confidential and not accessible.<sup>28</sup>

The *Opinions of the Ministry of Transport on Several Issues Concerning Promoting the Modernisation of the Transport Governance System and Governance Capability*, released on 24<sup>th</sup> October 2020, state that, "improving the standard system in transportation sector, strengthening effective supply of standards in key areas, and making use of the guiding role of standardisation" is essential for boosting the modernisation of the transport administration system.<sup>29</sup> On 27<sup>th</sup> December 2021, the NRA released the *14<sup>th</sup> Five-year Plan of Railway Standardisation Development* and presented a series of specific goals and requirements. These include but are not limited to the following:

- "Support the development of social organisation standards and enterprise standards for emerging strategic segments of the rail industry and key common technologies, with the goals of building a high-standard rail market system and accelerating indigenous innovation";

<sup>28</sup> *The Shape of Things to Come: The Race to Control Technical Standardisation*, European Union Chamber of Commerce in China, December 2<sup>nd</sup> 2021, viewed 24<sup>th</sup> May 2022, <[https://european-chamber.com/wp-content/uploads/documents/documents/The\\_Shape\\_of\\_Things\\_to\\_Come\\_English\\_Final\[966\].pdf](https://european-chamber.com/wp-content/uploads/documents/documents/The_Shape_of_Things_to_Come_English_Final[966].pdf)>

<sup>29</sup> *Opinions of the Ministry of Transport on Several Issues Concerning Promoting the Modernisation of the Transport Governance System and Governance Capability*, MOT, 24<sup>th</sup> October 2020, viewed 23<sup>rd</sup> May 2022, <[http://xxgk.mot.gov.cn/2020/jigou/zcyjs/202010/t20201024\\_3479808.html](http://xxgk.mot.gov.cn/2020/jigou/zcyjs/202010/t20201024_3479808.html)>





- “Encourage companies [...] to set enterprise standards that are technologically more advanced than national and industry standards to improve product and service quality”;
- “Encourage [...] the transformation of social organisation standards into national and industry standards”;
- “Proactively reference standards when making regulations and policy documents”;
- “Accurately adopt standards in industry development, industry management, market access, and safety and quality supervision and management.”<sup>30</sup>

The above policy statements indicate that during the 14FYP period, the relationship among social organisation standards, enterprise standards and industry access and market supervision in the field of rail transportation is set to become closer. Given that FIEs in the rail industry operating in China also need to ensure compliance with relevant standards and technical specifications, it is particularly important to allow them to participate as equal market players in the formulation of standards, technical specifications and the corresponding conformity assessment systems, and to encourage them to liaise and cooperate closely with the relevant standard-setting bodies.

Some positive signs have been expressed in relevant policy documents in this regard. On 23<sup>rd</sup> February 2022, 17 government agencies, including the Standardisation Administration of China (SAC) and the MOT, jointly issued the *Opinions on Encouraging the High-quality and Standardised Development of Social Organisation Standards*, requiring the participation of a wide range of stakeholders including production, operation, management, construction, consumption, testing and certification, and other entities. It also encourages standards-setting organisations to establish systems to attract FIEs and foreign experts to participate in the development of social organisation standards.<sup>31</sup> *The 14<sup>th</sup> Five-year Plan for Railway Standardisation Development* also indicated that China should “deepen railway standardisation exchange and cooperation [...] ensure timely tracking of international and foreign railway technical standards developments, strengthen

international standards research as well as the in-depth research and analysis of the differences and similarities of Chinese and foreign standards, and enhance the conversion rate of applicable standards.”<sup>32</sup> European companies operating in China have actively participated in formulating several international railway standards, and have accumulated rich experience in the development, applicability and trends of rail transportation industry standards. They have also actively participated in the analysis and research of international standards, and can thus make valuable contributions. The working group therefore recommends that FIEs be allowed equal participation in China's standardisation activities, as enshrined in the Foreign Investment Law, the Standardisation Law and the principles of the negotiated European Union-China Comprehensive Agreement on Investment. The working group further suggests that the fairness, rationality, openness and transparency, as well as extensive participation by all stakeholders, in the standard-setting process be taken as important indicators for improving the modernisation of the standards system for the rail industry.

FIEs' interest in taking part in the setting of rail-related standards and technical specifications derives from their willingness to access the Chinese rail market and specific projects, and is without prejudice to the economic and technological security objectives that China's indigenous innovation policies seek to ensure. On the contrary, allowing international participation in the Chinese standardisation system is conducive for Chinese domestic companies to stay abreast of technology and standardisation trends at the international level, and absorb what they need, thereby contributing to indigenous innovation. In light of the macro circumstances and industry realities, FIEs are willing to contribute to the long-term, gradual improvement of the standardisation system. Yet it is important to note, already at this stage, that the standards created for the market should remain market-orientated and technology neutral, so as to allow market players—FIEs included—to plan technology, capital, personnel and other inputs in an efficient and effective manner.

<sup>30</sup> 14<sup>th</sup> Five-year Plan for Railway Standardisation Development, NRA, 27<sup>th</sup> December 2021, viewed 14<sup>th</sup> March 2022, <[http://www.nra.gov.cn/jglz/fgzd/gfwj/202112/t20211227\\_309143.shtml](http://www.nra.gov.cn/jglz/fgzd/gfwj/202112/t20211227_309143.shtml)>

<sup>31</sup> *Opinions on Encouraging the High-quality Development of Association Standards and Regulations*, SAC and 16 other government agencies, 23<sup>rd</sup> February 2022, viewed 14<sup>th</sup> March 2022, <<https://www.samr.gov.cn/bzcxszcfcg/202202/P020220223539027798259.pdf>>

<sup>32</sup> 14<sup>th</sup> Five-year Plan for Railway Standardisation Development, NRA, 27<sup>th</sup> December 2021, viewed 14<sup>th</sup> March 2022, <[http://www.nra.gov.cn/jglz/fgzd/gfwj/202112/t20211227\\_309143.shtml](http://www.nra.gov.cn/jglz/fgzd/gfwj/202112/t20211227_309143.shtml)>



## Recommendations

- Provide equal access to all companies legally registered in China to participate in the standardisation activities of relevant technical committees or working groups, and give them the right to vote.
- Ensure FIEs can participate equally in the formulation of national standards, industry standards, social organisation standards and enterprise standards and encourage close and non-discriminatory coordination between standards-setting bodies and FIEs.
- Encourage the adoption of advanced technologies in Chinese standards, and their convergence with international standards.
- Accelerate the modernisation of the rail standards system, to make it fair, reasonable, inclusive and transparent, and make the extensive participation of stakeholders in the standards-setting process an important evaluation indicator.
- Regulate the standardisation activities of associations and recognise standards of associations as national standards or industry standards before applying them to the product certification system.
- Establish a mechanism for regular exchanges between key stakeholders in Europe and China, in particular with major Chinese SOEs, to promote understanding of the direction of technology and standards development.

## 4. Optimise the Rail Industry Supply Chain by Further Improving Intellectual Property Rights (IPR) Enforcement

### Concern

Poor IPR enforcement discourages technological innovation in the rail industry, especially by specialised small and medium-sized enterprises (SMEs).

### Assessment

In the *Business Confidence Survey 2022*, 86 per cent of respondents reported that China's written intellectual property laws and regulations are excellent or adequate. However, 46 per cent of respondents report that IPR enforcement is inadequate.<sup>33</sup> As a result, many are reluctant to bring their latest technology to China, which has the potential to affect project execution and partnerships between foreign and Chinese companies.

<sup>33</sup> *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022 viewed 20<sup>th</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

In the rail industry, SMEs can drive innovation and technological progress for the industrial supply chain. They have the flexibility and specialised expertise to actively promote innovation and provide necessary products and services for larger rail companies. Specialised companies are normally active in multiple industries, which helps them to introduce best practices and cutting-edge technologies from elsewhere.

To ensure the healthy development of the rail industry, China needs to secure the participation of SMEs. Meanwhile, as IPR is crucial to SMEs, China will need to continue to improve its IPR enforcement regime.

### Recommendation

- Improve IPR enforcement in order to encourage increased investment in the rail industry and to foster the participation of SMEs in the supply chain.

## Abbreviations

5G	fifth generation mobile network
BRI	Belt and Road Initiative
CPC	Communist Party of China
FIE	Foreign-invested Enterprise
FYP	Five-year Plan
IPR	Intellectual Property Rights
JV	Joint Venture
km	Kilometre
MOF	Ministry of Finance
MOT	Ministry of Transportation
NDRC	National Development and Reform Commission
NPC	National People's Congress
NRA	National Railway Administration
OEM	Original Equipment Manufacturer
PRC	People's Republic of China
R&D	Research and Development
SAC	Standardisation Administration of China
SME	Small and Medium-sized Enterprise
SOE	State-owned Enterprise
WFOE	Wholly Foreign-owned Enterprise



# Section Four

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Services

# 4





## Services

The Services section of the *Position Paper* includes four working groups and three sub-working groups of the European Chamber:

- Aviation and Aerospace
- Construction
  - Heating
- Information and Communication Technology (ICT)
  - Cybersecurity
- Logistics
  - International Liner Shipping

In 2021, China's gross domestic product (GDP) growth rate was 8.1 per cent,<sup>1</sup> with the services industry achieving a growth rate of 8.2 per cent and accounting for 53.3 per cent of GDP.<sup>2&3</sup>

According to the European Chamber's *Business Confidence Survey 2022*, while 2021 revenues improved for European companies' China operations overall,<sup>4</sup> it was a mixed bag for those in the service industry. For example, while more than three quarters of respondents in the logistics and transportation sector reported revenue increases of over five per cent, more than a third of respondents in the aviation and aerospace sector reported revenue decreases of over five per cent, half of which reported decreases of over 20 per cent.<sup>5</sup>

While China's service sector rebounded better than expected in the first two months of 2022, things took a turn for the worse following Russia's invasion of Ukraine and the mass lockdowns that were imposed across China in an effort to contain outbreaks of the COVID-19 Omicron variant. According to a flash survey conducted by the European Chamber at the end of April 2022, because of China's stringent COVID-19 containment measures, 94 per cent of respondents reported a negative impact on their ability to conduct face-to-face meetings, and 97 per cent reported a negative impact on business travel—both of which are crucial for the healthy functioning of the service sector—and around 60 per cent reduced their 2022 revenue projections.<sup>6</sup>

According to the International Air Transportation Association (IATA), both international travel to China and domestic travel in China remain at a very low level. China's international ticket sales per month were 97 per cent below 2019 levels between January 2022 and May 2022.<sup>7</sup> As of June 2022, the China Civil Aviation Administration (CAAC) continues to issue circuit-breaker orders to

1 *Statistical Communiqué of the People's Republic of China on the 2021 National Economic and Social Development*, National Bureau of Statistics of China (NBSC), 28<sup>th</sup> February 2022, viewed 14<sup>th</sup> July 2022, <[http://www.stats.gov.cn/english/PressRelease/202202/t20220227\\_1827963.html](http://www.stats.gov.cn/english/PressRelease/202202/t20220227_1827963.html)>.

2 Ibid.

3 Ibid.

4 *Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 14<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

5 Ibid.

6 *Flash Survey: COVID-19 and The War in Ukraine: The Impact on European Business In China*, European Union Chamber of Commerce in China, 5<sup>th</sup> May 2022, viewed 14<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-flash-survey-2022>>

7 *China's New COVID Lockdowns Hit Domestic Air Travel*, IATA, 29<sup>th</sup> April 2022, viewed 23<sup>rd</sup> July 2022. <<https://www.iata.org/en/iata-repository/publications/economic-reports/chinas-new-covid-lockdowns-hit-domestic-air-travel/>>

international flights.<sup>8,9</sup> The European Chamber is advocating the Chinese authorities to accelerate reasonable resumption of air transportation and the mobility of people and air cargo between China and the European Union (EU) as soon as possible.<sup>10</sup>

The full or partial closure of at least 45 cities starting in April 2022, as COVID-19 containment measures were tightened, had a severe impact on the logistics industry. For example, commercial freight volume was down 9.9 per cent year-on-year. Express delivery providers faced inconsistent and sporadic rules that blocked the passage of vehicles in different parts of the country, leading to a large backlog of express shipments at airports and distribution centres. Although the State Council and relevant ministries have jointly published multiple policies to standardise control measures throughout the country,<sup>11</sup> there has only been a gradual improvement.<sup>12</sup>

In addition to these new issues, and the increased uncertainty that they bring, traditional challenges of doing business in China remain, and in some cases have deteriorated. Market access barriers, standardisation and data security regulations remain key concerns for European companies operating in China.

For example, 64 per cent of surveyed member companies of the Aviation and Aerospace Working Group reported that they have missed business opportunities due to market access barriers.<sup>13</sup> International computer reservation system providers are prevented from fully operating in China due to the Interim *Permit Management Measures of Using and Entering the Foreign Computer Tickets Reservation System by the Sales Agency Appointed by Foreign Airline Carriers in China* (CCAR315) and other relevant policies, even though this sector is not on the *Negative List for Foreign Investment*.<sup>14</sup>

China's construction and building sector is the largest in the world. It discharged roughly 20 per cent of both China's total emissions and global construction emissions in 2020,<sup>15</sup> making decarbonisation of this sector crucial for China to reach its 30/60 Goals.<sup>16</sup> According to the China Association of Building Energy Efficiency, without introducing any new technologies or approaches, peaking emissions in the construction and building sector will only be possible by 2040, which would be a real blow to China's carbon neutrality drive.<sup>17</sup> Key to greening the sector will be introducing a

8 CAAC Issues Circuit-breaker Orders for Multiple Inbound Flights, CAAC, 6<sup>th</sup> July 2022, viewed 23<sup>rd</sup> July 2022, <[http://www.caac.gov.cn/en/XWZX/202207/20220706\\_214013.html](http://www.caac.gov.cn/en/XWZX/202207/20220706_214013.html)>

9 Circuit breakers are regulatory measures to temporarily halt trading on an exchange. On 4<sup>th</sup> June 2020, the CAAC issued the *Notice on Adjustments to International Passenger Flights*, which introduced the circuit breakers measures to manage inbound international flights to China. This policy introduced a reward and suspension mechanism, with detailed policies for the carriers to increase or suspend flights. For more information, please view: *CAAC Notice on Adjustments to International Passenger Flights*, CAAC, 4<sup>th</sup> June 2020, viewed 19<sup>th</sup> August 2022, <[http://www.caac.gov.cn/en/XWZX/202006/20200604\\_202949.html](http://www.caac.gov.cn/en/XWZX/202006/20200604_202949.html)>

10 For more information, please read the Aviation and Aerospace Working Group Paper on p. 307.

11 For example, on 14<sup>th</sup> April, the State Council issued the *Notice of the Special Class for Traffic Control and Transportation Support of the Comprehensive Group of the Joint Prevention and Control Mechanism of the State Council on Making Every Effort to Ensure the Smooth Flow of Freight Logistics*, State Council, 14<sup>th</sup> April 2022, viewed 14<sup>th</sup> July 2022, <[http://www.gov.cn/xinwen/2022-04/14/content\\_5685295.htm](http://www.gov.cn/xinwen/2022-04/14/content_5685295.htm)>

12 For more information, please read the *Logistics Working Group Position Paper* on p. 357.

13 *Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 14<sup>th</sup> July 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

14 For more information, please read the *Aviation and Aerospace Working Group Position Paper* on p. 307.

15 Wang, Yuanfeng, *China's carbon neutrality challenge*, *China Daily*, 27<sup>th</sup> November 2020, viewed 14<sup>th</sup> July 2022, <<https://www.chinadailyhk.com/article/150772>>

16 China's 30/60 Goals are to peak carbon emissions before 2030 and to achieve carbon neutrality by 2060.

17 *Interview with President of China Association of Building Energy Efficiency Wu Yong*, Secretariat of China Association of Building Energy Efficiency, 7<sup>th</sup> September 2021, viewed 15<sup>th</sup> July 2022, <<https://www.cabee.org/site/content/24137.html>>



clear and transparent legal framework for the certification of 'green' buildings. Currently, there are more than 10 different standards used for assessing different types of buildings at different stages of the construction process. Furthermore, as the application of green building labels is voluntary, it is difficult for European businesses to effectively promote their leading green technologies, building materials and expertise.<sup>18</sup>

As digitalisation looks set to underpin China's economic growth in the coming decades, the challenges facing European companies in the ICT industry unfortunately look set to increase, as China seeks to increase self-reliance in related technologies under the banner of 'national security'. Although European ICT companies have played an important role in supplying infrastructure, devices, services and applications to and in China, they have, by and large, been excluded from new opportunities in the market. This can be clearly seen in the continued drop in market share of European providers. By the end of 2021, China had deployed 1.42 million fifth generation mobile technology (5G) base stations (more than 60 per cent of the global total) and developed 355 million 5G subscribers (more than 70 per cent of the global total). At the same time, the percentage market share of European 5G service providers dropped to a single digit after having been around 30 per cent for the provision of 4G services. This has seriously weakened the strategic importance of the China market to EU investors in key ICT market segments, led to a de-prioritisation of China in global investment planning, and jeopardised the outlook for EU-China global collaboration in the broader ICT industry.<sup>19</sup> Ongoing restrictions on foreign shareholders in value-added telecommunication services also remain a key concern for the sector.<sup>20</sup> The burdensome and vaguely-defined requirements for data localisation, data security and cybersecurity are not only concerns for ICT and cybersecurity-related service providers but for all companies that need to communicate with either their headquarters or overseas branches.<sup>21</sup>

Last but not least, after more than 20 years of advocacy, the International Liner Shipping Sub-working Group had a breakthrough in November 2021, when the State Council announced permission, on a pilot basis, for foreign carriers to carry out cargo relay to/from three northern China ports for transshipment at Yangshan Port. It is believed that this will create new business opportunities, and reduce emissions and costs, while improving operational efficiency. However, there still a need to address certain restrictions that are preventing foreign carriers from fully utilising this opportunity.<sup>22</sup>

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18 For more information, please read the *Construction Working Group Position Paper* on p. 316

19 For more information, please refer to the *Information and Communication Technology Working Group Paper* on p. 335.

20 For more information, please refer to the *Information and Communication Technology Working Group Paper* on p. 335.

21 For more information, please refer to the *Cybersecurity Sub-Working Group Paper* on p. 347.

22 For more information, please read the *International Liner Shipping Sub-working Group Position Paper* on p. 368.



# Aviation and Aerospace Working Group

## Key Recommendations

### 1. Accelerate Full Resumption of Air Transportation for People and Cargo between China and the European Union (EU) 2

- Accelerate full resumption of air transportation and the mobility of people and air cargo between China and the EU.
- Consult with the European Commission, EU Member States, the European Aviation Safety Agency, and international bodies such as the International Civil Aviation Organization and the International Air Transport Association (IATA), to create an agreed system for mutual recognition of health information, and promote the use of digital health certificates for international passengers.
- Synchronise the requirement of cycle threshold levels in polymerase chain reaction (PCR) tests for infected inbound passengers with the requirement for local COVID-19 patients for discharge from hospital.
- Skip PCR testing procedures on foreign crew members to ensure return flights' operational reliability as the current closed-loop quarantine layover arrangement is watertight.
- Resume as early as possible consultations between China and EU Member States to ensure the restoration of bilateral air traffic entitlements as granted by Air Service Agreements, in order to facilitate a gradual and orderly resumption of international traffic, with a roadmap of border opening that will be consistent nationwide.
- Commit to applying international practices, as defined by the IATA, on slot allocation at airports to ensure fast recovery of air traffic flows with a reasonable grace period to allow airlines to adjust capacity back to pre-COVID-19 levels.

### 2. Realise the Full Potential of the Negative List (2021), and Relevant International, Regional or Bilateral Agreements Signed by the EU and China

- Review past policies and regulations and promptly abandon those that are not in compliance with the *Negative List (2021)*.
- Promote EU-China collaboration in the aviation industry in rule-making, regulatory approvals and policy implementation.
- Simplify airworthiness approval processes by effectively implementing the Bilateral Aviation Safety Agreement/Technical Information Procedures.
- Strengthen the consultation process to allow industry stakeholders to contribute their expertise and experience to improve industry governance.

### 3. Increase the Efficiency of Airspace Utilisation in China 6

- Enhance the utilisation of new data exchange technologies and systems interoperability in the aviation sector to ease airspace congestion and improve efficiency in the short term.
- Develop innovative operational concepts, procedures and human resources to maintain a high level of safety of air traffic management (ATM) services, while developing flexibility, capacity and service orientation, and reducing the environmental impact of flying.





- Utilise EU and China expertise to implement a nation-and system-wide information management-based data communication platform with a centralised pool of data.
- Increase EU-China bilateral cooperation in the field of new applications and operational concepts covering airspace design, flow management and interoperable flight management between flight information regions.
- Improve aircraft arrival capacity at major airports by implementing distance-based and time-based separation.
- Enhance exchanges between the European and Chinese authorities and industry to enable harmonisation of unmanned aerial vehicle standards and regulations, and integration of ATM and unmanned aircraft systems traffic management.
- Increase communication and explore a new framework to comply with both EU and China requirements for data management to improve collaboration on data-driven applications and platforms.

#### 4. Accelerate the Development of a Sustainable Ecosystem in China and Europe by Deepening Business-driven Actions Under Suitable Research, Legal, Standards and Investment Cooperation Frameworks

- Create a trusted and long-term communication channel between the EU and China, dedicated to the development of sustainable aviation.
- Cooperate on scenarios to prepare for the future of decarbonised aviation, including but not limited to sustainable air fuels, power-to-liquid technology and hydrogen.
- Relaunch projects on industrialisation of alternative fuels including power-to-liquid technologies and hydrogen by creating concrete-use cases.
- Leverage existing and previous cooperation frameworks, such as Horizon Europe, to implement concrete projects on sustainable aviation technology.

## Introduction to the Working Group

The Aviation and Aerospace Working Group includes over 50 passenger and freight air carriers and manufacturers of a wide range of aerospace products, including civil aircraft, engines, helicopters, space systems and other products across the supply chain. It is also comprised of maintenance and service companies that carry out repairs, training and other activities that support the aviation and aerospace industries.

COVID-19 has had a devastating impact on the aviation and aerospace industries. The working group has worked relentlessly to address several directly and indirectly related issues. These include discussions with the authorities addressing: the resumption of flights; the waiver of slot rights in China and Europe;

Industry 4.0 and the intelligent aviation industry; post-crisis industrial development; smart aviation; air cargo business; airworthiness certification; implementation of the European Union (EU)-China Bilateral Aviation Safety Agreement (BASA) and Technical Information Procedures (TIP), and mutual recognition of vaccinations, among others. The working group also worked on strengthening communication and partnerships with Chinese and European stakeholders in the interest of enhancing EU-China aviation cooperation and facilitating European business in China. Activities focussed on the 14<sup>th</sup> Five-year Plan (14FYP) in the areas of civil aviation and transportation, unmanned aerial vehicle (UAV) technology and market development in China and Europe, and sustainable development and emissions reduction.

The working group maintains a sound relationship





with key stakeholders, including the Civil Aviation Administration of China (CAAC), the Ministry of Industrial Information and Technology, the Civil Aviation University of China, the International Air Transport Association (IATA), the International Civil Aviation Organization (ICAO), the China Quality Certification Centre, the Chinese Aeronautical Establishment, the China Aeronautical Research and Development Centre, the European Aviation Safety Agency (EASA), the Directorate General for Transportation at the European Commission, and the embassies of EU Member States in China. The working group also maintains communication with other Chinese entities like the China-Europe Association for Technical and Economic Cooperation Constitution, and industrial actors like the Aviation Industry Corporation of China, the Commercial Aircraft Corporation of China (COMAC), and several Chinese airlines, among others.

## Recent Developments

By the beginning of 2022, both domestic and international air travel in China had only slowly recovered,<sup>1</sup> mainly due to COVID-19 testing and quarantine requirements.<sup>2</sup> It is projected that the global aviation sector will recover to pre-pandemic levels by 2023.<sup>3</sup> Despite increased oil prices, safety concerns and, in particular, strict restrictions,<sup>4</sup> China is targeting the recovery of international air travel from 2023 to 2025.<sup>5</sup> Any such recovery depends to a large extent on the implementation of effective vaccination programmes and their global recognition.

The development of aviation intelligence and information technologies is accelerating. China has certain advantages in the manufacture of feeder liners, general aviation aircraft, helicopters and rescue planes,<sup>6</sup> and is one of a few countries capable of assembling

large aircrafts. However, China needs to make further reforms in its aviation industry while also improving its legal system and strengthening international cooperation, both to break through the bottlenecks of administrative inefficiencies and boost innovation.

According to the 14<sup>th</sup> Five-year Plan for Civil Aviation Development in China, published by the CAAC in January 2022, China is committed to developing a smarter, greener and more efficient aviation sector from 2021 to 2025.<sup>7</sup> The plan highlights that China will promote the application of sustainable air fuels (SAFs), develop a market-orientated emission reduction mechanism,<sup>8</sup> and accelerate the circular economy of aircraft.<sup>9</sup> China is targeting an increase in utilisation of SAFs by 50,000 tonnes from 2021 to 2025 and promotion of the development of electric and gas-electric aeroplanes. China is also planning to increase the digitalisation of the civil aviation industry and develop a high-quality air logistics system.<sup>10&11</sup>

2022 marks the tenth year of the aviation industry's inclusion in the EU emissions trading system (ETS), the world's first international ETS. Over the last decade, all airlines operating in Europe have been required to monitor, report and verify their carbon dioxide (CO<sub>2</sub>) emissions.<sup>12</sup> In December 2019, the EU launched the European Green Deal, which sets a goal for the transport industry to reduce carbon emissions by 90 per cent by 2050 compared to 1990 levels.<sup>13</sup> A group of new proposals was approved by the European Commission's Directorate-General for Climate Action in July 2021 to facilitate the EU's climate

1 Passenger Traffic Recovery Continues in March, IATA, 4<sup>th</sup> May 2022, viewed 10<sup>th</sup> June 2022, <<https://www.iata.org/en/pressroom/2022-releases/2022-05-04-01/>>

2 Progress in Opening the World to Travel, IATA, 17<sup>th</sup> March 2022, viewed 12<sup>th</sup> April 2022, <<https://www.iata.org/en/pressroom/2022-releases/2022-03-17-01/>>

3 Cornwell, Alexander, Airline body IATA now sees industry recovery in 2023, IATA, 10<sup>th</sup> May 2022, viewed 31<sup>st</sup> May 2022, <<https://www.reuters.com/business/aerospace-defense/iata-boss-says-high-fuel-prices-not-likely-impact-travel-demand-now-2022-05-09/>>

4 Airlines, airports, regulators scramble to ferret out flight hidden risks in wake of crash, Global Times, 30<sup>th</sup> March 2022, viewed 12<sup>th</sup> April 2022, <<https://www.globaltimes.cn/page/202203/1257199.shtml>>

5 China targets 2023–2025 for recovery in international air travel, Reuters, 7<sup>th</sup> January 2022, viewed 24<sup>th</sup> April 2022, <<https://www.reuters.com/world/china-targets-over-270-civil-airports-by-2025-aviation-regulator-2022-01-07/>>

6 China's AG600 large amphibious aircraft gets financial-leasing support, Xinhua, 4<sup>th</sup> March 2022, viewed 12<sup>th</sup> April 2022, <<https://english.news.cn/20220304/2d1586655c5f4ce39ab79d3156654069/c.html>>

7 The 14<sup>th</sup> Five-year Plan for Civil Aviation Development is issued, CAAC, 7<sup>th</sup> January 2022, viewed 12<sup>th</sup> April 2022, <[http://www.caac.gov.cn/XWZX/MHYW/202201/t20220107\\_210799.html](http://www.caac.gov.cn/XWZX/MHYW/202201/t20220107_210799.html)>

8 According to the 14<sup>th</sup> Five-year Plan for Civil Aviation Development, a market-based voluntary emission mechanism as opposed to a government-led mandatory emission mechanism is promoted. For example, under a market-orientated emission mechanism, a company with expertise in energy-saving equipment (company A) can offer services to a steel-making company in need of lowering emission costs (company B). Thus, A and B can realise win-win results.

9 Notice by the CAAC on issuing the 14<sup>th</sup> Five-year Special Plan for Green Development of Civil Aviation, CAAC, 21<sup>st</sup> December 2021, viewed 12<sup>th</sup> April 2022, <[http://www.caac.gov.cn/XXGK/XXGK/FZGH/202201/t20220127\\_211345.html](http://www.caac.gov.cn/XXGK/XXGK/FZGH/202201/t20220127_211345.html)>

10 Notice by the CAAC on issuing the Roadmap for Smart Development of Civil Aviation, CAAC, 21<sup>st</sup> January 2022, viewed, 12<sup>th</sup> April 2022, <[http://www.caac.gov.cn/XXGK/XXGK/ZCFB/202201/t20220121\\_211212.html](http://www.caac.gov.cn/XXGK/XXGK/ZCFB/202201/t20220121_211212.html)>

11 CAAC issued the 14<sup>th</sup> Five-year Special Plan for Air Logistics Development, CAAC, 16<sup>th</sup> February 2022, viewed 12<sup>th</sup> April 2022, <[http://www.caac.gov.cn/XWZX/MHYW/202202/t20220216\\_211783.html](http://www.caac.gov.cn/XWZX/MHYW/202202/t20220216_211783.html)>

12 Aviation and the EU ETS, European Commission, viewed 12<sup>th</sup> April 2022, <[https://ec.europa.eu/clima/eu-action/european-green-deal/delivering-european-green-deal/aviation-and-eu-ets\\_en](https://ec.europa.eu/clima/eu-action/european-green-deal/delivering-european-green-deal/aviation-and-eu-ets_en)>

13 Providing Efficient, Safe and Environmentally Friendly Transport, European Commission, viewed 12<sup>th</sup> April 2022, <[https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal/transport-and-green-deal\\_en](https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal/transport-and-green-deal_en)>





neutrality commitments, which emphasise a “route-based approach” in aviation emissions calculations.<sup>14</sup> In light of the development of these EU environmental regulations, a number of EU companies have become pioneers in green technologies, digital management and capitalisation in the aviation industry. These same companies and members of the working group are keen to contribute to China’s commitment to carbon neutrality and digitalisation. According to the findings of the European Chamber report, *Carbon Neutrality: The Role of European Companies in China’s Race to 2060*, 46 per cent of member companies have taken concrete steps to decarbonise their China operations, and around 67 per cent have achieved at least a basic level of preparation.<sup>15</sup>

## Key Recommendations

### 1. Accelerate Full Resumption of Air Transportation for People and Cargo between China and the European Union (EU)

#### Concern

Air traffic entitlements have not been fully restored, and China’s remaining strict travel and quarantine policies for international travellers and crew are seriously harming the operations of European carriers and obstructing the movement of essential people and cargo between China and Europe.

#### Assessment

At the end of 2019, COVID-19 emerged in China and subsequently spread worldwide. Following the decrease in demand for air travel due to travel restrictions imposed as a result, the aviation industry suffered historic losses. The Chinese authorities launched aid measures to assist the industry, such as subsidies for airlines that continued to fly, reductions of or exemptions from airport fees, increases in infrastructure investment related to emergency needs, the resumption of work and restoring safety.<sup>16</sup> However, foreign airlines

did not benefit from many of these financial incentives due to travel bans on international passengers and non-operation of flights.

In order to prevent and control COVID-19 cases being imported from abroad through passenger air travel, the CAAC issued the Five-One policy and the *Notice on the Adjustment of Circuit Breaker Measures for International Passenger Flights* in March and December 2020 respectively, which specify that one passenger flight of one route operated by one foreign airline to China from overseas is permitted every one week.<sup>17&18</sup> The Five-One policy has been partially softened since then, allowing foreign airlines to apply for more than one flight per week, but only under strict conditions. Certain cities, such as Beijing, still do not allow foreign carriers to fly there non-stop from EU Member States, resulting in unequal treatment between Chinese and foreign carriers. In addition, the circuit breaker policy penalised airlines that carried five or more COVID-19-positive passengers into China,<sup>19</sup> even though the airlines themselves were already complying with the Chinese regulations to accept the health code issued and verified by Chinese embassies.

Regrettably, these limitations are still in place as of June 2022, and bilateral air traffic entitlements with EU Member States have not yet been restored. The Five-One Policy has not helped in the opening of airspace in China and has hindered enforcement of the International Trade Law. These unfair arrangements also seriously harm the operations of European carriers and need to be rectified to ensure fair competition.

Throughout 2022, there have been some signals that restrictions will be relaxed. In March 2022, the National Health Commission published the *Diagnosis and Treatment Protocol for Novel Coronavirus Pneumonia (Trial Version 9)*.<sup>20</sup> Based on *Trial Version 9*, COVID-19 patients can be discharged from hospital if their cycle threshold (CT) value of polymerase chain reaction

14 *Aviation and the EU ETS*, European Commission, viewed 8<sup>th</sup> June 2022, <[https://ec.europa.eu/clima/eu-action/european-green-deal/delivering-european-green-deal/aviation-and-eu-ets\\_en](https://ec.europa.eu/clima/eu-action/european-green-deal/delivering-european-green-deal/aviation-and-eu-ets_en)>

15 *Carbon Neutrality: The Role of European Companies in China’s Race to 2060*, European Union Chamber of Commerce in China, 25<sup>th</sup> May 2022, viewed 8<sup>th</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-carbon-neutrality-report>>

16 *Notice on Support Policies to Actively Respond to COVID-19*, CAAC, 9<sup>th</sup> March 2020, viewed 12<sup>th</sup> April 2022, <[http://www.caac.gov.cn/XXGK/XXGK/TZTG/202003/t20200309\\_201361.html](http://www.caac.gov.cn/XXGK/XXGK/TZTG/202003/t20200309_201361.html)>

17 *Notice on Further Reducing International Passenger Flights during the Epidemic Prevention and Control Period*, CAAC, 26<sup>th</sup> March 2020, viewed 12<sup>th</sup> April 2022, <<http://www.caac.gov.cn/XXGK/XXGK/TZTG/202003/P020200326766958017420.pdf>>

18 *Notice on Adjustment of Circuit Breaker Measures for International Passenger Flights*, CAAC, 16<sup>th</sup> December 2020, viewed 12<sup>th</sup> April 2022, <[http://www.caac.gov.cn/XXGK/XXGK/TZTG/202012/t20201216\\_205607.html](http://www.caac.gov.cn/XXGK/XXGK/TZTG/202012/t20201216_205607.html)>

19 *Ibid.*

20 *Notice on Diagnosis and Treatment Protocol for Novel Coronavirus Pneumonia (Trial Version 9)*, National Health Commission, 15<sup>th</sup> March 2022, viewed 27<sup>th</sup> April 2022, <<http://www.nhc.gov.cn/yzygj/s7653p/202203/b74ade1ba4494583805a3d2e40093d88.shtml>>



(PCR) tests is 35 or above. However, for inbound passengers confirmed as being infected with COVID-19 upon arrival, a PCR test with a CT value of 40 is still required before they can be discharged from hospital. Requirements should be synchronised so that incoming passengers receive the same treatment as local residents.

Another example of a relaxation of restrictions arose during the 2022 Winter Olympics in Beijing, when exceptions were granted to foreign airline crews to skip the PCR test to facilitate smooth transportation of athletes and other Winter Olympics stakeholders in and out of China. Upon arrival in Beijing, all crew members were subject to closed-loop quarantine management, posing no risk of spreading infection outside of the 'loop'. This practice worked well and could be promoted to facilitate flight operations, at the very least to stabilise the frequency of air cargo flights.

Air travel is the only viable transportation option for strengthening business and people-to-people exchanges between the EU and China. A lack of smooth flight connections causes market access barriers and high communication costs. An overwhelming number of countries worldwide have already reopened their airspace and borders based on a roadmap of mutual recognition of health information or other specific agreements: China is now one of the last exceptions, and the restrictions in China are also affecting the recovery of the Asian market.<sup>21</sup> Therefore, in order to facilitate trade and exchanges with the EU and EU Member States, travel restrictions—including the suspension of work permits or the imposition of visa restrictions—that hinder the resumption of airlines' normal, scheduled routes between the EU and China, urgently need to be eased by the Chinese authorities.

#### Recommendations

- Accelerate full resumption of air transportation and the mobility of people and air cargo between China and the EU.
- Consult with the European Commission, EU Member States, the EASA, and international bodies such as the ICAO and the IATA, to create an agreed system for mutual recognition of health information, and promote the use of digital health certificates for international passengers.

- Synchronise the requirement of CT levels in PCR tests for infected inbound passengers with the requirement for local COVID-19 patients for discharge from hospital.
- Skip PCR testing procedures on foreign crew members to ensure return flights' operational reliability as the current closed-loop quarantine layover arrangement is watertight.
- Resume as early as possible consultations between China and EU Member States to ensure the restoration of bilateral air traffic entitlements as granted by Air Service Agreements, in order to facilitate a gradual and orderly resumption of international traffic, with a roadmap of border opening that will be consistent nationwide.
- Commit to applying international practices, as defined by the IATA, on slot allocation at airports to ensure fast recovery of air traffic flows with a reasonable grace period to allow airlines to adjust capacity back to pre-COVID-19 levels.

## 2. Realise the Full Potential of the Negative List (2021), and Relevant International, Regional or Bilateral Agreements Signed by the EU and China

#### Concern

Numerous EU-China initiatives have been introduced that cover aviation investment and airworthiness, but few have delivered significant results due to implementation issues and a lack of support.

#### Assessment

China is a very important part of the aviation industry and will continue to hold an irreplaceable position in the post-COVID era. Europe and China are already significant trading partners and have established strong collaboration in the aviation and aerospace sector. To further leverage and contribute to this relationship, EU-China exchanges on the formulation of aviation regulations and industry consultations need to be enhanced and elevated.

Following the release of the *Special Measures on Foreign Investment (Negative List 2021)* by the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) on 27<sup>th</sup> December

<sup>21</sup> *Accelerate Asia-Pacific Aviation Recovery*, IATA, 17<sup>th</sup> May 2022, viewed 8<sup>th</sup> June 2022, <<https://www.iata.org/en/pressroom/2022-releases/2022-05-17-01/>>





2021,<sup>22</sup> government agencies were urged to review past policies and regulations and promptly abandon those not in compliance with the updated list.

However, the working group notes that some incumbent regulations that are not consistent with the *Negative List 2021* are still in force and need to be repealed or replaced, including but not limited to: the *Interim Permit Management Measures of Using and Entering the Foreign Computer Tickets Reservation System by the Sales Agency Appointed by Foreign Airline Carriers in China (CCAR315)*,<sup>23</sup> the *Notice on Issuing the Measure of Management for Air Transport E-Ticket Itinerary Receipt (Interim) [2008] (Notice No. 54)*,<sup>24</sup> and its subsequent *Notice No. 83* issued in 2012.<sup>25</sup>

After the EU-China BASA and TIP were signed in September 2020, both the EASA and the CAAC started to implement them. The industry is encouraged by the improved mutual trust and approval efficiency brought by this implementation; however, the working group considers that to further simplify airworthiness approval processes and remove pain points, consultation with industry stakeholders is necessary.

#### Recommendations

- Review past policies and regulations and promptly abandon those that are not in compliance with the *Negative List (2021)*.
- Promote EU-China collaboration in the aviation industry in rule-making, regulatory approvals and policy implementation.
- Simplify airworthiness approval processes by effectively implementing the BASA/TIP.
- Strengthen the consultation process to allow industry stakeholders to contribute their expertise and experience to improve industry governance.

22 *Special Measures on Foreign Investment (Negative List 2021)*, NDRC and MOFCOM, 27<sup>th</sup> December 2021, viewed 22<sup>nd</sup> August 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-12/28/content\\_5664886.htm](http://www.gov.cn/zhengce/zhengceku/2021-12/28/content_5664886.htm)>

23 *Interim Permit Management Measures of Using and Entering the Foreign Computer Tickets Reservation System by the Sales Agency Appointed by Foreign Airline Carriers in China*, CAAC, 28<sup>th</sup> March 2016, viewed 13<sup>th</sup> April 2022, <[http://www.caac.gov.cn/XXGK/XXGK/MHGZ/201605/t20160530\\_37632.html](http://www.caac.gov.cn/XXGK/XXGK/MHGZ/201605/t20160530_37632.html)>

24 *Notice on Issuing the Measure of Management for Air Transport E-Ticket Itinerary Receipt (Interim) [2008]*, STA and CAAC, 9<sup>th</sup> July 2008, viewed 13<sup>th</sup> April 2022, <[http://www.caac.gov.cn/XXGK/XXGK/TZTG/201510/t20151022\\_2507.html](http://www.caac.gov.cn/XXGK/XXGK/TZTG/201510/t20151022_2507.html)>

25 *Notice on Issues Relating to the Use of the Electronic Ticket Itinerary for Air Transportation for International Passenger Tickets*, STA and CAAC, 30<sup>th</sup> August 2012, viewed 13<sup>th</sup> April 2022, <<http://www.shuiwu114.com/zcfgkShow/43691.aspx>>

### 3. Increase the Efficiency of Airspace Utilisation in China

#### Concern

Congested airspace in China—caused by both limited air routes and a lack of data exchange/communication, in conjunction with inefficient air traffic management (ATM)—leads to additional costs, longer flying times and increased environmental damage for air carriers, while restricted access to low-altitude airspace further hinders the development of the industry.

#### Assessment

The rapid increase in air traffic demand globally calls for further development of ATM organisations, operational concepts, systems, human resources and procedures, as well as civil-military cooperation in order to further improve services, and increase safety, efficiency and environmental performance. In view of traffic hotspots, as well as EU-wide regulatory developments regarding all these aspects, considerable experience has been built up in Europe, which—while it may not be directly transferrable to China—can serve to accelerate the development of China's aviation industry.

China has been investing heavily in the expansion of its ATM systems to support the rapid growth in air travel. To allow airports to reach their full capacities, many construction and expansion projects are being carried out at an accelerated pace throughout the country.

However, different types of systems are being implemented in different projects, making it increasingly challenging to achieve seamless interoperability and data exchange. This has been compounded by insufficient ability to centralise ATM data or utilise concepts such as big data, despite the early implementation of the Central Air Traffic Flow Management (C-ATFM) system. This represents a significant missed opportunity to study ways to improve the efficiency of air traffic flows in China and increase the capacity of airport resources, as well as to better utilise airspace.

If dataflow is the bloodstream of the ATM systems, then having an interoperable data exchange and information management platform would form a critical vein, linking every system and sub-system within the ATM ecosystems. Having such a well-connected



infrastructure would unlock huge potential in operational concepts to improve airspace congestion. For instance, better air traffic flow management coordination could be achieved; landing and take-off sequences could be dynamically exchanged between airports and transmitted across different system platforms; aeroplane separation could be safely reduced to increase airspace capacity; and coordination between heterogeneous ATM systems could be more seamless, thereby reducing the workload of air traffic controllers.

The working group is pleased to see the CAAC set out a roadmap for smart development in civil aviation.<sup>26</sup> The working group also notes the ongoing actions to push development, for example, the publication of a series of regulations on Smart Civil Aviation Data Management.<sup>27</sup> To leverage the expertise and intelligence from both the EU and China, the working group recommends more cooperation and international exchange to support better data usage under proper governance and to ensure the consistency of regulations among different regions.

The 14FYP includes regional projects, such as the Greater Bay Area, which calls for harmonisation of the ATM across Guangzhou, Shenzhen, Zhuhai, Hong Kong and Macau. These regional projects require a re-planning of ATM that spans different government administrations. It demands an efficient ATM concept, smooth coordination and effective operational procedures. It also calls for flow management tools that can optimise airspace efficiency and runway capacities of the different airports.

Looking forward, the working group would like to see both the EU and China engage in long-term cooperation on ATM modernisation plans. This would enhance cooperation between service providers and industries in the EU and China, and encourage the adoption of common standards and the sharing of best practices.

In the meantime, to improve controllers' career planning, professional development and training, the working group suggests implementing a working-level partnership between the Air Traffic Management Bureau

of the CAAC and leading European Air Navigation Service Providers. Integration of civil/military and international/domestic airspace and routing would also help increase the flexibility and punctuality of flights, and create room for future growth in aircraft movements. Being able to fly the shortest routes, without having to circumnavigate restricted airspace, has clear implications on both costs and time, as well as the environment, as suggested in the report released by the European Chamber in 2020, *In for the Long Haul: Developing a Sustainable Operating Environment for Airlines in China*.<sup>28</sup>

Another issue that requires improvements to China's ATM is the rapid development of the unmanned aircraft systems (UAS) industry, which has exacerbated safety and security challenges. Public safety incidents and airspace conflicts between UAVs and civil transport aircraft are not unusual. The working group recommends that the Chinese authorities safeguard civil manned air traffic while promoting UAS usage. From an industry perspective, UAS traffic management (UTM) and the insertion of UAS into civil airspace should be subjects of future research in order to optimise the usage of airspace by different stakeholders while maintaining and further developing civil air traffic safety and capacity.

#### Recommendations

- Enhance the utilisation of new data exchange technologies and systems interoperability in the aviation sector to ease airspace congestion and improve efficiency in the short term.
- Develop innovative operational concepts, procedures and human resources to maintain a high level of safety of ATM services, while developing flexibility, capacity and service orientation, and reducing the environmental impact of flying.
- Utilise EU and China expertise to implement a nation- and system-wide information management-based data communication platform with a centralised pool of data.
- Increase EU-China bilateral cooperation in the field of new applications and operational concepts covering airspace design, flow management and interoperable flight management between flight information regions.
- Improve aircraft arrival capacity at major airports

<sup>26</sup> Notice on issuing the Roadmap for Smart Development of Civil Aviation by the CAAC, CAAC, 21<sup>st</sup> January 2022, 8<sup>th</sup> June 2022, <[http://www.caac.gov.cn/XXGK/XXGK/ZCFB/202201/20220121\\_211212.html](http://www.caac.gov.cn/XXGK/XXGK/ZCFB/202201/20220121_211212.html)>

<sup>27</sup> CAAC issued a Series of Regulations on Smart Civil Aviation Data Management, CAAC, 5<sup>th</sup> January 2022, viewed 8<sup>th</sup> June 2022, <[http://www.caacnews.com.cn/1/1/202201/20220105\\_1337422.html](http://www.caacnews.com.cn/1/1/202201/20220105_1337422.html)>

<sup>28</sup> *In for the Long Haul: Developing a Sustainable Operating Environment for Airlines in China*, European Union Chamber of Commerce in China, 2<sup>nd</sup> June 2020, viewed 8<sup>th</sup> June 2022, <<https://www.europeanchamber.com.cn/en/press-releases/3228>>





by implementing distance-based and time-based separation.

- Enhance exchanges between the European and Chinese authorities and industry to enable harmonisation of UAV standards and regulations, and integration of ATM and UTM.
- Increase communication and explore a new framework to comply with both EU and China requirements for data management to improve collaboration on data-driven applications and platforms.

#### 4. Accelerate the Development of a Sustainable Ecosystem in China and Europe by Deepening Business-driven Actions Under Suitable Research, Legal, Standards and Investment Cooperation Frameworks

##### Concern

Although China and Europe both committed to the Paris Agreement, differences in political strategies to reach the targets of this agreement, and approaches to the COVID-19 crisis, constitute barriers on the route to the goal.

##### Assessment

Recent issues between the EU and China have evolved in such a way that existing cooperation schemes have been negatively impacted. These issues include the COVID-19 situation; the position of the EU regarding China as "a competitor, rival and partner",<sup>29</sup> and the evolution of the Chinese industry and subsequent political moves to protect it. Negotiations on the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) are still ongoing between the ICAO and the Chinese authorities. With the ICAO assembly taking place in late September/October 2022,<sup>30</sup> the working group recommends creating a trusted and long-term communication channel between the EU and China dedicated to the development of sustainable aviation.

In order to achieve emission reduction commitments

29 "China is a partner, competitor and rival": Interview by Foreign Minister Heiko Maas with Redaktionsnetzwerk Deutschland, German Federal Foreign Office, 12<sup>th</sup> July 2020, viewed 13<sup>th</sup> April 2022, <<https://www.auswaertiges-amt.de/en/newsroom/news/maas-md/2367552>>

30 New decisions at ICAO Council's 223<sup>rd</sup> Session support aviation's recovery and development, ICAO, 29<sup>th</sup> June 2021, viewed 19<sup>th</sup> April 2022, <<https://www.icao.int/Newsroom/Pages/New-decisions-at-ICAO-Councils-223rd-Session-support-aviations-recovery-and-development.aspx>>

while accommodating the growing demand for flights, the aviation industry needs to develop climate/energy scenarios for China and Europe that take into consideration the evolution of air traffic, energy pathways, competition with other industries for access to renewable energy, regulations and the ecosystem in general. Through such cooperation, there are good prospects of both the EU and China benefitting from the era of decarbonised aviation.

A significant part of realising sustainable aviation will be putting in place industrial solutions for sustainable energy. In the short-term, the use of SAF is a common strategy in the EU and China. Very promising cooperation initiatives have been launched to create a SAF industry in China for the benefit of original equipment manufacturers and airlines.<sup>31</sup> EU-China cooperation on SAFs has already taken place, with test flights successfully carried out in Shanghai in 2012. Unfortunately, because Chinese standards are not compatible with international standards, the cooperation was suspended. However, following the launch of the CAAC roadmap for sustainable aviation,<sup>32</sup> the working group believes that new opportunities now exist to have more commercial flights utilising SAF until 2025. In the medium to long-term, the development and industrialisation of power-to-liquid technologies and hydrogen will be key to ensuring the decarbonisation of the aviation industry. The working group recommends reactivating bilateral discussions to promote the industrialisation and use of new fuels.

With regard to joint green aviation research, the EU and China have launched a number of coordination and support actions (CSA) since 2005, as well as several successful research and innovation actions, which have benefitted both the Chinese and European industries. The existing, long-term CSA within the Seventh Framework Programme, the Greener Aeronautics International Networking 2 (GRAIN2),<sup>33</sup> under Horizon 2020, has now closed and there are no other joint calls scheduled in the near future. The working group

31 *The Business Aviation Sustainable Aviation Fuel Alliance (SAF Alliance) has released new SAF guidelines*, Tanpaifang, 27<sup>th</sup> August 2020, viewed 13<sup>th</sup> April 2022, <<http://www.tanpaifang.com/tanguwen/2020/0827/73530.html>>

32 *Notice on issuing the 14<sup>th</sup> Five-Year Special Plan for Green Development of Civil Aviation by CAAC*, CAAC, 21<sup>st</sup> December 2021, viewed 13<sup>th</sup> April 2022, <[http://www.caac.gov.cn/XXGK/XXGK/FZGH/202201/t20220127\\_211345.html](http://www.caac.gov.cn/XXGK/XXGK/FZGH/202201/t20220127_211345.html)>

33 *Coordination and support action: Seventh Framework Programme – GRAIN2*, European Commission, 31<sup>st</sup> March 2015, viewed 13<sup>th</sup> April 2022, <<https://trimis.ec.europa.eu/sites/default/files/project/documents/10294/final1-grain2-m36-final-report.pdf>>



recommends that both the EU and China launch new cooperation schemes on the standardisation and certification of new technology, products and services for green aviation development.

### Recommendations

- Create a trusted and long-term communication channel between the EU and China, dedicated to the development of sustainable aviation.
- Cooperate on scenarios to prepare for the future of decarbonised aviation, including but not limited to SAF, power-to-liquid technology and hydrogen.
- Relaunch projects on industrialisation of alternative fuels including power-to-liquid technologies and hydrogen by creating concrete-use cases.
- Leverage existing and previous cooperation frameworks, such as Horizon Europe, to implement concrete projects on sustainable aviation technology.

## Abbreviations

14FYP	14 <sup>th</sup> Five-year Plan
ATM	Air Traffic Management
BASA	Bilateral Aviation Safety Agreement
CAAC	Civil Aviation Administration of China
COMAC	Commercial Aircraft Corporation of China
CORSIA	Carbon Offsetting and Reduction Scheme for International Aviation
CSA	Coordination and Support Action
CT	Cycle Threshold
EASA	European Union Aviation Safety Agency
ETS	Emissions Trading System
EU	European Union
GA	General Aviation
IATA	International Air Transport Association
ICAO	International Civil Aviation Organization
MOFCOM	Ministry of Commerce
NDRC	National Development and Reform Commission
PCR	Polymerase Chain Reaction
SAF	Sustainable Aviation Fuel
TIP	Technical Implementation Procedure
UAS	Unmanned Aircraft System
UAV	Unmanned Aerial Vehicle
UTM	UAS Traffic Management





## Construction Working Group

### Key Recommendations

#### 1. Accelerate Decarbonisation of the Built Environment and Support Construction of Green Buildings

- Make voluntary green building labels mandatory, coherent and compatible with international standards.
- Develop databases and tools to support the industry's transition to a carbon-neutral, more resilient, future.
- Include life-cycle costing approaches in public procurement procedures and increase the weight of energy efficiency performance on procurement scorecards.
- Ensure equal access for European investments and technologies in China's construction sector.
- Involve European companies in the implementation process for green building standards / calculation of carbon emission standards.
- Develop knowledge-sharing, practical training of building practitioners and education programmes, drawing on the expertise of European companies and institutions.

#### 2. Allow European Companies Greater Access to the Bidding Process for Government Procurement Work

- Join the World Trade Organization's Government Procurement Agreement to allow foreign companies greater access to the bidding process for government procurement work, ensuring that tendering and construction services are covered.

#### 3. Facilitate Market Access for European Planning, Architecture and Design, Construction, and Real Estate Service Providers to Enable Fair Competition and Encourage Expertise Sharing

- Foster mutual recognition of degrees, certificates and experience to further level the playing field for foreign-invested construction and design firms.
- Allow foreign-invested architectural firms to register as certifying bodies for environmental product declarations.
- Improve local standards to reach the same quality as international green building standards.
- Allow qualification exams to be conducted in English to offer fair opportunities for foreign professionals.

#### 4. Continue to Ensure a Fair, Balanced and Open Market for Foreign Investment in the Real Estate (RE) Sector

- Issue further clarifications or implementing rules regarding *Circular No. 122* to create a fair market environment for foreign companies investing in the Chinese RE market.
- Facilitate market access of foreign-invested RE enterprises to absorb immovable assets from illiquid or insolvent Chinese developers.





## Heating Sub-working Group

### 1. Update the Standard for Energy Efficiency of Domestic Gas Appliances and Introduce National Guidelines or Policies to Promote Full Premixed Condensing Boilers with Level I Energy Efficiency

#### 1.1 Update the Energy Efficiency Standard, and Refine and Improve Requirements for Domestic Gas Appliances

- Update and refine the energy efficiency standards for domestic gas appliances.
- Refine and improve the efficiency requirements for domestic gas appliances.
- Establish energy efficiency requirements for major components while keeping the overall requirements coherent.
- Abandon outdated energy efficiency evaluation methods and implement a standardised carbon efficiency evaluation system alongside primary energy to compare the thermal efficiency rates of different primary energies and the wiring system efficiencies of various heating products.

#### 1.2 Introduce Policy Guidelines for Promoting Energy-saving and Low-emission Gas Boiler Technologies

- Introduce policy guidelines for promoting energy-saving and low-emission technologies, starting from key cities and regions.
- Issue relevant policies to encourage consumers to buy full premixed condensing boilers for the first installation of heating in a building.
- Encourage research projects on full premixed condensing technology, including its application, energy-saving and emission-reducing effects.

### 2. Improve and Effectively Implement Standards for the Installation and Maintenance of Heating Boilers, and Educate Consumers on the Need for Regular Maintenance and Replacement

#### 2.1 Strengthen the Standardisation and Management of the Installation of Heating Boilers

##### 2.1.1 Improve the Standards for Installation of Heating Boilers and Strengthen the Standardisation and Management of Responsible Enterprises and Personnel

- Formulate and implement regulations for installation of heating boilers.
- Emphasise and introduce the use of water treatment products for new installations.
- Improve the training for personnel and enterprises responsible for installation and establish a vocational certification system.

##### 2.1.2 Reasonably Adjust the Content and Cycle of Product Tests for Local Market Access based on the China Compulsory Certification (CCC) Policy

- Reasonably reduce repetitive test items for local market access, and extend the test cycle.

#### 2.2 Strengthen the Publicity and Effective Supervision of the Maintenance of Heating Boilers

- Strengthen effective supervision of regular maintenance of heating boilers, and educate consumers accordingly.
- Issue regulations for periodic maintenance of heating boilers to ensure their efficient and safe operation.



- Improve awareness of overall heating system safety, and service employee and user knowledge of the benefits of using water treatment products in heating systems.
- Encourage factory and gas management departments to work together to raise awareness of the requirements for regular maintenance of wall-hung heaters.

### 2.3 Cultivate Consumers' Awareness of the Need for Timely Removal and Replacement of Heating Boilers with High Energy Consumption and Emissions or Those at the End of Their Service Life

- Cultivate consumers' awareness of the need for timely removal and replacement of heating boilers with high energy consumption and emissions or those at the end of their service life.
- Assist users in ensuring regular maintenance and repairment of wall-hung heaters, providing guidance to end-users, and raising gas safety awareness.
- Formulate policies to encourage and support consumers to replace low-efficiency and high-energy-consumption heating boilers that have reached the end of their service life with more efficient and eco-friendly full premixed condensing boilers.

## 3. Research and Discuss the Role of Hydrogen-mixed Technology in the Laying of Gas Pipeline Networks for Domestic Appliances in China

- Set up pilot areas, build demonstration projects, and promote the concept of zero-carbon heating via hydrogen.
- Draft corresponding standards and regulations to guide products and industries with standardised development.
- Encourage the creation of technical standards, such as manufacturing standards and standards for the installation and inspection of hydrogen blending and pure hydrogen combustion equipment.

## Introduction to the Working Group

The Construction Working Group is the voice of European, world-leading real estate investors, land developers, architects, engineers, project managers, main contractors, suppliers, certification bodies and other professional consultants specialising in the construction industry that are operating in China.

The Construction Working Group was established in 2003, to represent European construction service providers (CSPs) operating in China. As part of the European Chamber's working group reorganisation in March 2016, the European Heating Industry Desk became a sub-working group of the Construction Working Group.

The main objective of the Construction Working Group is to engage in dialogue with key stakeholders,

including the Ministry of Housing and Urban-rural Development (MOHURD), the National Development and Reform Commission (NDRC), the Ministry of Land and Natural Resources, the Ministry of Industry and Information Technology (MIIT), the Ministry of Science and Technology, European Union (EU) institutions and construction-related organisations and associations. This cooperation provides feedback on and support for Chinese construction policies, with a current focus on sustainable urban development and the promotion of investment in high-quality, energy-efficient buildings.

## Recent Developments

### Market Trends in 2021

Faced with sporadic outbreaks of COVID-19 and regulatory tightening, China's property and construction sectors experienced a significant slowdown in 2021 despite a 0.4 and 4.4 per cent increase in investment in





infrastructure and real estate development respectively.<sup>1</sup> Investment also increased in the mining industry by 10.9 per cent; and in the power, heat, gas and water production and supply industry by 1.1 per cent, while investment in water conservancy, environment and public facilities management decreased by 1.2 per cent; in road transportation also by 1.2 per cent; and in railway transportation by 1.8 per cent.<sup>2</sup> The total construction output value reached Chinese yuan (CNY) 29.3 trillion, up 11 per cent year-on-year.<sup>3</sup> The value added of construction enterprises was over CNY 8,000 billion, up 2.1 per cent over the previous year.<sup>4</sup> Since 2012, the ratio of value added by the construction industry to China's national gross domestic product (GDP) has remained above 6.8 per cent. The ratio in 2021 declined compared to 2020 but still reached seven per cent.<sup>5</sup>

By the end of 2021, the urbanisation rate reached 64.7 per cent, 0.83 percentage points higher than the end of 2020.<sup>6</sup> After a rebound in housing demand from late-2020 to mid-2021, fuelled by a surge in household savings, housing sector activity weakened quickly and land sales plunged due to regulatory tightening and credit conditions.<sup>7</sup> Since September 2021, China's largest property developer, Evergrande, and a few other major developers have experienced debt payment delays and liquidity stress. Their troubles have spread to their suppliers, investors and clients. As a result, the amount of new construction projects and projects under construction contracted from the third quarter of 2021, and the average house price started to decline for both new and second-hand housing.<sup>8</sup> Fitch Ratings

forecast sales to stay weak in 2022 before further policy relaxation.<sup>9</sup>

### A Greener, Smarter and Safer Path Towards Carbon Neutrality

China's construction sector generates about 11 per cent of the world's total carbon emissions each year.<sup>10</sup> In the last quarter of 2020 and the first quarter of 2021, China's carbon dioxide (CO<sub>2</sub>) emissions rose sharply by approximately nine per cent compared with the previous year, as construction and heavy industrial activities led the recovery after the initial COVID-19 lockdowns were lifted.<sup>11</sup> As building and construction activities worldwide are responsible for almost 40 per cent of global carbon emissions, reform and decarbonisation of the sector are key to meeting the goals of the Paris Agreement as well as for China to reach its dual objectives of peaking CO<sub>2</sub> emissions before 2030 and achieving carbon neutrality by 2060 (30/60 Goals).<sup>12</sup>

Since the State Council's first regulation related to building energy conservation in 1986, China has made remarkable achievements in the formulation of standards, engineering design and construction. Some 199 building energy-efficiency-related policies have been issued by the MOHURD, the Ministry of Finance and the State Council since 1986.<sup>13</sup> The development process can be divided into four phases: the exploration phase between 1986 and 2000, where the building energy efficiency goal was set at a 30 per cent reduction in building energy consumption; the pilot demonstration phase between 2000 and 2005, with the introduction of a series of energy-efficiency standards, with energy-efficiency targets set to 50 per cent; the development phase from 2005 to 2015, with targets set to 65 per cent; and the final phase starting in 2015, with

1 *National Economy Continued to Recover with Expected Development Targets Well Achieved in 2021*, National Bureau of Statistics (NBS), 17<sup>th</sup> January 2022, viewed 1<sup>st</sup> April 2022, <[http://www.stats.gov.cn/english/PressRelease/202201/t20220117\\_1826409.html](http://www.stats.gov.cn/english/PressRelease/202201/t20220117_1826409.html)>

2 *Investment in Fixed Assets from January to December 2021*, NBS, 18<sup>th</sup> January 2022, viewed 25<sup>th</sup> May 2022, <[http://www.stats.gov.cn/english/PressRelease/202201/t20220118\\_1826496.html](http://www.stats.gov.cn/english/PressRelease/202201/t20220118_1826496.html)>

3 *Statistical analysis of the development of the construction industry in 2021, The Paper*, 15<sup>th</sup> March 2022, viewed 1<sup>st</sup> April 2022, <[https://m.thepaper.cn/newsDetail\\_forward\\_17126351](https://m.thepaper.cn/newsDetail_forward_17126351)>

4 *Ibid.*

5 *Ibid.*

6 *Statistical Communiqué of the People's Republic of China on the 2021 National Economic and Social Development*, National Bureau of Statistics (NBS), 28<sup>th</sup> February 2022, viewed 1<sup>st</sup> April 2022, <[http://www.stats.gov.cn/english/PressRelease/202202/t20220227\\_1827963.html](http://www.stats.gov.cn/english/PressRelease/202202/t20220227_1827963.html)>

7 *China Economic Update - Rebalancing Act: From Recovery to High-Quality Growth*, World Bank Group, December 2021, viewed 2<sup>nd</sup> April 2022, <<https://thedocs.worldbank.org/en/doc/7aa7a16968768ccb51f11818654d42561-0070012021/original/CEU-December-2021-ENG.pdf>>

8 *Ibid.*

9 *Slow Recovery for China New Housing Sales After 1Q22 Trough*, Fitch Ratings, 21<sup>st</sup> April 2022, viewed 25<sup>th</sup> May 2022, <<https://www.fitchratings.com/research/corporate-finance/slow-recovery-for-china-new-housing-sales-after-1q22-trough-21-04-2022>>

10 Wang, Yuanfeng, *China's carbon neutrality challenge*, *China Daily*, 27<sup>th</sup> November 2020, viewed 2<sup>nd</sup> April 2021, <<https://www.chinadailyhk.com/article/150772>>

11 Myllyvirta, Lauri, *Analysis: China's CO<sub>2</sub> emissions see first quarterly fall since post-lockdown surge*, Carbon Brief, 25<sup>th</sup> November 2021, viewed 2<sup>nd</sup> April 2022, <<https://www.carbonbrief.org/analysis-chinas-co2-emissions-see-first-quarterly-fall-since-post-lockdown-surge>>

12 For more information on carbon neutrality, please also refer to the European Chamber's report: *Carbon Neutrality: The Role of European Business in China's Race to 2060*, European Union Chamber of Commerce in China, 25<sup>th</sup> May 2022, viewed 26<sup>th</sup> May 2022, <<https://www.europeanchamber.com.cn/en/publications-carbon-neutrality-report>>

13 Wu, Zezhou; He, Qiufeng; Yang, Kaijie; Zhang, Jinming & Xu, Kexi, *Investigating the Dynamics of China's Green Building Policy Development from 1986 to 2019*, *International journal of environmental research and public health*, vol.18, no.1, p. 196, 29<sup>th</sup> December 2020, viewed 25<sup>th</sup> May 2022, <<https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7795857/>>





Beijing, Shanghai, Jiangsu and Zhejiang establishing a 75 per cent building energy-efficiency target.<sup>14</sup>

In October 2021, the MOHURD released a new national standard, the *General Specifications for Building Energy Conservation and Renewable Energy Utilisation*, to be implemented from 1<sup>st</sup> April 2022.<sup>15</sup> The standard sets requirements for calculating carbon emissions and improving energy efficiency and consumption of buildings. Control of energy consumption, energy conservation and emission reductions have become compulsory for every company in China. Building on the 13<sup>th</sup> Five-year Plan's (FYP's) requirements for energy conservation in buildings and green building targets, the 14FYP emphasises the need for clean, low-carbon production, safe and high-quality buildings and more widespread application of advanced information technology.<sup>16</sup>

### Coordinated Regional Development to Pursue Common Prosperity

Regional development stands out as one of the major components of China's 14FYP.<sup>17</sup> Amid its efforts to pursue 'common prosperity', China is aiming for increasingly balanced development among its regions, working toward developing the West, revitalising the north-eastern region, and accelerating modernisation of the East. As a result, new projects, such as a new section of a pipeline transporting natural gas from the city of Zhongwei in northwest China's Ningxia Hui Autonomous Region to the city of Ji'an in east China's Jiangxi Province, commenced construction in late 2021.<sup>18</sup>

*The Outline of the People's Republic of China 14<sup>th</sup> Five-year Plan for National Economic and Social Development and Long-Range Objectives for 2035*

<sup>14</sup> Sun, Yuning; Xu, Li; Chen, Xing; and Zai, Debin, *Research on energy consumption constitution and energy efficiency strategies of residential buildings in China based on carbon neutral demand*, *Sustainability*, vol.14, no.5, p. 2741, 25<sup>th</sup> February 2022, viewed 2<sup>nd</sup> April 2022, <<https://doi.org/10.3390/su14052741>>

<sup>15</sup> *Announcement on the Issuance of the National Standard on General Specifications for Building Energy Conservation and Renewable Energy Utilisation*, MOHURD, 13<sup>th</sup> October 2021, viewed 2<sup>nd</sup> April 2022, <[https://www.mohurd.gov.cn/gongkai/fdzdkgkn/zfxcxjsbwj/202110/20211013\\_762460.html](https://www.mohurd.gov.cn/gongkai/fdzdkgkn/zfxcxjsbwj/202110/20211013_762460.html)>

<sup>16</sup> *14<sup>th</sup> Five-year Plan for Construction Industry*, MOHURD, 25<sup>th</sup> January 2022, viewed 2<sup>nd</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2022-01/27/content\\_5670687.htm](http://www.gov.cn/zhengce/zhengceku/2022-01/27/content_5670687.htm)>

<sup>17</sup> *Outline of the People's Republic of China 14<sup>th</sup> Five-year Plan for National Economic and Social Development and Long-Range Objectives for 2035*, National People's Congress, 12<sup>th</sup> March 2021, viewed 2<sup>nd</sup> April 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592681.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm)>

<sup>18</sup> *China begins construction on new section of gas transmission pipeline*, State Council, 23<sup>rd</sup> September 2021, viewed 2<sup>nd</sup> April 2022, <[http://english.www.gov.cn/news/topnews/202109/23/content\\_WS614c2b35c6d0df57f98e0b91.html](http://english.www.gov.cn/news/topnews/202109/23/content_WS614c2b35c6d0df57f98e0b91.html)>

(*Outline*) also emphasises the development of urban agglomerations, putting forward the strategy of "two horizontals and three verticals" to upgrade five urban clusters, i.e., Beijing-Tianjin-Hebei, the Yangtze River Delta, the Pearl River Delta, Chengdu-Chongqing and the middle reaches of the Yangtze River.

### The Beijing-Tianjin-Hebei Integration Plan

The region, made up of the two municipalities of Beijing and Tianjin as well as the province of Hebei, accounts for approximately 10 per cent of China's total GDP, eight per cent of China's population and covers over 200,000 square kilometres (km<sup>2</sup>). The Beijing-Tianjin-Hebei Integration Plan's main objective was the overall development of Hebei Province. However, to ensure sustainable development, resources within the region will need to be rebalanced and green solutions implemented to tackle environmental problems.<sup>19</sup>

To this end, President Xi Jinping announced the creation of the Xiong'an New Area in 2017. Spanning three counties in Hebei Province, about 100 km southwest of Beijing, the new area is intended to act as a testing ground for pilot reforms and new technologies.<sup>20</sup> The *Outline* also highlights the importance of high-quality development of Tianjin's Binhai New Area, of the construction of the Zhangjiakou Capital Water Source Conservation Functional Zone and Ecological Environment Supporting Zone, and of the deeper integration of Beijing-Tianjin-Hebei production and innovation chains.

## Key Recommendations

### 1. Accelerate Decarbonisation of the Built Environment and Support Construction of Green Buildings

#### Concern

While new technologies and alternative building materials can already help both the construction sector and China meet their emission targets, procedural and legal inefficiencies prevent their deployment.

#### Assessment

Between the State Council's first regulation related to building energy conservation in 1986 and the *Green*

<sup>19</sup> Preen, Mark, *The Beijing-Tianjin-Hebei Integration Plan*, China Briefing, 26<sup>th</sup> April 2018, viewed 2<sup>nd</sup> April 2022, <<https://www.china-briefing.com/news/the-beijing-tianjin-hebei-integration-plan/>>

<sup>20</sup> Ibid.





*Label Management Scheme* published by the MOHURD in January 2021,<sup>21</sup> technical criteria, assessment standards and grade setting have improved, which is helping to guide the industry towards carbon neutrality. However, the procedural and legal landscape is fragmented with more than 10 different standards used for assessing different types of buildings and at different stages of the construction process. At the same time, the application of green-building labels remains voluntary.<sup>22</sup> In order to decarbonise the built environment and construction of green buildings faster and more efficiently, it would be preferable to move from a system that is voluntary to one based on mandatory standards.

Green building design and development requires a thorough understanding of the different parameters influencing the overall performance of a building. Buildings are responsible for the consumption of resources and energy as well as greenhouse gas emissions at each stage of their life cycles. In Europe, open databases and tools to calculate the environmental performance of building elements and buildings in a uniform way are available for industry professionals, certification bodies and other stakeholders.<sup>23</sup> Thanks to data-sharing and industry cooperation, inefficiencies can be avoided; lessons learned from other projects can be applied to increase time and cost efficiency; and progress can be measured consistently. Furthermore, identification and calculation of energy consumption and emission data are necessary to formulate effective policy interventions. Therefore, the working group recommends that the relevant authorities develop databases and tools to support the industry's transition to a low-carbon, more resilient future. The working group also suggests including life-cycle costing approaches in public procurement procedures and increasing the weight of energy-efficiency performance on procurement scorecards.

The 14FYP encourages more widespread application and integration of new technologies, such as the Internet of Things, artificial intelligence and big data processing, in the construction sector. Information collection, data analysis, real-time monitoring, early

risk-warning and decision-making assistance can not only help optimise construction processes and improve site safety, but also raise the general quality of constructions. The working group believes European companies' expertise and high-efficiency products are in line with China's 30/60 Goals and could be of great benefit to China's ongoing development.

Decarbonising the sector will also come down to finding and using greener materials, as more than 90 per cent of the construction industry's carbon emissions come from materials used. The steel industry alone burns more than a fifth of China's coal. Cement is another high-polluting sector in China because its production is coal-fuelled and energy-intensive.<sup>24</sup> Even though special preference is given to companies and products that meet environmental standards and a *National Recommended Catalogue of Energy-saving Technologies and Equipment for Industry* has been compiled for reference and study,<sup>25</sup> there is no clear database of eco-friendly building materials mentioning the materials' environmental performance in a standardised way.

While the transition to green construction is gaining momentum in China, it is hampered by a lack of understanding of sustainability and green building principles among some key players and decision-makers. Professional training in green building practices and technology is therefore essential to optimise development of the industry.

Internationally, three major certification systems for buildings were established in the 1990s, starting with the British Building Research Establishment Environmental Assessment Method in 1990, followed by the High Environmental Quality developed by the French in 1996 and finally the Leadership in Energy and Environmental Design by the United States Green Building Council in 1998.<sup>26&27</sup> European land developers, architects,

21 *Green Label Management Scheme*, MOHURD, 8<sup>th</sup> January 2021, viewed 7<sup>th</sup> April 2022, <<http://www.gov.cn/zhengce/zhengceku/2021-01/17/5580528/files/6f59e30c120043da8eb221f3ab18a665.pdf>>

22 Ibid.

23 *About TOTEM*, TOTEM Create | Evaluate | Innovate, 2018, viewed 8<sup>th</sup> April 2022, <<https://www.totem-building.be/pages/about.xhtml#2.1>>

24 *The Chinese Companies Polluting the World More Than Entire Nations*, Bloomberg, 25<sup>th</sup> October 2021, viewed 8<sup>th</sup> April 2022, <<https://www.bloomberg.com/graphics/2021-china-climate-change-biggest-carbon-polluters/>>

25 *Notice on the Announcement of the Fifth Batch of Green Manufacturing List*, MIIT, 16<sup>th</sup> October 2020, viewed 8<sup>th</sup> April 2022, <[https://www.miit.gov.cn/zwgk/zcwj/wjfb/zh/art/2020/art\\_6dc9386121b945b3927fdcca5c79cd1b.html](https://www.miit.gov.cn/zwgk/zcwj/wjfb/zh/art/2020/art_6dc9386121b945b3927fdcca5c79cd1b.html)>

26 Zeinal Hamedani, A., & Huber, F., 2012, *A Comparative Study of DGNB, LEED and BREEAM Certificate Systems in Urban Sustainability, The Sustainable City VII: Urban Regeneration and Sustainability (WIT Transactions on Ecology and The Environment, vol. 155)*, vol.1, pp. 121–132, viewed 25<sup>th</sup> May 2022, WIT Press ISSN 1743-3541 1, <<https://www.witpress.com/Secure/elibRARY/papers/SC12/SC12011FU1.pdf>>

27 For more information on standards, please also refer to the *Standards and Conformity Assessment Working Group Position Paper 2022/2023* on p. 126.





engineers and project managers have extensive expertise and deep knowledge from working with such technical requirements. The working group therefore recommends that China develops knowledge-sharing, practical training of building practitioners and education programmes in cooperation with and drawing on the expertise of European companies and institutions.

### Recommendations

- Make voluntary green building labels mandatory, coherent and compatible with international standards.
- Develop databases and tools to support the industry's transition to a carbon-neutral, more resilient, future.
- Include life-cycle costing approaches in public procurement procedures and increase the weight of energy efficiency performance on procurement scorecards.
- Ensure equal access for European investments and technologies in China's construction sector.
- Involve European companies in the implementation process for green building standards / calculation of carbon emission standards.
- Develop knowledge-sharing, practical training of building practitioners and education programmes, drawing on the expertise of European companies and institutions.

## 2. Allow European Companies Greater Access to the Bidding Process for Government Procurement Work

### Concern

Foreign-invested companies face many constraints when bidding for government procurement projects.

### Assessment

China currently has two sets of laws governing public tendering: the Government Procurement Law (GPL) and the Tender and Bidding Law (TBL).<sup>28&29</sup>

After its accession to the World Trade Organization

28 Broadly speaking, the GPL covers central and sub-central government purchases. See The *Government Procurement Law*, Standing Committee of the National People's Congress, 29<sup>th</sup> June 2002, viewed 15<sup>th</sup> April 2022, <[http://www.ccg.gov.cn/zc/gjfg/201310/t20131029\\_3587339.htm](http://www.ccg.gov.cn/zc/gjfg/201310/t20131029_3587339.htm)>

29 The TBL regulates all state-owned enterprise tenders, in particular, large-scale infrastructure projects (such as in construction, aviation, shipping, engineering, architecture, transportation, power and water), as well as large-scale, privately-invested projects for public interest (mainly joint ventures). See: Tender and Bidding Law, *China.org.cn*, 12<sup>th</sup> February 2011, viewed 15<sup>th</sup> April 2022, <[http://www.china.org.cn/china/LegislationsForm2001-2010/2011-02/12/content\\_21908008.htm](http://www.china.org.cn/china/LegislationsForm2001-2010/2011-02/12/content_21908008.htm)>

(WTO) in 2001, China committed to join the organisation's Government Procurement Agreement (GPA) "as soon as possible".<sup>30,31&32</sup> On 21<sup>st</sup> October 2019, China submitted its seventh offer (sixth revised offer) for accession to the agreement,<sup>33</sup> which included further commitments to open up market access to foreign companies. China currently has GPA observer status.

In this context, on 3<sup>rd</sup> December 2019, the NDRC proposed revisions to the TBL and invited public comments to be submitted by 1<sup>st</sup> January 2020. These revisions are part of a wider effort by China to modernise its already twenty-year-old procurement framework.<sup>34</sup>

The Ministry of Finance is at the time of writing examining how application of the GPL conflicts with the TBL, China's GPA accession and recent reforms in the country's procurement regime.<sup>35</sup> This is also in line with the Foreign Investment Law that came into effect at the beginning of 2020.<sup>36</sup> So far, the GPL "is much more closely aligned with GPA requirements than the TBL".<sup>37</sup>

The proposed revisions to the TBL by the NDRC could have a positive impact and lead to increased transparency and improved fairness in tendering activities, which would bring it more in line with GPA

30 The GPA is a plurilateral agreement between 48 WTO member countries that have agreed to open up their non-defence public procurement markets to each other. Suppliers of each GPA member country can participate in the public procurement bids of other GPA member countries and be treated no less favourably than local bidders in the award of government contracts. However, out of these, 11 members are in the process of acceding to the Agreement (including China). See *Agreement on Government Procurement*, WTO, viewed 14<sup>th</sup> April 2022, <[https://www.wto.org/english/tratop\\_e/gproc\\_e/gp\\_gpa\\_e.htm](https://www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm)>

31 Heilman Grier, Jean, *Do Open Markets Decrease China's Incentive to Join GPA?*, *Perspectives on Trade: Perspectives and Observations*, 2<sup>nd</sup> November 2017, viewed 14<sup>th</sup> April 2022, <<https://trade.djaghe.com/?p=4414>>

32 Wang, P., 2009, *China's accession to the WTO – challenges and the way forward*, *Journal of International Economic Law*, vol. 12, no. 3, pp. 663–706, viewed 15<sup>th</sup> April 2022, <<https://academic.oup.com/jiel/article-abstract/12/3/663/817776>>

33 *China Submits Revised Offer for Joining Government Procurement Pact*, WTO, 23<sup>rd</sup> October 2019, viewed 15<sup>th</sup> April 2022, <[https://www.wto.org/english/news\\_e/news19\\_e/gpro\\_23oct19\\_e.htm](https://www.wto.org/english/news_e/news19_e/gpro_23oct19_e.htm)>

34 Heilman Grier, Jean, *China: Revising Tendering and Bidding Law*, *Perspectives on Trade: Perspectives and Observations*, 13<sup>th</sup> April 2020, viewed 15<sup>th</sup> April 2022, <<https://trade.djaghe.com/?p=6363>>

35 Government Procurement Law (Draft for Comments), MOF, 8<sup>th</sup> December 2020, viewed 15<sup>th</sup> April 2022, <[http://www.gov.cn/hudong/2020-12/08/content\\_5567837.htm](http://www.gov.cn/hudong/2020-12/08/content_5567837.htm)>; *Administrative Measures for the Management of Government Procurement Demand*, MOF, 10<sup>th</sup> May 2021, viewed 15<sup>th</sup> April 2022, <[http://gks.mof.gov.cn/guizhangzhidu/202105/t20210510\\_3699403.htm](http://gks.mof.gov.cn/guizhangzhidu/202105/t20210510_3699403.htm)>

36 Foreign Investment Law of the People's Republic of China, Investment Policy Hub, UNCTAD, 19<sup>th</sup> March 2019, viewed 15<sup>th</sup> April 2022, <<https://investmentpolicy.unctad.org/investment-laws/laws/317/china-foreign-investment-law-of-the-people-s-republic-of-china>>

37 Heilman Grier, Jean, *China: Revising Tendering and Bidding Law*, *Perspectives on Trade: Perspectives and Observations*, 13<sup>th</sup> April 2020, viewed 15<sup>th</sup> April 2022, <<https://trade.djaghe.com/?p=6363>>





requirements.<sup>38</sup> The revisions would help China pave the way towards fulfilling its WTO commitments, but it remains to be seen how they will be implemented, as foreign companies still face many issues when it comes to obtaining government procurement work. It is also worth mentioning that the longer China fails to accede to the GPA and open up its procurement markets, the more likely it is to end up in the crosshairs of the EU's proposed International Procurement Instrument.<sup>39</sup>

The European Chamber's *Business Confidence Survey 2022* registered that 28 per cent of civil engineering and construction companies reported missing business opportunities due to market access restrictions and regulatory barriers, which include barriers to government procurement processes.<sup>40</sup> This data serves to illustrate the importance of a timely accession of China to the GPA and an accurate revision of the TBL.

#### Recommendation

- Join the WTO's GPA to allow foreign companies greater access to the bidding process for government procurement work, ensuring that tendering and construction services are covered.

### 3. Facilitate Market Access for European Planning, Architecture and Design, Construction and Real Estate Service Providers to Enable Fair Competition and Encourage Expertise Sharing

#### Concern

European CSPs—including architects, quantity surveyors, project managers and contractors—face difficulties entering the Chinese market, preventing them from sharing their world-class expertise and cutting-edge technology with Chinese CSPs.

#### Assessment

Construction is one of the key drivers of a country's economy, especially for a large country like China in the midst of rapid urbanisation. The healthy development of the construction industry is of paramount importance to ensuring the effective use of resources and providing optimum living standards and environmental protection. For instance, good city planning can: optimise land use and ensure the long-standing quality of construction; positively influence peoples' moods by providing visually attractive architecture; and ensure the overall quality of a city's construction by utilising advanced technology and management skills—including the proper application of new materials—which reduces the total amount of labour and financing needed while also minimising disturbance to the environment. In most cases, European CSPs are not allowed to bid for third-parties contracts in Chinese Government projects. As a result, European service providers gain no recognition for the value they add, cannot control the quality of the final design and their business opportunities in China are extremely limited.

Foreign construction companies have been permitted to establish wholly foreign-owned construction enterprises in China for more than 15 years, and relevant limitations on the performance of so-called wholly foreign-owned projects were abolished in connection with the Foreign Investment Law, which is much appreciated. However, in order to further level the playing field, fostering the mutual recognition of certificates, degrees and experience between China and the EU may help facilitate the issuance of construction and design licences to European CSPs operating in China. The working group also recommends that foreign professionals in the field of architecture be given the opportunity to conduct in English the exams needed to gain local Chinese qualifications, with the qualification based on knowledge of local codes and rules. This would guarantee fair and equal opportunities for foreign professionals in China.

Foreign companies would also like to see local standards and regulations standardised so that they coordinate with, and guarantee the same quality as, well-established European and international green building standards.

#### Recommendations

- Foster mutual recognition of degrees, certificates

<sup>38</sup> Ibid.

<sup>39</sup> *Legislative Train Schedule: A Balanced and Progressive Trade Policy to Harness Globalisation - A New EU International Procurement Instrument (IPI)*, European Parliament, 26<sup>th</sup> April 2020, viewed 15<sup>th</sup> April 2022, <[https://www.europarl.europa.eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harness-globalisation/file-international-procurement-instrument-\(ipi\)>](https://www.europarl.europa.eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harness-globalisation/file-international-procurement-instrument-(ipi)>)

<sup>40</sup> Even if improvements were seen in the civil engineering and construction sector, members report that barriers remain and that the decrease is partly attributable to the change in business strategies they have adopted in China. They are either increasingly providing design and consulting services to domestic players, or pursuing joint projects with local government or private players, to enable them to circumvent regulatory barriers. *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 20<sup>th</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>





and experience to further level the playing field for foreign-invested construction and design firms.

- Improve local standards to reach the same quality as international green building standards.
- Allow qualification exams to be conducted in English to offer fair opportunities for foreign professionals.

#### 4. Continue to Ensure a Fair, Balanced and Open Market Exists for Foreign Investment in the Real Estate (RE) Sector



##### Concern

In China's RE sector, both foreign and domestic developers face procedural and regulatory hurdles, and European land developers are still locked out of the market due to stringent regulations and unclear government approval processes.

##### Assessment

The RE field in China still has very stringent regulations that cause a lot of problems for both domestic and foreign enterprises. Foreign-invested enterprises (FIEs) in the RE sector are faced with even more stringent regulations than FIEs in other sectors. One of the most stringent regulations, the *Opinions for Regulating the Access by and Administration of Foreign Investment in the Real Estate Market (Circular No. 171)*,<sup>41</sup> addresses a variety of measures for controlling the flow of foreign capital in the RE sector. Besides outlining the required 50 per cent proportion between registered capital and investment, *Circular No. 171* lists two more conditions that affect FIEs: they are not allowed to obtain loans from Chinese or overseas sources before getting land-use rights certification or before realising 35 per cent of their total investment.<sup>42</sup> This creates unfair competition between local and foreign companies, especially in relation to the different requirements for registering capital.

In 2015, the *Notice to Adjust Policies regarding Market Access and Administration of Foreign Investment in China's Real Estate Market (Circular No. 122)* rescinded

41 *Impact of Recent Restrictions on Foreign Investors in the Chinese Real Estate Market*, JD, March 2008, viewed 15<sup>th</sup> April 2022, <<https://www.jonesday.com/en/insights/2008/03/impact-of-recent-restrictions-on-foreign-investors-in-the-chinese-real-estate-market>>

42 Regarding the realisation of total investment, the rate is also 35 per cent for domestic companies. See, *Guidance to Risk Management of Real Estate Loan for Commercial Banks [2004] No. 57*, Central People's Government of the People's Republic of China, 30<sup>th</sup> June 2006, viewed 15<sup>th</sup> April 2022, <[http://www.gov.cn/ztl/2006-06/30/content\\_323806.htm](http://www.gov.cn/ztl/2006-06/30/content_323806.htm)>.

these requirements relating to the full payment of registered capital by FIEs and on the proportion of registered capital having to equal up to 50 per cent of total investment. Furthermore, *Circular No. 122* simplified the procedure allowing foreign-invested RE companies to register foreign currencies directly.<sup>43</sup>

The working group welcomed this improvement and recognised the positive steps undertaken by the Chinese authorities to promote a more mature and international investment environment. However, the working group believes that outdated or obsolete terms and restrictions carried forward from *Circular No. 171* need to be clarified. It has been seven years since *Circular No. 122* was released as an update, and no significant improvement has yet been seen on this issue.

Furthermore, the *Notice on Further Strengthening and Regulating the Examination, Approval and Supervision of Foreign Direct Investment in the Real Estate Industry (Circular No. 50)*, issued in 2007, introduced rigid controls on foreign investment in high-end RE projects, particularly for the acquisition of and investment in domestic RE enterprises.<sup>44</sup> Some of the stringent measures introduced in this circular have not been removed yet.

For instance, *Circular No. 122* does not expressly address a major practical hurdle that RE FIEs face when seeking foreign loans, i.e., according to relevant regulations issued by the State Administration of Foreign Exchange (SAFE),<sup>45</sup> any RE FIE approved and registered with the Ministry of Commerce on or after 1st June 2007 is not permitted to register its foreign debts with the SAFE. Therefore, unless the SAFE makes further clarifications on this point, the benefits and flexibility brought by *Circular No. 122* will be limited.

##### Recommendations

- Issue further clarifications or implementing rules regarding *Circular No. 122* to create a fair market

43 *Circular of the MOHURD and Other Departments on Adjusting Policies Regarding Market Access and Administration of Foreign Investment in China's Real Estate Market*, MOFCOM, 19<sup>th</sup> August 2015, viewed on 9<sup>th</sup> May 2022, <<http://wzs.mofcom.gov.cn/article/n/201508/20150801093662.shtml>>

44 *Notice on Further Strengthening and Regulating the Examination, Approval and Supervision of Foreign Direct Investment in the Real Estate Industry*, MOFCOM, 23<sup>rd</sup> May 2007, viewed 15<sup>th</sup> April 2022, <<http://www.mofcom.gov.cn/aarticle/b/g/200707/20070704900232.html>>

45 *Notice of the Measures for the Administration of Foreign Debt Registration*, SAFE, 28<sup>th</sup> April 2013, viewed 15<sup>th</sup> April 2022, <[http://www.gov.cn/zwgk/2013-05/03/content\\_2395170.htm](http://www.gov.cn/zwgk/2013-05/03/content_2395170.htm)>





environment for foreign companies investing in the Chinese RE market.

- Facilitate market access of foreign-invested RE enterprises to absorb immovable assets from illiquid or insolvent Chinese developers.

## Abbreviations

CNY	Chinese Yuan
CO <sub>2</sub>	Carbon Dioxide
CSP	Construction Service Provider
EU	European Union
FIE	Foreign-invested Enterprise
FYP	Five-year Plan
GDP	Gross Domestic Product
GPA	Government Procurement Agreement
GPL	Government Procurement Law
km	Kilometre
m <sup>2</sup>	Square Metre
MIIT	Ministry of Industry and Information Technology
MOHURD	Ministry of Housing and Urban-Rural Development
NBS	National Bureau of Statistics
NDRC	National Development and Reform Commission
RE	Real Estate
SAFE	State Administration of Foreign Exchange
TBL	Tender and Bidding Law
WTO	World Trade Organization





## Heating Sub-working Group

### Introduction to the Sub-working Group

The Heating Sub-working Group (or the Europe China Heating Initiative (ECHI)) seeks to promote European technologies that provide eco-friendly and sustainable heating appliances and components. The goal is to ensure that energy resources are conserved, while air quality is improved by significantly decreasing pollutant emissions. The 'coal-to-gas' (CTG) transition programme<sup>1</sup> is one of China's national strategies to fundamentally reduce particulate matter and nitrogen oxide (NOx) emissions, as well as to achieve increased energy efficiency.<sup>2</sup> European heating manufacturers can make significant contributions to the successful implementation of the CTG strategy while helping China to realise its carbon neutrality goals. The recommendations in this *Position Paper* aim to provide Chinese stakeholders with valuable industry insights and experience to improve the regulatory environment of the heating industry in China and benefit the Chinese population.

The representation of the European Heating Industry in China was created in 2002. It currently consists of 14 European enterprises involved in the manufacturing of highly efficient and renewable-based heating technologies and heating components. They manufacture heating appliances (such as high-efficiency heating boilers), burners, water heaters, renewables (such as solar and heat pumps) and industrial components. In 2016, the Heating Working Group became a sub-working group of the Construction Working Group. Together with its parent group, it strives to promote advanced European heating technology and offers information on the latest trends and developments in the heating industry.

### Recent Developments

#### Market Developments

In 2021, the market for gas-fired heating and hot

water combi-boilers (hereinafter referred to as heating boilers) decreased by more than 20 per cent, with total sales volume of 3.1 million units, falling back to a level similar to market volume in 2018.<sup>3</sup> Sales in the CTG replacement market dropped significantly in 2021, by a decrease of 64.6 per cent compared with 2020 (2.68 million units) as the CTG transition programme comes to an end.<sup>4</sup> On the other hand, the non-CTG (traditional retail and engineering) market reached 2.15 million units, with an annual sales increase of 41.4 per cent compared to 2020 (1.52 million units). The annual sales volume of condensing boilers increased by 18.2 per cent compared to 2020 figures, rising from 220,000 to 260,000 units. The growth can be attributed to imported brands, which increased by approximately 53 per cent year-on-year (from 111,000 to 160,000 units).<sup>5</sup>

#### Regulatory Environment

The Chinese authorities set stricter technical product requirements in 2021 to strengthen the heating appliance industry management. The Certification and Accreditation Administration (CNCA) published the *Notice on Amending the Compulsory Product Certificate Rules for Domestic Gas Equipment* on 6<sup>th</sup> July 2021,<sup>6</sup> which changed the safety testing programme requirements. Furthermore, the national standard *GB 25034-2020 Gas-fired Heating and Hot Water Combi-Boilers* came into effect on 1<sup>st</sup> November 2021, which supervises and urges companies to produce safer, standardised products under the new requirements, aiming to revive the sluggish domestic market for heating boilers.<sup>7</sup> While the *Compulsory Product Certification Catalogue Description and Definition Table (2020 version)* was not updated along with *GB 25034-2020*, and continues to restrict certification of products using more than 70 kilowatts (kW) and products with maximum heating water pressure greater than 0.3MPa,

3 *Gas-Fired Heating and Hot Water Combi-Boilers 2021 Market Statistics*, China Gas Heating Specialty Committee (CGHC), 28<sup>th</sup> January 2022, viewed 16<sup>th</sup> March 2022, <<http://cghc.chinagas.com.cn/News/detail/item/2372/category/204.html>>

4 *ibid.*

5 *ibid.*

6 *Notice of the CNCA on Amending the Compulsory Product Certificate Rules for Domestic Gas Equipment*, CNCA, 6<sup>th</sup> July 2021, viewed 16<sup>th</sup> March 2022, <[http://www.cnca.gov.cn/zwl/gg/gg2021/202107/t20210706\\_65191.shtml](http://www.cnca.gov.cn/zwl/gg/gg2021/202107/t20210706_65191.shtml)>

7 *The Promotion Conferences on Mandatory National Standard for Gas-fired Heating and Hot Water Combi-boilers GB 25034-2020 were successfully held in Shanghai, Guangdong and Tianjin*, bgl88.com, 21<sup>st</sup> December 2020, viewed 16<sup>th</sup> March 2022, <<http://www.bgl88.com/cms/show-11363.html>>

1 CTG strategy refers to the energy-efficiency policy of the Chinese central government and the Beijing-Tianjin-Hebei governments to promote replacing coal with natural gas.

2 *Notice on the Action Plan for Comprehensive Management of Air Pollution in the Autumn and Winter of 2018/2019 in Beijing-Tianjin-Hebei and Surrounding Areas*, Ministry of Ecology and Environment (MEE), 21<sup>st</sup> September 2018, viewed 16<sup>th</sup> March 2022, <[http://www.mee.gov.cn/gkml/sthjbgw/sthjbjw/201809/t20180927\\_630570.htm](http://www.mee.gov.cn/gkml/sthjbgw/sthjbjw/201809/t20180927_630570.htm)>





the certification scope is expected to be updated by the appropriate agencies in the near future.<sup>8</sup>

The National Energy Administration's (NEA's) *Energy Work Guidance 2021* lays out the future direction for the energy and heating sector, to "enhance energy security capabilities, expedite clean and low-carbon development, achieve harmonious development of both energy and ecology, increase clean heating, carry out clean heating conversions according to local conditions, and implement and improve the clean heating policy system to ensure the safe and stable operation of heating facilities".<sup>9</sup> The working group hopes the NEA guidelines will go further and promote studying and testing hydrogen blending standards to provide a theoretical basis for developing large-scale, long-distance hydrogen blending and pure hydrogen transportation.

During the 14<sup>th</sup> Five-year Plan period, the working group hopes that China's efforts to foster energy efficiency and reduce environmental pollution will boost the market for highly efficient and energy-saving boilers. The CGHG has called on all parties in the heating boiler industry to improve collaborative technological innovation and technology sharing, in order to encourage the widespread use of energy-saving technologies such as condensation technology in heating boilers.<sup>10</sup> It also states that efforts should be made to deepen consumer and industry awareness, and push ahead with marketing energy-saving products such as condensing boilers.<sup>11</sup>

The Heating Sub-working Group is ready to share its experience in the policymaking process to help achieve these government goals. In return, the working group hopes that government agencies fully consider protecting the interests of companies, reducing the administrative burden on companies, and facilitating collaborative and healthy industry development.

8 Notice of the State Administration for Market Regulation on Optimizing the Compulsory Product Certificate Catalogue, CNCA website, 28<sup>th</sup> April 2020, viewed 16<sup>th</sup> March 2022, <[http://www.cnca.gov.cn/zw/gg/zjgg/202008/t20200820\\_63968.shtml](http://www.cnca.gov.cn/zw/gg/zjgg/202008/t20200820_63968.shtml)>

9 Notice of the National Energy Administration on Printing and Distributing the "Guiding Opinions on Energy Operations in 2021", NEA, 22<sup>nd</sup> April 2020, viewed 16<sup>th</sup> March 2022, <[http://www.nea.gov.cn/2020-06/22/c\\_139158412.htm](http://www.nea.gov.cn/2020-06/22/c_139158412.htm)>

10 Gas-Fired Heating and Hot Water Combi-Boilers 2021 Market Statistics, China Gas, 28<sup>th</sup> January 2022, viewed 16<sup>th</sup> March 2022, <<http://cghc.chinagas.com.cn/News/detail/item/2372/category/204.html>>

11 Ibid.

## Key Recommendations

### 1. Update the Standard for Energy Efficiency of Domestic Gas Appliances and Introduce National Guidelines or Policies to Promote Full Premixed Condensing Boilers with Level I Energy Efficiency 3

#### 1.1 Update the Energy Efficiency Standard, and Refine and Improve Requirements for Domestic Gas Appliances 3

##### Concern

The energy efficiency standard for heating boilers is out of date and does not reflect the energy efficiency levels such appliances can actually achieve.

##### Assessment

*GB 20665-2015 Minimum Allowable Values of Energy Efficiency and Energy Efficiency Grades for Domestic Gas Instantaneous Water Heaters and Gas-fired Heating and Hot Water Combi-Boilers*,<sup>12</sup> which took effect in June 2016, has played a vital role in promoting the structural upgrading of heating boilers, and implementing energy-saving and emission-reduction requirements for gas appliances. The standard divides energy efficiency into three levels: the thermal efficiency value for Level I equals a minimum of 96 per cent, Level II a minimum of 88 per cent, and Level III a minimum of 84 per cent. Currently, only heating boilers of Level II or higher can enter the market. Some regions and cities already promote a large-scale utilisation of Level I energy efficiency heating boilers only, with Levels II and III becoming obsolete. However, the energy efficiency of the latest full premixed condensing boilers could reach 108 per cent of this standard,<sup>13</sup> therefore updating *GB 20665-2015* would help promote use of the most efficient products on the market while continuing to weed out products with lower energy-efficiency rates.

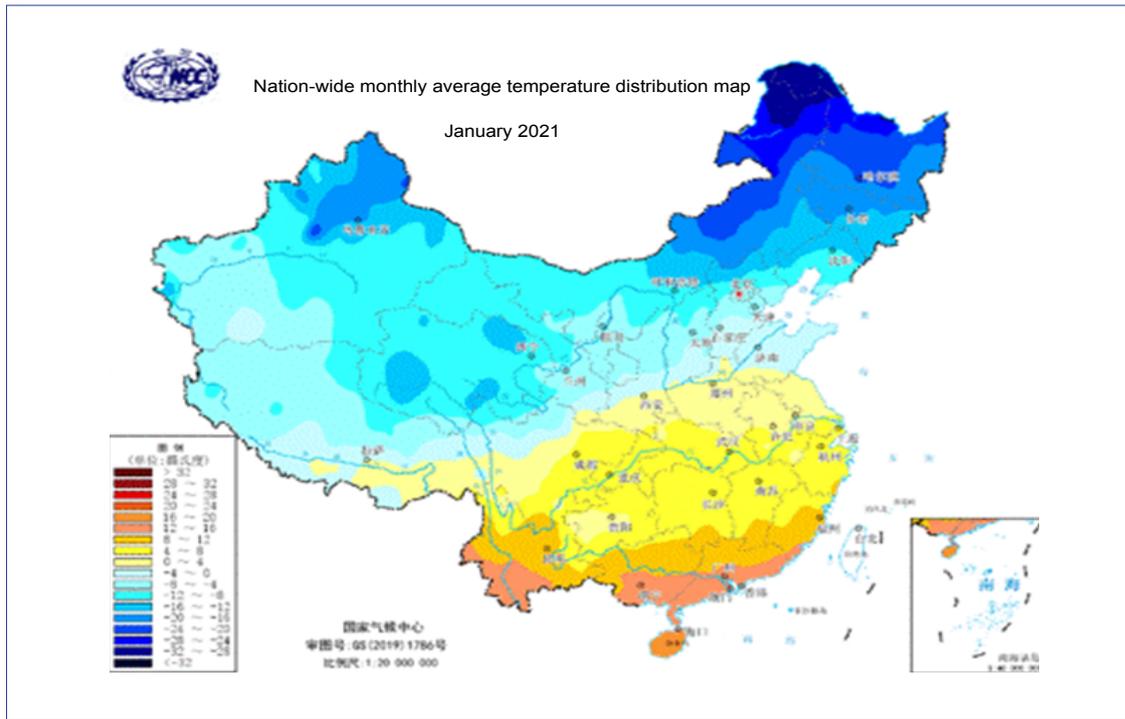
Coal-fired power generation accounted for 63.2 per cent of China's total in 2020.<sup>14</sup> In addition, power

12 *GB 20665-2015 Minimum Allowable Values of Energy Efficiency and Energy Efficiency Grades for Domestic Gas Instantaneous Water Heater and Gas-fired Heating and Hot Water Combi-boilers*, SAMR, 15<sup>th</sup> May 2015, viewed 16<sup>th</sup> March 2022, <<http://www.gb688.cn/bzgk/gb/newGbInfo?hcno=75D38814EF3EE95E56E53DC00CF759C6>>

13 *Gas Condensing Technology: Key for Efficiency and Clean Air in China*, Federation of German Heating Industry, 3<sup>rd</sup> June 2019, viewed 16<sup>th</sup> March 2022, <[https://www.bdh-industrie.de/fileadmin/user\\_upload/ISH2019/Broschueren/broschuere\\_februar\\_2019\\_gas\\_condensing\\_technology\\_cn.pdf](https://www.bdh-industrie.de/fileadmin/user_upload/ISH2019/Broschueren/broschuere_februar_2019_gas_condensing_technology_cn.pdf)>

14 *China Coal-fired Power Generation Report in 2021*, China Power, 21<sup>st</sup> July 2021, viewed 15<sup>th</sup> March 2022, <<http://mm.chinapower.com.cn/zx/zxbg/20210721/89863.html>>





transmission losses will lower the actual efficiency rate. Therefore, when comparing the energy efficiency of gas and electrical appliances, it is important to bear in mind the primary energy thermal efficiency, instead of simply comparing energy efficiency, to accurately measure actual carbon emissions between different heat sources and actual product energy efficiency.

In addition, heat source products should be tested at various outdoor temperatures or simulated indoor temperatures. For example, the tests should be performed at 10 degrees Celcius (°C), 0°C and -10°C, to accurately reflect the heat source product's actual energy efficiency. Heat source products are mainly used in winter. The map above shows the average temperatures in China in January, which in most areas is below 0 °C.

The energy efficiencies of various heat-producing products, such as air-source heat pumps, varies based on the outdoor temperature. For example, in the air-source heat pump cycle, heat energy is drawn from outside air or flowing water that is at a temperature higher than the evaporation temperature, which then is heated mechanically and supplied to the indoor heating system.<sup>15</sup> As a result, heat pumps have relatively low

energy efficiency when operating at below-freezing temperatures.

When evaluated alongside several other heating products, heat pumps are generally more energy-efficient. However, over time, and given China's energy endowment restrictions, the carbon emissions of heat pumps are higher than fully premixed wall-mounted gas boilers, due to heat pumps' reliance on only a single heat source for power generation.

In Europe, energy labels for household heating products display 10 levels and have specific requirements relating to energy efficiency, which helps to better categorise products.<sup>16</sup> While European standards for energy efficiency of domestic appliances differ from Chinese standards, a more refined evaluation system in China would encourage manufacturers to pursue higher energy efficiency.

#### Recommendations

- Update and refine the energy efficiency standards for domestic gas appliances.
- Refine and improve the efficiency requirements for domestic gas appliances.

<sup>15</sup> The First Law of Thermodynamics, Baidu Encyclopedia, viewed 15<sup>th</sup> March 2022, <<https://baike.baidu.com/item/laws-of-thermodynamics/476312>>

<sup>16</sup> About the Energy Label and Ecodesign, European Commission, n.d., viewed 16<sup>th</sup> March 2022, <[https://ec.europa.eu/info/energy-climate-change-environment/standards-tools-and-labels/products-labelling-rules-and-requirements/energy-label-and-ecodesign/about\\_en](https://ec.europa.eu/info/energy-climate-change-environment/standards-tools-and-labels/products-labelling-rules-and-requirements/energy-label-and-ecodesign/about_en)>





- Establish energy efficiency requirements for major components while keeping the overall requirements coherent.
- Abandon outdated energy efficiency evaluation methods and implement a standardised carbon efficiency evaluation system alongside primary energy to compare the thermal efficiency rates of different primary energies and the wiring system efficiencies of various heating products.

## 1.2 Introduce Policy Guidelines for Promoting Energy-saving and Low-emission Gas Boiler Technologies

### Concern

The government does not sufficiently encourage the adoption of energy-efficient and low-emission heating technologies, such as full premixed condensing technologies, while relevant applications and research are limited, resulting in a lack of active promotion of air pollution control or energy efficiency policies.

### Assessment

There are two main types of heating boilers: conventional and condensing. Condensing boilers increase energy efficiency by up to 20 per cent and reduce pollutant emissions; for example, they can cut NOx emissions by up to 75 per cent compared with non-condensing models.<sup>17</sup>

Therefore, it is better when formulating guidelines and policies on energy efficiency and pollution control in construction projects to promote the use of condensing boilers from first installation. Doing so will eliminate the need to rearrange corresponding accessories and pipes in order to replace conventional gas boilers in the future.

Article 26 of Beijing's *Three-year Action Plan for Winning the Battle of Blue Sky Protection*, a guiding document on energy conservation and emission reduction from 2018–2020, states clearly:

#### Further reduce NOx emissions from heating boilers

The Beijing Municipal Commission of Housing and Urban-Rural Development leads the revision of

<sup>17</sup> *Gas Condensing Technology: Key for Efficiency and Clean Air in China*, Federation of German Heating Industry, 3<sup>rd</sup> June 2019, viewed 16<sup>th</sup> March 2022, < [https://www.bdh-industrie.de/fileadmin/user\\_upload/ISH2019/Broschuere/broschuere\\_februar\\_2019\\_gas\\_condensing\\_technology\\_cn.pdf](https://www.bdh-industrie.de/fileadmin/user_upload/ISH2019/Broschuere/broschuere_februar_2019_gas_condensing_technology_cn.pdf) >

the *Municipal Catalogue of Promotion, Restriction and Prohibition of the Use of Building Materials*. In new, renovation and expansion projects, the use of condensing boilers with Level II energy efficiency or below is prohibited, and NOx emissions must meet the Level V requirement of the condensing boilers national standard.<sup>18</sup>

This guideline helped to effectively control pollutant emissions while reducing consumers' gas fees.

The relevant institutions lack full understanding of premixed condensing technology applications and its energy-conserving and emission-reducing benefits. In addition, China lacks supporting policies to encourage high-efficiency and low-emission heating technologies, such as full premixed condensing technology, which offers high energy efficiency and low NOx emissions and has relatively low replacement costs.

Most studies on premixed condensing technology applications are from enterprises and associations, such as the Beijing Association of Building Energy Efficiency and Environmental Engineering. Very few universities have relevant departments or research programmes, except for Tongji University and Tianjin Chengjian University, which have research projects on condensing technology and full premixed combustion. The working group recommends that industry stakeholders and authorities consider the advantages of full premixed condensing technology. It is necessary to strengthen relevant Chinese institutions' research in full premixed condensing technology applications and the effects on energy conservation and emission reduction. Also, the working group recommends implementing subsidies for high-efficiency and low-emission technologies such as full premixed condensing boilers in major cities and regions, and further expanding the projects to more areas to encourage consumers to purchase full premixed condensing boilers.

### Recommendations

- Introduce policy guidelines for promoting energy-saving and low-emission technologies, starting from key cities and regions.
- Issue relevant policies to encourage consumers to buy full premixed condensing boilers for the first

<sup>18</sup> *Three-Year Action Plan for Winning the Battle of Blue-Sky Protection*, State Council, 3<sup>rd</sup> July 2018, viewed 16<sup>th</sup> March 2022, <[http://www.gov.cn/zhengce/content/2018-07/03/content\\_5303158.htm](http://www.gov.cn/zhengce/content/2018-07/03/content_5303158.htm) >





installation of heating in a building.

- Encourage research projects on full premixed condensing technology, including its application, energy-saving and emission-reducing effects.

## 2. Improve and Effectively Implement Standards for the Installation and Maintenance of Heating Boilers, and Educate Consumers on the Need for Regular Maintenance and Replacement



### 2.1 Strengthen the Standardisation and Management of the Installation of Heating Boilers

#### 2.1.1 Improve the Standards for Installation of Heating Boilers and Strengthen the Standardisation and Management of Responsible Enterprises and Personnel



##### Concern

The development of the heating boiler market is hindered by the lack of adequate installation technical guidelines or standards, as well as the varying competence of enterprises and personnel responsible for installation, both of which raise safety concerns.

##### Assessment

Heating boilers are complex products that require the installation of heating and hot water systems. The operation of these products involves the use of gas, running water, electricity, air intake and exhaust pipes. To ensure long-term efficient use and stable and safe operation, equipment manufacturers should provide a complete set of products and systems as well as periodic servicing and maintenance (see Key Recommendation 2.2).

The water quality of domestic heating systems has a significant impact on the system's operating efficiency and service life. In general, installation companies and consumers pay little attention to this aspect. Poor water quality can lead to the system clogging up, higher unnecessary after-sales costs, and lower heating efficiency rates due to limescale and corrosion, which is contrary to the Chinese Government's energy conservation and emission reduction efforts. A good quality chemical protector and magnetic filter can avoid

such problems and advance energy conservation and emission reduction efforts.

While the Chinese Government and authorities have issued new national standards for heating boilers and formulated industry standards for product applications, there is still a lack of effective monitoring and maintenance after installation. Although the installation of heating boilers requires professionals and enterprises with technical capabilities to select, design and install the entire system, the authorities lack effective rules and regulations for monitoring practitioners' and enterprises' capabilities, as well as for supervising installations. Based on feedback from member companies, the main issues that arise during warranty are a result of low-quality installation. If installation quality cannot be effectively controlled and improved, it will hinder the further development of the industry.

European Union (EU) Member States have over 50 years of rich experience in using heating boilers. More importantly, EU heating boiler-related standards, products, applications and services are mature and comprehensive. EU Member States also have well-regulated and mature methods and systems for certifying the qualifications of installation engineers and providers, as well as for supervising installation quality. European enterprises represented by the ECHI entered the Chinese market quite early, and therefore have much experience—from both China and Europe—to assist the Chinese authorities in formulating relevant regulations. Establishing a training mechanism for heating boilers installers and a vocational threshold would promote the technical skills of qualified installers and ensure the quality of installation as well as safety during subsequent usage.

In addition, the working group recommends using water treatment products for new installations, including magnetic filters to filter debris from the water and system protectors to prevent corrosion and limescale problems in the long term. European quality certification systems such as KIWA and BuildCert CIAS are mature standards for water treatment equipment and chemicals.<sup>19</sup> As working group members have

<sup>19</sup> KIWA GAS TEC is the most respected gas safety certification organisation in Europe, founded in 1929 and based in Apeldoorn in the Netherlands. For over 70 years, it has focussed on providing independent third-party safety monitoring and testing certification services for the gas applications industry. The BuildCert CIAS, also known as the BuildCert Chemical Inhibitor Approval Scheme (CIAS), is an experimental test for central heating system protector performance based on British Heating Industry Standard BS 7593-2019, which is an extension of the





qualifications and experience in these standards, they can engage in information-sharing with their Chinese counterparts and the authorities. European manufacturers / critical parts manufacturers have similar qualifications from their experiences in the developed EU market .

#### Recommendations

- Formulate and implement regulations for installation of heating boilers.
- Emphasise and introduce the use of water treatment products for new installations.
- Improve the training for personnel and enterprises responsible for installation and establish a vocational certification system.

### 2.1.2 Reasonably Adjust the Content and Cycle of Product Tests for Local Market Access based on the China Compulsory Certification (CCC) Policy 2

#### Concern

Since implementing the CCC policy, authorities' requirements for product quality control and supervision have improved, but local repetitive test items and the test cycle remain unchanged.

#### Assessment

In recent years, as China amended standards and requirements relating to natural gas supply, the quality of the fuel has improved and stabilised.

Since 2020, domestic gas appliances have been managed by the CCC from 1<sup>st</sup> October 2020, which, from the perspective of company product quality management, involves high-level requirements for product quality control and management of gas appliance companies. In the *Decision of the State Council on Further Reducing the Catalogue of Production Licences for Industrial Products and Simplifying the Examination and Approval Procedures*,<sup>20</sup> the CCC system is applied to products involving public health, safety and environmental protection to 'unify certification standard and reasonably reduce and combine certification test items'. The management system aims to unify market access conditions as well

industry specification Approved Document L - Conservation of fuel and power.

20 *Decision of the State Council on Further Reducing the Catalogue of Production Licences for Industrial Products and Simplifying the Examination and Approval Procedures*, State Council, 30<sup>th</sup> September 2018, viewed 16<sup>th</sup> March 2022, <[http://www.gov.cn/zhengce/content/2018-09/30/content\\_5327123.htm](http://www.gov.cn/zhengce/content/2018-09/30/content_5327123.htm)>

as simplify the industrial product approval procedure.

Tests for domestic gas appliances under the previous production certification system and tests on the compatibility of local gas sources are not aligned in terms of test items or standards. Additionally, the tests overlap with or exceed test items under the new CCC system. The sub-working group believes that the various tests could be integrated and optimised alongside the CCC system and implementation of *GB 25034-2020 Gas-fired Heating and Hot Water Combi-boilers*.

#### Recommendation

- Reasonably reduce repetitive test items for local market access, and extend the test cycle.

### 2.2 Strengthen the Publicity and Effective Supervision of the Maintenance of Heating Boilers 3

#### Concern

Consumers only pay attention to initial investment in the purchase and installation of heating boilers, and overlook the servicing and maintenance necessary for long-term operation.

#### Assessment

In European countries, where technologies and applications for heating boilers are quite developed, the necessity for regular maintenance has been accepted by the public. As a result, Europe has mature supervision measures that could act as an example for Chinese market regulators and consumers. However, cultivating consumers' awareness of the need to regularly maintain heating boilers depends on vigorous publicity and effective supervision by relevant authorities, along with appeals and calls from the industry.

Usually, the after-sales services provided by manufacturers and the regular maintenance provided by systems installers only focus on the main system component, resulting in incomplete maintenance. Instead of only performing maintenance on the heating boiler, system maintenance coverage needs to include the whole system. For example, the impact of poor water quality on gas furnaces for heating hot water in closed water systems should not be underestimated.





However, if the entire gas furnace system is kept maintained, problems due to water quality issues would not inevitably lead to declines in energy efficiency or boiler operational failures.

Regular maintenance guarantees the efficient operation of heating boilers, increases reliability, prolongs service life, and reduces operation costs and risks. Regular inspection is an indispensable part of maintenance. In Europe, there is a system for periodic inspection for leakage of flue combustion emissions (such as carbon monoxide and NOx), originally established for environmental protection but which also secures combustion performance and safety of the boilers. Gas security is also both an environmental protection and livelihood issue, in which the regular maintenance of wall-mounted gas boilers is vital. Apart from having manufacturers effectively promote awareness of these issues, gas companies also need to cooperate to gain consumer trust and convince them of the need for regular maintenance for wall-mounted gas boilers.

#### Recommendations

- Strengthen effective supervision of regular maintenance of heating boilers, and educate consumers accordingly.
- Issue regulations for periodic maintenance of heating boilers to ensure their efficient and safe operation.
- Improve awareness of overall heating system safety, and service employee and user knowledge of the benefits of using water treatment products in heating systems.
- Encourage factory and gas management departments to work together to raise awareness of the requirements for regular maintenance of wall-hung heaters.

### 2.3 Cultivate Consumers' Awareness of the Need for Timely Removal and Replacement of Heating Boilers with High Energy Consumption and Emissions or Those at the End of Their Service Life

#### Concern

Chinese consumers are not accustomed to replacing heating boilers that have reached the end of their service life or that do not meet relevant regulations.

#### Assessment

Replacement of heating boilers with high energy consumption and high emissions is not only conducive

to improving environmental protection, but also helps to reduce maintenance requirements and costs for users. Heating boilers have been installed and used in China for more than 20 years, and a certain number of products in the market have exceeded their intended service life. If these old products are not replaced in line with relevant regulations, emissions of carbon dioxide and NOx will not be reduced as fast as is needed to meet China's carbon neutrality goals. The sub-working group is aware that several EU Member States have programmes to assess the age and efficiency of previously installed condensing boilers. This has raised awareness among consumers that some products need to be replaced and that energy and household expenses could be saved by doing so. In Beijing, new, renovation and expansion projects prohibit the use of heating boilers with Level II energy efficiency or below, and support and encouragement to replace about 800,000 low-efficiency and high-emission heating boilers is to start in the near future.<sup>21</sup> This will help to improve regional air quality and save energy. The working group hopes that such replacement work can be embarked on in more places.

The development of consumer awareness largely depends on the immediate interests of users. For instance, gas fees can be reduced in the long-term by dismantling energy-intensive and high-emission gas heaters and replacing them with environmentally friendly and energy-efficient condensing heaters. In terms of safety, replacing worn-out gas heaters ensures user personal and property safety. The working group recommends that gas companies regularly conduct gas safety inspections to supervise and optimise wall-hung heater energy efficiency and lifespans, and to encourage regular maintenance or replacement of wall-hung heaters.

#### Recommendations

- Cultivate consumers' awareness of the need for timely removal and replacement of heating boilers with high energy consumption and emissions or those at the end of their service life.
- Assist users in ensuring regular maintenance and repairment of wall-hung heaters, providing guidance

<sup>21</sup> Beijing Building Energy-Efficiency & Environment Engineering Association, China Quality Supervising and Test Centre for Gas Appliances, Guangdong Gas Combi-Boiler Chamber of Commerce and the ECHI jointly submit a report on the research project of BCEMA on replacing wall-hung boiler policy in Beijing-to-Beijing Municipal Government in 2020, BCEMA, 2020, report not available publicly.





- to end-users, and raising gas safety awareness.
- Formulate policies to encourage and support consumers to replace low-efficiency and high-energy-consumption heating boilers that have reached the end of their service life with more efficient and eco-friendly full premixed condensing boilers.

### 3. Research and Discuss the Role of Hydrogen-mixed Technology in the Laying of Gas Pipeline Networks for Domestic Appliances in China

#### Concern

The government's encouragement of hydrogen mixing in civil natural gas pipelines is insufficient, related applications and research are limited, and there is a lack of national or industry standards.

#### Assessment

Economic development and improvements in people's living standards has caused China's energy consumption and carbon emissions to increase significantly, so that its total carbon emission now accounts for a third of global carbon emissions.<sup>22</sup> Since President Xi Jinping announced in September 2022 that China's carbon emissions will peak in 2030 and carbon neutrality will be accomplished by 2060 (the 30/60 Goals), the Chinese Government has determined the way for low-carbon development for various industries,<sup>23</sup> including the construction industry.<sup>24</sup> A rapid and efficient energy transition is critical to realising the 30/60 Goals.

Heating and cooling buildings alone accounts for nearly one-third of global carbon emissions;<sup>25</sup> therefore, the heating industry plays a vital role in the energy transition. European heating equipment and solution vendors have strived to encourage low-carbon and even zero-carbon energy solutions in the European market. In recent years, over 80 projects on the use of hydrogen in buildings have sprung up in several

European countries. In collaboration with the countries' national energy departments, pilot projects have been set up, in order to advertise and encourage zero-carbon heating technology, which has started to receive public acceptance and awareness. Currently, there are few policies to create conditions and opportunities to assist the domestic heating industry in taking the first step toward zero-carbon emissions. Therefore, progress in this area is plodding, regardless of technological developments, product iteration or concept development at the consumption level.

An appropriate proportion of hydrogen blended into existing natural gas pipeline networks to be transported to end-users can help Chinese stakeholders accumulate experience for future large-scale, long-distance and low-cost hydrogen delivery. Hydrogen blended can play a role in energy storage, power-load shifting and peak shaving, effectively reducing carbon emissions. Although the *Medium and Long-term Plan for the Development of Hydrogen Energy Industry (2021-2035)* defines hydrogen energy as new energy and supports hydrogen delivery through natural gas pipelines, there are no additional supporting policies, technical measures or technical standards for implementation.<sup>26</sup> As a result, agencies still regard hydrogen as a hazardous chemical based on the *Catalogue of Hazardous Chemicals 2015*,<sup>27</sup> thus restricting the application of hydrogen energy in a broader range of fields. Infrastructure (such as hydrogen production, hydrogen blending technology and pipeline networks coverage) is necessary for applying hydrogen energy technology. Despite having the latest technologies and products at their downstream hydrogen and heating equipment manufacturers disposal, the market lacks the necessary application environment and implementation conditions. Therefore, downstream hydrogen and heating equipment manufacturers cannot play a leading role and take social responsibility in the zero carbon field.

The working group recommends that the energy supply departments develop a sound top-level design, expedite the research and development of standards and technical specifications related to hydrogen blending

22 *White Paper on Low Carbon Transition of Chinese Energy Companies*, Accenture, 6<sup>th</sup> November 2021, reviewed 15<sup>th</sup> March 2022, <<https://www.accenture.com/cn-zh/insights/energy/chinese-energy-enterprises-low-carbon-transition>>

23 *The Strategy and Challenges of Realising the Dual Carbon Policy*, gmw.cn, 7<sup>th</sup> July 2021, reviewed 11<sup>th</sup> May 2022, <[https://www.gmw.cn/xueshu/2021-07/07/content\\_34976788.htm](https://www.gmw.cn/xueshu/2021-07/07/content_34976788.htm)>

24 *State Council: Notice on the Issuance of the Carbon Peaking Action Plan by 2030*, State Council, 26<sup>th</sup> October 2021, reviewed 11<sup>th</sup> May 2022, <[http://www.gov.cn/zhengce/content/2021-10/26/content\\_5644984.htm](http://www.gov.cn/zhengce/content/2021-10/26/content_5644984.htm)>

25 *Why the Building Sector? Architecture 2030*, viewed 15<sup>th</sup> March 2022, <<https://architecture2030.org/why-the-building-sector/>>

26 *China releases medium- and long-term development plan for hydrogen energy*, *Tank News International*, 5<sup>th</sup> April 2022, viewed 28<sup>th</sup> June, 2022, <<https://tanknewsinternational.com/china-releases-medium-and-long-term-development-plan-for-hydrogen-energy/>>

27 *Catalogue of Hazardous Chemicals 2015*, Ministry of Emergency Management (MEM), 31<sup>st</sup> March 2015, reviewed 11<sup>th</sup> May 2022, <[http://www.gov.cn/ffig/2011-03/11/content\\_1822902.htm](http://www.gov.cn/ffig/2011-03/11/content_1822902.htm)>





in natural gas pipelines for civil construction. It should be clarified that hydrogen production stations used for carrying a blend of natural gas and hydrogen are not subject to the entry of hazardous chemical production projects into chemical parks<sup>28</sup> and that natural gas blending pipelines are still managed as natural gas pipelines. Additionally, under the guidance and participation of the NEA, hydrogen blending standards should be studied and tested, mainly; hydrogen blending ratios (five per cent, 10 per cent, 15 per cent, 20 per cent); the impact on the natural gas combustibility and the Wobble Index;<sup>29</sup> as well as the degree of damage caused by pipeline materials. This will help to provide a theoretical basis for the development of large-scale, long-distance, hydrogen blending, and pure hydrogen transportation. Technical standards for natural gas pipelines blended with hydrogen should be prepared for the civil HVAC<sup>30</sup> industry, alongside the construction of independent civil buildings and the creation of demonstration projects for the application of natural gas blending and hydrogen combustion condensing boilers in civil construction, in order to prove actual operation data for large-scale improvement and implementation.

### Recommendations

- Set up pilot areas, build demonstration projects, and promote the concept of zero-carbon heating via hydrogen.
- Draft corresponding standards and regulations to guide products and industries with standardised development.
- Encourage the creation of technical standards, such as manufacturing standards and standards for the installation and inspection of hydrogen blending and pure hydrogen combustion equipment.

## Abbreviations

CCC	China Compulsory Certification
CGHC	China Gas Heating Specialty Committee
CNCA	Certification and Accreditation Administration of the China
CTG	Coal-to-Gas
ECHI	Europe China Heating Initiative
EU	European Union
HVAC	Heating, Ventilation and Air Conditioning
kW	Kilowatt
MEE	Ministry of Ecology and Environment
MEM	Ministry of Emergency Management
NEA	National Energy Administration
NOx	Nitrogen Oxide
SAMR	State Administration for Market Regulation

<sup>28</sup> Implementation Measures for Safety Production Permit for Hazardous Chemical Production Enterprises, MEM, 6<sup>th</sup> March 2017, reviewed 11<sup>th</sup> May 2022, <[https://www.mem.gov.cn/gk/zfxxgkpt/fdzdgknr/gz11/201112/t20111201\\_405679.shtml](https://www.mem.gov.cn/gk/zfxxgkpt/fdzdgknr/gz11/201112/t20111201_405679.shtml)>

<sup>29</sup> The Wobble Index is a measure of the interchangeability of fuel gases and their relative ability to deliver energy. It gives an indication of whether a turbine or burner will be able to run on an alternative fuel source without tuning or physical modifications.

<sup>30</sup> HVAC refers to heating, ventilation, and air conditioning.





# Information and Communication Technology Working Group

## Key Recommendations

### 1. Ensure that Supply Chain Regulations Serve to Secure Foreign Investment and Anchor China More Deeply into the Global System, Not Vice Versa

- Give full play to the role of international companies in stabilising the information and communication technology (ICT) supply chain.
- Ensure that regulatory controls improve overall supply chain security, instead of pursuing self-sufficiency at the expense of long-term interdependencies and cooperation prospects.
- Narrowly define the concept of 'national security' to avoid generalisation.
- Allow voluntary standards and certification programmes to remain truly so.
- Rely on international standards to the largest extent possible, rather than imposing undue restrictions on both the usage of such standards, and the scenarios in which they can be used (for example, only for international interconnection).
- Ensure technology neutrality in supply chain regulations to drive competition and long-term growth.

### 2. Ensure Reciprocity on Market Share for European ICT Companies

- Implement measures to improve market share for the European ICT industry to ensure and maintain reciprocity in the long run.
  - Identify all ICT market segments where market share reciprocity is lacking and develop actions—jointly defined by Chinese and European stakeholders—that address the imbalances.
  - Review the status of market share reciprocity regularly.
- Establish an open and effective monitoring and correction mechanism for ICT market reciprocity, with sponsorship from the EU and China, in order to address the current, prominent issues.

### 3. Open up Value-added Telecoms Services (VATS) and Internet Sectors to International Companies 13

- Reduce further the *Negative List* and allow increased international participation in the telecoms- and internet-related sectors.
- Continue to open up the *Telecoms Catalogue* and allow international companies in China to obtain VATS licences, particularly for internet resource collaboration, internet protocol virtual private network, internet access services, online data processing and transaction processing services, and information services.

### 4. Develop and Implement Commercial Cryptography Laws, Regulations, Standards and Conformity Assessment Systems in Such a Way that They are Clear, Fair and Conducive to International Harmonisation 3

- Allow the adoption of international standards related to commercial cryptography.
- Reference explicitly the primary function test in the revised *Commercial Cryptography Regulation*.
- Define narrowly the scope of commercial cryptography products subject to testing, certification,





application security assessment, and import licence and export control.

- Ensure technology-neutral and streamlined conformity assessment processes for commercial cryptography, and that intellectual property and trade secrets are protected.
- Define 'mass consumer products' as 'cryptography features as found in components and products openly available to the public, that can be either charged or free, for personal or business use, and where the cryptographic functionality cannot be modified by the end user'.
- Clarify the scope and processes for commercial cryptography application security assessments in such a way that they are proportionate and non-disruptive to normal business activities.
- Refrain from mandating or expanding the scope of conformity assessment under the guise of 'application promotion', and revise incompatible regulations, standards and conformity assessment systems.
- Apply clarity and transparency to the design and roll-out of the Cryptography Law's implementing regulations and ensure that any such regulations, including standards, are fully in line with the superordinate law.

## 5. Ensure Timely and Globally-harmonised Spectrum Allocations for Key Technologies and Applications Development that Benefit both China and the Global Industry as well as Consumers

- Ensure the timely availability for usage of 5G spectrum, the 60 gigahertz (GH) band and the 79–81GHz band.
- Strengthen exchanges and coordination between China and the European Union regarding spectrum regulation in the lead-up to the World Radiocommunication Conference-23, including by integrating the spectrum topic in relevant government-to-government dialogues.

## Cybersecurity Sub-working Group

### 1. Ensure that Chinese Security Legislation Does Not Create Discriminatory Market Access Barriers 6

- Define the concepts of 'national security' and 'critical information infrastructure' as narrowly as possible, and differentiate them from 'commercial security' in a clear manner.
- Limit the applicability and influence of the various theoretically non-binding documents, such as recommended national standards, in such a manner that they do not go beyond binding legislation.
- Promote mutual recognition and adoption and reliance upon, applicable international standards and global industry best practices.
- Relax restrictions on cross-border data transfer to allow easier market access.
- Take steps to ensure that the terms negotiated in cross-national trade and investment deals are effectively implemented in practice.

### 2. Minimise Unnecessary Operational Burdens Created by Extensive, Ambiguous and Discretionary Security Schemes 7

- Ensure consistency between upper-level legislation and relevant implementing regulations, and follow the least interference principle in the course of legitimate international business operations.





- Ensure a coordinated and unified approach for oversight and enforcement among the government authorities involved.
- Reduce security-related administrative burdens on companies, including those due to duplicative or fragmented requirements.

### 3. Ensure Transparency, Consistency, Non-discrimination and Proportionality in Security Rulemaking and Law Enforcement

- Provide in a timely and meaningful manner an open and transparent platform that allows European businesses to engage in security rulemaking.
- Review existing and planned security-related laws and regulations, and release unambiguous implementation guidelines to ensure consistent requirements and enforcement.
- Clarify the roles and responsibilities of government authorities involved in security rulemaking.
- Recognise multinational corporations with operations in China as Chinese companies and avoid extensive interpretations of “national security”.
- Ensure security regulations are appropriate and commensurate with the risk.

## Introduction to the Working Group

Formed in 2001, the Information and Communication Technology (ICT) Working Group consists of major European telecommunications vendors, service providers, digital content providers and other companies that meet on a regular basis to assess reforms that can affect the ICT industry. The working group also serves as a platform for information exchange on developments in the ICT industry, including but not limited to standardisation and conformity assessment, services, technical regulations, research and development (R&D), interoperability and global harmonisation. The Information and Communication Technology Working Group contains the Cybersecurity Sub-working Group.

## Recent Developments

### ICT Industrial Development Blueprint

A number of policies and strategies were released in late 2021 that shed light on China's ICT industrial development plan.

On 16<sup>th</sup> November 2021, the Ministry of Industry and Information Technology (MIIT) released the *Information and Communication Industry Development Plan During the 14<sup>th</sup> Five-year Plan Period*,<sup>1</sup> formulating development

goals for a wide spectrum of ICT market segments, such as communication network infrastructure, green and intelligent computing facilities, and converged infrastructures such as the Industrial Internet and the Internet of Vehicles. The plan also encourages the development of emerging technologies like artificial intelligence (AI), big data, blockchain, edge computing, embedded subscriber identification module and quantum computing in vertical industries. Meanwhile, the plan aims to strengthen industry management, including with regard to spectrum resources and terminal equipment, and through the formulation of the Telecommunications Law and data regulations.

On 30<sup>th</sup> November 2021, the MIIT released the *14<sup>th</sup> Five-year Plan for the Development of the Big Data Industry*,<sup>2</sup> proposing a host of measures including establishing a market-orientated pricing mechanism for data as a key factor of production; incentivising advanced big data-powered products and services; tapping into big data potential across such vertical industries as equipment manufacturing, consumer goods, information and communications, finance, healthcare, power and transportation; and developing basic hardware and software, open-source framework and other technologies. In addition, the MIIT plans to

1 *14<sup>th</sup> Five-year Plan for Developing the Information and Communications Industry*, MIIT, 16<sup>th</sup> November 2021, viewed 20<sup>th</sup> April 2022, <[https://wap.miit.gov.cn/zwgk/zcwj/wjfb/tz/art/2021/art\\_3a0b0c726bd94b7d9b5092770d581c73.html](https://wap.miit.gov.cn/zwgk/zcwj/wjfb/tz/art/2021/art_3a0b0c726bd94b7d9b5092770d581c73.html)>

2 *14<sup>th</sup> Five-year Plan for the Development of the Big Data Industry*, MIIT, 30<sup>th</sup> November 2021, viewed 20<sup>th</sup> April 2022, <[https://www.miit.gov.cn/zwgk/zcwj/wjfb/tz/art/2021/art\\_c4a16fae377f47519036b26b474123cb.html](https://www.miit.gov.cn/zwgk/zcwj/wjfb/tz/art/2021/art_c4a16fae377f47519036b26b474123cb.html)>





introduce policies, regulations and standards to better balance security and development.

On 12<sup>th</sup> January 2022, the State Council released the 14<sup>th</sup> Five-year Plan for the Digital Economy Development.<sup>3</sup> The plan puts forward eight major tasks and a number of sub tasks, including expediting the construction of network infrastructure and national-level integrated big data centres (one highlight of which is the Eastern Data, Western Computing project); boosting the digital transformation of traditional industries; enhancing innovation of key technologies in strategic fields such as sensors, quantum information, network communications, integrated circuits, key software, big data, AI and blockchain; developing new business models such as smart elderly care, automated driving, unmanned delivery, smart parking and smart manufacturing; and establishing regulations on cross-border data flows, market access, anti-monopoly work and the digital yuan.

Another sectoral Five-year Plan released in 2021 of relevance to the ICT industry is the Cyberspace Affairs Commission's (CAC's) plan for national informatisation.<sup>4</sup> The plan aims to advance both the country's digital infrastructure construction and key technologies, with a focus on fifth generation mobile technology (5G), vehicle-mounted intelligent equipment and smart road infrastructure, advanced automatic driving above Level 3, and critical and advanced areas such as AI, quantum information and integrated circuits. The document requires full implementation of pre-entry national treatment plus negative list management for foreign investment, as well as expansion of access to the value-added telecom services (VATS) market. The working group looks forward to concrete opening-up measures being trialled in the free trade zones, and being rolled out nationwide as soon as possible.

3 14<sup>th</sup> Five-Year Plan for the Digital Economy Development, State Council, 12<sup>th</sup> January 2022, viewed 30<sup>th</sup> March 2022, <[http://www.gov.cn/zhengce/content/2022-01/12/content\\_5667817.htm](http://www.gov.cn/zhengce/content/2022-01/12/content_5667817.htm)>

4 14<sup>th</sup> Five-Year Plan for National Informatisation, Cyberspace Affairs Commission of the CPC Central Committee, 27<sup>th</sup> December 2021, viewed 20<sup>th</sup> April 2022, <[http://www.cac.gov.cn/2021-12/27/c\\_1642205314518676.htm](http://www.cac.gov.cn/2021-12/27/c_1642205314518676.htm)>

## Key Recommendations

### 1. Ensure that Supply Chain Regulations Serve to Secure Foreign Investment and Anchor China More Deeply into the Global System, Not Vice Versa

#### Concern

The implementation of excessive, non-transparent and sometimes arbitrary supply chain controls damages trust and international cooperation, as well as the allure of the Chinese market as an investment destination, which could result in necessary interdependencies within the supply chain being dissolved.

#### Assessment

ICT users rely on a globally distributed and interconnected supply chain ecosystem. Improved supply chain security is a reasonable and internationally shared desire, needed to address a wide range of disruptive factors such as product deficiencies, malicious human activities and natural disasters. However, as a result of geopolitics, the Information and Communication Technology Working Group has witnessed a number of controls being misused, which subsequently led to import substitution.

It is costly and impossible for any country alone to try to indigenise the entire ICT supply chain, which is the most complex and globalised of any industry. To improve supply chain security therefore, a country needs to consider its unique situation and strike a proper balance between: 1) finding ways to anchor itself more deeply into the global ecosystem; and 2) developing a certain level of technological autonomy, which should only act as a fail-safe, to ultimately ensure better coupling across different layers of the supply chain. President Xi Jinping stated in a speech to the Chinese Communist Party's Central Economic and Financial Affairs Commission in April 2020 that the way forward for China is to deepen its "involvement in global industrial chains". President Xi further noted that "the fewer impediments to domestic economic flow, the more global resources will gravitate toward China".<sup>5</sup>

Self-sufficiency should be treated as one of many means, and not as an end in itself that becomes an

5 Xi Jinping, *China's Medium- and Long-Term Economic, Social Development Strategy*, *Qiushi*, 31<sup>st</sup> October 2020, viewed 15<sup>th</sup> April 2022, <[http://www.qstheory.cn/dukan/qs/2020-10/31/c\\_1126680390.htm](http://www.qstheory.cn/dukan/qs/2020-10/31/c_1126680390.htm)>





absolute priority. The EU seems to have recognised this, stating in a recent industrial policy aimed at improving the bloc's supply capacities for certain ICT components that the objective is not "to become self-sufficient, which is not an achievable target", but to "strengthen its strengths and work with third countries in a supply chain where interdependencies will remain strong."<sup>6</sup>

To maintain those interdependencies, regulatory supply chain controls must be carefully designed to ensure that regular contractual activities are still permissible, and to provide the minimum regulatory certainty, economies of scale and returns on investment necessary for sustainable long-term investment. Yet the working group is aware of examples, in both the ICT industry and its related upstream and downstream industries, where such controls are putting members at a significant competitive disadvantage. In some instances, this is due to such controls being broad and opaque, and involving lengthy processes and heavy documentation requirements, as is the case with the *Cybersecurity Review Measures*.<sup>7</sup> Also, in some commercial market segments, China-specific standards, technology roadmaps and product implementations are being mandated, because foreign technology is unreasonably considered to be inherently less secure, and therefore may not pass politicised supply chain scrutiny.<sup>8</sup> In fact, very often the foreign technology in question has already long been deployed globally, and proved secure by countless attacks and close examinations.

Some of these controls are being carried out in a sophisticated way, such as through the broadening of the 'national security' concept to commercial fields,<sup>9</sup> and the mandating of non-mandatory standards and certification programmes.<sup>10</sup> Another method is by cascading relevant targets down to government-supported industry alliances; critical information infrastructure (CII) operators that are encouraged to

procure 'secure and controllable' ICT;<sup>11</sup> and state-owned enterprises that are considered commercial players yet expected to support and drive industrial and supply chain development.<sup>12</sup> As a result of such a subtle approach, checks imposed by such multilateral agreements as the World Trade Organization Technical Barriers to Trade (WTO/TBT) could be circumvented. This is why it is important to take stock of the negative impact of opaque, overly stringent and discriminatory regulatory controls on overall business confidence, irrespective of whether they are legally well-founded.

Excessive controls erode trust along the ICT supply chain. According to the European Chamber's *Business Confidence Survey 2022*, 46 per cent of respondents expect negative impacts as a result of CII guidelines/requirements and 47 per cent expect negative impacts as a result of 'autonomous and controllable' requirements. More broadly, 42 per cent of respondents missed out on business opportunities due to market access restrictions and regulatory barriers in 2021, and 54 per cent of respondents expect the number of regulatory obstacles to increase over the next five years. Eroded trust could affect broader aspects like innovation, talent and international cooperation, which would not be conducive to supply chain security.

Although grateful for the market openings and business environment improvements that have taken place in recent years in many other industries, the Information and Communication Technology Working Group hopes to see a further reduction in regulatory barriers to boost business confidence among European investors in the ICT sector. Members of the working group have been, and are willing to remain, valuable contributors to, and stabilisers of, the Chinese economy. They look forward to cooperating, partnering and competing with domestic Chinese companies along the ICT supply chain in a market free of excessive regulatory controls, and where both domestic and international companies can find room to grow and prosper.

## Recommendations

- Give full play to the role of international companies in stabilising the ICT supply chain.

6 *Proposal for a Council Regulation amending Regulation (EU) 2021/2085 establishing the Joint Undertakings under Horizon Europe, as regards the Chips Joint Undertaking*, EUR-Lex, 8<sup>th</sup> February 2022, viewed 1<sup>st</sup> April 2022, <<https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52022PC0047>>

7 *Cybersecurity Review Measures*, CAC, 4<sup>th</sup> January 2022, viewed 22<sup>nd</sup> April 2022, <[http://www.cac.gov.cn/2022-01/04/c\\_1642894602182845.htm](http://www.cac.gov.cn/2022-01/04/c_1642894602182845.htm)>

8 Please refer to key recommendations 2 and 3 of this paper, Key Recommendation 1 of the *Cybersecurity Sub-working Group Position Paper*, and Key Recommendation 1 of the *Rail Working Group Position Paper*.

9 Please refer to Key Recommendation 2 of this paper and Key Recommendation 1 of the *Cybersecurity Sub-working Group Position Paper*.

10 Please refer to Key Recommendation 1 of the *Standards and Conformity Assessment Working Group Position Paper*, and Key Recommendation 3 of this paper.

11 While 'secure and controllable' itself can be interpreted in a risk-based and non-discriminatory way, certain real-life regulations and/or practices run contrary to this positive direction.

12 *Full Text: Report on the Work of the Government*, Xinhua, 12<sup>th</sup> March 2022, viewed 1<sup>st</sup> April 2022, <[http://www.xinhuanet.com/english/2021-03/12/c\\_139806315.htm](http://www.xinhuanet.com/english/2021-03/12/c_139806315.htm)>





- Ensure that regulatory controls improve overall supply chain security, instead of pursuing self-sufficiency at the expense of long-term interdependencies and cooperation prospects.
- Narrowly define the concept of ‘national security’ to avoid generalisation.
- Allow voluntary standards and certification programmes to remain truly so.
- Rely on international standards to the largest extent possible, rather than imposing undue restrictions on both the usage of such standards, and the scenarios in which they can be used (for example, only for international interconnection).
- Ensure technology neutrality in supply chain regulations to drive competition and long-term growth.

## 2. Ensure Reciprocity on Market Share for European ICT Companies

### Concern

Continued unbalanced reciprocity on market share in certain important ICT market segments risks seriously weakening the strategic importance of China to European Union (EU) industry regarding scale and sustainability, causing de-prioritisation of its market in global investment planning and jeopardising the future of EU-China ICT industry collaboration and technology acceleration.

### Assessment

China and the EU have long been important trading partners, with the Information and Communication Technology Working Group’s members—who have had long-term investments in China—playing a cornerstone role in building up supply chain interdependencies. Ensuring reciprocity in market access, but more importantly in market share—the ultimate way to confirm meaningful access—is undisrupted by non-commercial considerations is crucial to maintaining and further promoting such vital interdependencies.

In this regard, the current dynamic of the 5G market landscape is emblematic of the loss of market share due to excessive regulatory controls, as discussed in the preceding key recommendation, and has become a major issue of concern.

In 2019, China began a massive deployment of 5G technology, and now has the world’s largest and most

advanced 5G network. According to MIIT statistics,<sup>13</sup> by the end of 2021, China had deployed 1.42 million 5G base stations (more than 60 per cent of the global total) and developed 355 million 5G subscribers (more than 70 per cent of the global total). China’s total 5G investment in 2020 and 2021 amounted to approximately CNY 360 billion.

The global success of the mobile industry relies on harmonised standards. In this field, China and the EU have made the most contributions and have cooperated both in the 4G era and now towards 5G, to great mutual benefit.

However, as the commercial development of 5G in China has exploded, European ICT companies’ 5G market share has dropped dramatically, creating a significant imbalance in bilateral 5G market share reciprocity. In fact, the EU industry’s market share in China dropped from around 30 per cent in 4G to single digit market share in 5G, a drop so sharp that it can hardly be explained by commercial reasons alone. According to one market report published in February 2022,<sup>14</sup> the EU industry’s accumulated 5G market share in China sank to just 2.9 per cent by the end of 2021, while that of domestic vendors hit a record-high of 97.1 per cent. In an apple-to-apple comparison, Chinese vendors had won more than 30 per cent of 5G market share in the EU market by the end of 2021, representing a 10-fold imbalance in reciprocity.<sup>15</sup>

This trend of increasing imbalance represents the general challenge or fear that many European companies are facing today in the China market. It is a significant concern and has seriously weakened the strategic importance of the China market to EU investors in key ICT market segments, led to a de-prioritisation of China in global investment planning, and jeopardised the outlook for EU-China global collaboration in the broader ICT industry. Due to the visibility of large Chinese 4G/5G tenders and the broad attention they attract from the global industry, the increasing imbalance over the past ten years has

<sup>13</sup> *Interpretation of the ICT Industry Statistical 2021*, MIIT, 25<sup>th</sup> January 2022, viewed 18<sup>th</sup> April 2022, <[https://www.miit.gov.cn/gxsj/tjfx/txy/art/2022/art\\_e2c784268cc74ba0bb19d9d7eeb398bc.html](https://www.miit.gov.cn/gxsj/tjfx/txy/art/2022/art_e2c784268cc74ba0bb19d9d7eeb398bc.html)>

<sup>14</sup> *2021 5G global market report*, Dell’Oro Group, 24<sup>th</sup> February 2022, viewed 18<sup>th</sup> April 2022, <<https://www.delloro.com/market-research/telecommunications-infrastructure/mobile-radio-access-network/>>

<sup>15</sup> *Dell’oro Report: Global Ran Market to Grow Over 10% By 2021 Huawei maintains share lead*, C114.net.cn, 24<sup>th</sup> February 2022, viewed 18<sup>th</sup> April 2022, <<http://www.c114.com.cn/news/116/a1188479.html>>



unfortunately set a negative example to other European industries. To ensure sustainable global collaboration in ICT technology, and to work towards harmonisation of the ICT ecosystem in the best interests of end consumers, this issue needs to be urgently addressed.

#### Recommendations

- Implement measures to improve market share for the European ICT industry to ensure and maintain reciprocity in the long run.
  - Identify all ICT market segments where market share reciprocity is lacking and develop actions—jointly defined by Chinese and European stakeholders—that address the imbalances.
  - Review the status of market share reciprocity regularly.
- Establish an open and effective monitoring and correction mechanism for ICT market reciprocity, with sponsorship from the EU and China, in order to address the current, prominent issues.

### 3. Open up Value-added Telecoms Services (VATS) and Internet Sectors for International Companies

#### Concern

Although many European companies have attempted to enter or expand into the Chinese VATS and internet market, VATS and internet business operation licences act as a major barrier to their participation.

#### Assessment

The convergence of the telecoms, internet, software, consumer electronics and information technology industries, together with traditional sectors' digital transformation, is accelerating economic development. European companies play a fundamental and irreplaceable role in global supply chains and technology ecosystems, putting them in a position to greatly contribute to China as it seeks to further encourage innovation and opening up. European companies are important providers to China of ICT infrastructure, devices and services, thereby creating a significant source of employment. Nevertheless, they are almost completely excluded from new opportunities in China's ICT market.

According to China's *2021 Negative List for Foreign Investment*,<sup>16</sup> and *Telecom Service Catalogue 2015*,<sup>17</sup> generally only companies that are less than 49 per cent foreign-invested can apply for a Basic Telecoms Services licence. Also, only companies that are less than 50 per cent foreign-invested can apply for a VATS licence, with the exception of e-commerce, domestic multi-party communications services, store-and-forward services and call centre services. Substantial changes are needed in the Chinese market to open up the majority of VATS, which remain restricted. According to analysis by the China Academy of Information and Communication Technology (CAICT), as of the end of December 2021, foreign-invested enterprises accounted for only 2.8 per cent of the total number of VATS business operators issued by the MIIT.<sup>18</sup>

#### a. Cloud services

Cloud services are commonly understood as comprising Infrastructure as a Service (IaaS), Platform as a Service (PaaS) and Software as a Service (SaaS). While China has issued numerous policies promoting cloud services domestically, international providers still encounter insurmountable market access barriers in the form of licensing requirements.

Among the various types of VATS under the *Telecom Service Catalogue 2015*,<sup>19</sup> internet resource coordination (IRC) is one of the services that foreign players most want to provide.<sup>20</sup> In addition, the provision of SaaS, of which there is no clear definition in Chinese policies, could also be subject to licensing, as some types of SaaS might fall within the scope of various telecom services under the *Telecom Service Catalogue*, such as IRC or information services. Licences for these services remain difficult for international companies, or those not meeting a certain domestic shareholding cap, to obtain.

16 *Special Management Measures for Foreign Investment Access (Negative List) (2021)*, National Development and Reform Commission (NDRC), 27<sup>th</sup> December 2020, viewed 20<sup>th</sup> May 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-12/28/content\\_5664886.htm](http://www.gov.cn/zhengce/zhengceku/2021-12/28/content_5664886.htm)>

17 *Telecom Service Catalogue 2015*, MIIT, 28<sup>th</sup> December 2015, viewed 7<sup>th</sup> April 2022, <[https://www.miit.gov.cn/zwgk/zcwj/wjfb/tg/art/2020/art\\_e98406cd89844f7e92ea1bcf3b5301e0.html](https://www.miit.gov.cn/zwgk/zcwj/wjfb/tg/art/2020/art_e98406cd89844f7e92ea1bcf3b5301e0.html)>

18 *Analysis Report on Domestic Value-added Telecommunications Business Licensing*, CAICT, December 2021, viewed 7<sup>th</sup> April 2022, <<http://www.caict.ac.cn/kxyj/qwfb/qwsj/202201/P020220117587898212350.pdf>>

19 *Telecom Service Catalogue 2015*, MIIT, 28<sup>th</sup> December 2015, viewed 20<sup>th</sup> May 2022, <[https://www.miit.gov.cn/zwgk/zcwj/wjfb/tg/art/2020/art\\_e98406cd89844f7e92ea1bcf3b5301e0.html](https://www.miit.gov.cn/zwgk/zcwj/wjfb/tg/art/2020/art_e98406cd89844f7e92ea1bcf3b5301e0.html)>

20 IRC is defined as a sub-category of Internet Data Centre (IDC) services, while IaaS is a type of IDC services (IDC with or without IRC), and PaaS likely falls into the category of IRC.





#### b. IP-VPN

International companies in China have limited access to domestic IP-VPN services. Businesses, innovation, cross-border transactions and ultimately investments are all underpinned by free access to, and flow of, information. Further opening-up of domestic IP-VPN services to foreign enterprises would therefore help increase competition and bring more affordable solutions to companies, small and medium-sized enterprises in particular.

#### c. Internet access services

The working group welcomes the trial policy allowing foreign participation in internet access services announced by the Beijing Government and the State Council in February 2019.<sup>21</sup> Large-scale opening in internet access services is strongly needed at the national level, so this trial will have a positive impact on guiding industry openness and development. However, implementation plans are needed to provide clarity to foreign enterprises that want to apply for such a licence or trial qualification.

#### d. Online data processing and transaction processing services (except e-commerce services)

Online data processing and transaction processing services are growing in relevance for big data service providers and other data platform businesses. However, many foreign companies are concerned about regulatory uncertainty when introducing new data platform business models in China.

#### e. Information services (except APP store services)

Information services are another VATS of particular interest to international companies operating in China, but is also highly regulated. As mobile Internet and the IoT continue to develop, these kinds of restrictions are an increasingly burdensome obstacle to European businesses that wish to bring their expertise to the Chinese market.

#### Recommendations

- Reduce further the *Negative List* and allow increased international participation in the telecoms- and internet-related sectors.
- Continue to open up the *Telecom Services Catalogue*

<sup>21</sup> Reply of The State Council on the Comprehensive Pilot Work Plan for Promoting the Expansion and Opening Up of Beijing's Service Industry, State Council, 22<sup>nd</sup> February 2019, viewed 20<sup>th</sup> May 2022, <[http://www.gov.cn/zhengce/content/2019-02/22/content\\_5367708.htm](http://www.gov.cn/zhengce/content/2019-02/22/content_5367708.htm)>

and allow international companies in China to obtain VATS licences, particularly for IRC, IP-VPN, internet access services, online data processing and transaction processing services, and information services.

### 4. Develop and Implement Commercial Cryptography Laws, Regulations, Standards and Conformity Assessment Systems in Such a Way that They are Clear, Fair and Conducive to International Harmonisation 3

#### Concern

The Cryptography Law's roll-out and the development of its implementing regulations do not accurately reflect the language used in the law itself.

#### Assessment

While most jurisdictions do not apply strict restrictions to the domestic production and use of cryptography, China has long been one of the most challenging environments in this regard for international companies to navigate. Significant improvements to the substantive and procedural aspects of the Chinese commercial cryptography regulatory system are needed for it to remain aligned with the Cryptography Law,<sup>22</sup> established international practices and the World Semiconductor Council principles, which call for deregulating commercial cryptography in mass-marketed ICT products. In particular, the regulatory system should continue to rely on the 'core function' principle clarified by the State Cryptography Administration (SCA) in 2000, or on a similar concept.

#### a. Standardisation

China's national standardisation body for cryptography, the National Information Security Standardisation Technical Committee's (TC260's) Working Group 3 on Cryptographic Solutions, and the industry standardisation body, the Cryptography Standardisation Technical Committee, have long been closed to foreign participation. While the TC260's Working Group 3 has recently taken in two international companies as a goodwill gesture, other international applications remain pending. The Information and Communication Technology Working Group hopes that European

<sup>22</sup> Cryptography Law, National People's Congress Standing Committee, 27<sup>th</sup> October 2019, viewed 5<sup>th</sup> April 2022, <[http://www.oscca.gov.cn/sca/xxgk/2019-10/27/content\\_1057225.shtml](http://www.oscca.gov.cn/sca/xxgk/2019-10/27/content_1057225.shtml)>



companies can be granted equal access to these standardisation bodies, as they are equally bound by relevant standards set by the bodies.<sup>23</sup>

At the same time, certain standards developed by these closed or semi-closed bodies contain requirements incompatible with China's WTO/TBT commitments and the Cryptography Law and un conducive to improving overall security. For example, although TC260 has been actively pushing domestic Chinese algorithms to become international standards, and with some success, certain standards for information system cryptography application still demand compliance with national and industry standards, while referring to international standards only where global interconnection is needed.<sup>24</sup>

### b. Testing and certification

The Cryptography Law replaced the previous administrative licensing-based market access system with one that features mandatory and voluntary testing and certification.<sup>25</sup> The working group believes that this voluntary certification system needs to remain truly voluntary and open to international companies for every specific product category in the certification catalogue in a reciprocal manner. Significantly, while no international chip makers have so far managed to obtain a certificate for security chips, their Chinese counterparts can obtain all qualifications necessary to operate in the European market. For example, Tongxin Microelectronics was the first to pass the SOGIS Common Criteria Evaluation Assessment Level (EAL) 6+ security certification in July 2020,<sup>26</sup> and it only took Huada Electronic Design three months to pass the same EAL later that year.<sup>27</sup>

23 Key Recommendation 3 of the *Standards and Conformity Assessment Position Paper 2022/2023* also discusses the lack of access by international companies to certain Chinese standards developing organisations.

24 Key Recommendation 4 of the *Standards and Conformity Assessment Position Paper 2022/2023* discourages the adoption of recommended national standards as market access requirements, and calls for improving the adoption rate of international standards.

25 *Announcement on Releasing the Commercial Cryptographic Products Certification Catalogue (First Batch) and the Commercial Cryptographic Products Certification Rules*, SCA, 11<sup>th</sup> May 2020, viewed 5<sup>th</sup> April 2022, <[http://www.oscca.gov.cn/sca/xwdt/2020-05/11/content\\_1060749.shtml](http://www.oscca.gov.cn/sca/xwdt/2020-05/11/content_1060749.shtml)>

26 *Applus+ Laboratories evaluates TMC secure microcontroller 'THD89', the first Chinese chip to achieve Common Criteria EAL6+ high assurance certification*, Applus+ Laboratories, 9<sup>th</sup> August 2020, viewed 6<sup>th</sup> April 2022, <<https://www.appluslaboratories.cn/cn/en/news/applus+-laboratories-evaluates-tmc-secure-microcontroller-%E2%80%98thd89%E2%80%99,-the-first-chinese-chip-to-achieve-common-criteria-eal6+-high-assurance-accreditation->>

27 *CEC Huada Electronics Design Co Ltd achieves SOGIS EAL6+ certificate within 3 months of applying to the Dutch Common Criteria scheme (NSCIB)*, Brightsight, 18<sup>th</sup> November 2020, viewed 5<sup>th</sup> April 2022, <<https://www.brightsight.com/blogs/post/cec-huada-electronics-design-co-ltd.-achieves-sogis-eal6-certificate-within-3-months-of-applying-to->>

Furthermore, commercial cryptography—to the extent considered for testing and certification—needs to be limited to cases where encryption is the primary function. That means a component in a product should not be considered the product's primary function if encryption is not the core function or set of functions of the component; or the feature set is not specifically designed or fixed and cannot be modified to customer specification. The working group also calls for adequate protection for applicants' IP and trade secrets. Protection should ensure that source code, non-public design information and trade secrets cannot be systematically demanded, and that international laboratories are allowed to conduct relevant testing activities.

### c. Import licence and export control

China released both the import licence and export control lists dedicated to commercial cryptography—with a narrower scope for import licensing that is much welcomed by the working group—and the revised *Catalogue of Technologies Subject to Import Prohibition and Restriction*,<sup>28</sup> which lists foreign “data encryption technology employing a key strength greater than 256 bits” as a technology that requires an import permit. The following aspects in the lists and the catalogue would benefit from additional clarification in explicit, written form, preferably in the revised *Commercial Cryptography Regulation*,<sup>29</sup> in order to facilitate import and export compliance, especially in the face of technological advancements such as post-quantum cryptographic algorithms.

- **Primary function test:** As the import licence and export control lists for commercial cryptography have placed a much stronger emphasis on products whose ‘primary function’ is encryption, the working group encourages the primary function test to be explicitly adopted in the regulation in all circumstances.
- **Mass consumer product exemption:** While the lists seem to have implicitly exempted “commercial cryptography in mass consumer products” as per the Cryptography Law, the working group believes this term should be clearly defined as “cryptography

28 *Catalogue of Technologies Subject to Import Prohibition and Restriction*, Ministry of Commerce (MOFCOM), 19<sup>th</sup> November 2021, viewed 5<sup>th</sup> April 2022, <<http://cnzh.gov.cn/UploadFile/SiteFile/798/2021/11/19/9e1ff36542654997ae508932492c9b9c.pdf>>

29 *Commercial Cryptography Regulation (Revised Draft for Comments)*, SCA, 20<sup>th</sup> August 2020, viewed 5<sup>th</sup> April 2022, <[https://oscca.gov.cn/sca/hdjl/2020-08/20/content\\_1060779.shtml](https://oscca.gov.cn/sca/hdjl/2020-08/20/content_1060779.shtml)>





features in components and products openly available to the public, that can be either charged or free, for personal or business use, and where the cryptographic functionality cannot be modified by the end user”.

- **Scope of security chips:** A clearer definition is needed for ‘security chips’ subject to export control, excluding general-purpose chips, and including only security chips with indigenous, non-public algorithms tailor-made for such sectors as electricity, taxation, public security and finance, and which meet the technical thresholds.
- **Key strength:** The threshold of “key strength greater than 256 bits” should explicitly refer to symmetric algorithm keys, as asymmetric algorithms generally have much longer keys for equivalent resistance to attack.

#### d. Application promotion

The revised draft of the *Commercial Cryptography Regulation* demands in Chapter VI—which is dedicated to ‘application promotion’—that networks with classified cybersecurity protection above Grade 3 also undergo security assessment for commercial cryptography; and that they only use tested and certified commercial cryptography products, as well as technologies included in a so-called catalogue for guidance of commercial cryptography technologies proposed in Article 9. Such provisions are beyond the Cryptography Law, as they establish a new requirement for technology review, significantly broaden the scope of security assessment from CII to all networks above Grade 3, and make the voluntary certification programme a *de facto* mandatory requirement. According to the law, only “commercial cryptography products involving national security, national economy, people’s livelihood, and social and public interests” included in the *Catalogue of Critical Network Equipment and Specialised Network Security Products* are mandated to be certified.

These provisions have been coupled with industrial policies aimed at promoting voluntary certification and the use of domestic algorithms. For example, the working group is aware of cases where the government has subsidised efforts to replace international cryptography in key industries like financial services and automotive.

As far as the Information and Communication Technology Working Group is concerned, the only way to ensure

that cryptography regulations and policies do not constitute an unfair advantage for domestic enterprises is to guarantee that SCA-approved technologies include international ones; to design the certification programme in such a way that it remains technology-neutral and focusses only on elements conducive to improving overall security; to certify the products of international companies in a timely, transparent and reciprocal manner; and to narrow the scope of voluntary certification and that of the security assessment down to what has been prescribed in the Cryptography Law.

#### Recommendations

- Allow the adoption of international standards related to commercial cryptography.
- Reference explicitly the primary function test in the revised *Commercial Cryptography Regulation*.
- Define narrowly the scope of commercial cryptography products subject to testing, certification, application security assessment and import licence and export control.
- Ensure technology-neutral and streamlined conformity assessment processes for commercial cryptography, and that IP and trade secrets are protected.
- Define ‘mass consumer products’ as ‘cryptography features in components and products openly available to the public, that can be either charged or free, for personal or business use, and where the cryptographic functionality cannot be modified by the end user’.
- Refrain from mandating or expanding the scope of conformity assessment under the guise of ‘application promotion’, and revise incompatible regulations, standards and conformity assessment systems.
- Ensure that any implementing regulations and standards are fully in line with the Cryptography Law.

### 5. Ensure Timely and Globally-harmonised Spectrum Allocations for the Development of Key Technologies and Applications that Benefit both China and the Global Industry as well as Consumers

#### Concern

In today’s challenging world, it is an urgent, common goal of the global ICT industry to avoid fragmented spectrum allocation, which will jeopardise both the global ecosystem and technology development.





## Assessment

Successful spectrum management is key to the radio industry and serves as an enabler of the ICT industry and broader economic sectors. The Information and Communication Technology Working Group strongly advises that China, as an important global stakeholder, identify key spectrum in a timely and globally harmonised manner, so as to underpin growth and secure long-term competitive advantages in the global ecosystem.

### a. 5G spectrum

A proper spectrum mix is needed to support cost-effective 5G deployment. While the MIIT has already identified 3,300–3,600 megahertz (MHz), 4,800–5,000MHz<sup>30</sup> and 703–733/758–788MHz as 5G frequency bands,<sup>31</sup> it is becoming increasingly important to identify additional, high-quality spectrum resources to accommodate accelerated 5G roll-out across China.

At the International Telecommunication Union (ITU) World Radiocommunication Conference in 2019 (WRC-19), a number of millimetre wave bands, including the 24.25–27.5 gigahertz (GHz), 37–43.5GHz, 45.5–47GHz, 47.2–48.3GHz, and 66–71GHz bands, were identified for International Mobile Telecommunications (IMT). In China, in 2017, the MIIT had sought the public's opinions on 24.75–27.5GHz, 37–42.5GHz and other possible bands for 5G in the millimetre wave range,<sup>32</sup> and approved 5G trial frequencies usage in the 24.75–27.5GHz and 37–42.5GHz bands the same year. According to the MIIT's *14<sup>th</sup> Five-year Plan for Developing the Information and Communications Industry*,<sup>33</sup> China will make dedicated usage plans for 5G/6G frequencies, and release 5G millimetre wave frequencies in different stages. The working group calls on the MIIT to make these bands available to industry as early as possible, and looks forward to communicating with the MIIT to better prepare the industry for upcoming millimetre wave frequency allocations.

30 *Notice on Matters Concerning the Usage of 3300-3600MHz and 4800-5000MHz Frequency Bands by 5G Systems*, MIIT, 15<sup>th</sup> November 2017, viewed 4<sup>th</sup> April 2022, <[https://ythxxfb.miit.gov.cn/ythzxfwpt/hlwmh/zcwj/xzxxk/wxdhwxxt/art/2020/art\\_8e89ad16e5b44fb89c5bc316c259fd3c.html](https://ythxxfb.miit.gov.cn/ythzxfwpt/hlwmh/zcwj/xzxxk/wxdhwxxt/art/2020/art_8e89ad16e5b44fb89c5bc316c259fd3c.html)>

31 *Notice on Adjusting the Usage Plan of the 700MHz Frequency Band*, MIIT, 1<sup>st</sup> April 2020, viewed 4<sup>th</sup> April 2022, <[https://www.miit.gov.cn/jgsj/wgj/wjfb/art/2020/art\\_c4a1c245a208400cb0f0a95bcc91745d.html](https://www.miit.gov.cn/jgsj/wgj/wjfb/art/2020/art_c4a1c245a208400cb0f0a95bcc91745d.html)>

32 *Public Call for Comments on Planning Millimetre-wave Spectrum for 5G Use*, MIIT, 8<sup>th</sup> June 2017, viewed 4<sup>th</sup> April 2022, <[https://www.miit.gov.cn/gzcy/yjzj/art/2020/art\\_55b1cecb2b2416094d70922057b4ed9.html](https://www.miit.gov.cn/gzcy/yjzj/art/2020/art_55b1cecb2b2416094d70922057b4ed9.html)>

33 *14<sup>th</sup> Five-year Plan for Developing the Information and Communications Industry*, MIIT, 16<sup>th</sup> November 2021, viewed 4<sup>th</sup> April 2022, <<https://www.miit.gov.cn/zwgk/zcwj/wjfb/tz/art/2021>>

This sectoral *14<sup>th</sup> Five-year Plan* also reveals the MIIT's intention of adding mid-band spectrum resources, as they strike a better balance between capacity and coverage. Efforts are still needed to harmonise the use of this spectrum between different countries and regions, especially regarding agenda item 1.2 of the WRC-23 on frequency-related matters in IMT identification.<sup>34</sup> The working group calls on the EU and China to increase exchanges on this agenda item, conclude relevant technical studies as soon as possible, and jointly ensure the optimal assignment of the relevant bands at the upcoming WRC.

### b. 60GHz frequency band

Unlicensed spectrum is the backbone for many new technologies and key economic sectors. One very promising band is 60GHz, as it enjoys a large and contiguous bandwidth, allowing for communication links with high-speed data transmission with very high data rates and, for radar, a much higher range resolution that enables detection of micro motions in the millimetre range. In addition, the high free-space path loss and strong oxygen absorption at 60GHz effectively reduce interference risks between devices. These features make this band unsuitable for IMT, but one of the best candidates for such short-range technologies as radar, contactless connector and WiGig (wireless gigabit protocol). The Information and Communication Technology Working Group itself counts many members who have either been commercialising 60GHz devices, or stand to benefit from the innovative, smart, energy-saving and safety features that these devices offer. It has noted similarly strong interest from domestic Chinese companies along the value chain.

China is among the pioneers in 60GHz allocation, with the MIIT allowing the band to be used by low-power, short-range devices as early as October 2006.<sup>35</sup> Today, nearly all major economies—including Europe and the United States—have opened, or are in the process of opening up, the band for unlicensed applications such as in-cabin sensing, consumer electronics, smart building, robotics, healthcare and augmented reality / virtual reality. Many of these economies are important export markets of Chinese companies. This explains

34 *ITU-R Preparatory Studies for WRC-23*, ITU, viewed 5<sup>th</sup> April 2022, <<https://www.itu.int/en/ITU-R/study-groups/rcpm/Pages/wrc-23-studies.aspx>>

35 *Notice on Relevant Matters Concerning the Use of Low-power Short-range Technology in 60GHz*, MIIT, 23<sup>rd</sup> October 2006, viewed 5<sup>th</sup> April 2022, <<https://www.miit.gov.cn/n1146295/n1146592/n3917132/n4062354/n4062391/n4062397/n4062399/c4148141/part/4148142.pdf>>





why the 60GHz device market has been forecasted to be on the verge of significant growth in the coming years. To benefit from it, regulators and market players need to take immediate actions. The Information and Communication Technology Working Group therefore invites the MIIT to clarify that the 60GHz band remains an unlicensed band, and that existing technical parameters specified in 2006 remain valid until the release of new rules.

### c. 79–81GHz frequency band

Another frequency band of interest to the working group is 79–81GHz. In December 2021, the MIIT released the *Interim Provisions on Automotive Radar Radio Management*, officially allocating parts of this band, namely 76–79GHz, for advanced driver assistance systems (ADAS).<sup>36</sup> This move is welcomed, as it represents further international harmonisation. As a next step, the working group recommends the 79–81GHz band be equally reserved for ADAS applications. This would enable next-generation automotive radars to further improve their resolution, boost automotive safety, and benefit China as it seeks to become a world leader in intelligent and connected vehicles.

### Recommendations

- Ensure the timely availability for usage of 5G spectrum, the 60GHz band and the 79–81GHz band.
- Strengthen exchanges and coordination between China and the EU regarding spectrum regulation in the lead-up to the WRC-23, including by integrating the spectrum topic in relevant government-to-government dialogues.

## Abbreviations

ADAS	Advanced Driver Assistance System
AI	Artificial Intelligence
BCS	Business Confidence Survey
CAC	Cyberspace Affairs Commission
CAICT	China Academy of Information and Communication Technology
CII	Critical Infrastructure Information
CNY	Chinese Yuan
EAL	Evaluation Assessment Level
EU	European Union
G	Mobile Technology Generation
GHz	gigahertz
IaaS	Infrastructure as a Service
ICT	Information and Communication Technology
IDC	Internet Data Centre
IMT	International Mobile Telecommunications
IoT	Internet of Things
IP	Intellectual Property
IP-VPN	Internet Protocol Virtual Private Network
IRC	Internet Resource Collaboration
ITU	International Telecommunication Union
MHz	megahertz
MIIT	Ministry of Industry and Information Technology
MOFCOM	Ministry of Commerce
NDRC	National Development and Reform Commission
PaaS	Platform as a Service
R&D	Research and Development
SCA	State Cryptography Administration
SaaS	Software as a Service
TBT	Technical Barriers to Trade
TC260	National Information Security Standardisation Technical Committee
VATS	Value-added Telecoms Services
WiGig	Wireless Gigabit
WRC	World Radiocommunication Conference
WTO	World Trade Organization

<sup>36</sup> *Interim Provisions on Automotive Radar Radio Management*, MIIT, 6<sup>th</sup> December 2021, viewed 5<sup>th</sup> April 2022, <[https://wap.miit.gov.cn/zwgk/zcwj/wjfb/tz/art/2021/art\\_289b278b60dc47d7a01292d15a0a2bde.html](https://wap.miit.gov.cn/zwgk/zcwj/wjfb/tz/art/2021/art_289b278b60dc47d7a01292d15a0a2bde.html)>





## Cybersecurity Sub-working Group

### Introduction to the Sub-working Group

In view of the increasingly strengthened Chinese regulatory environment, the Cybersecurity Sub-working Group was established in February 2016 under the European Chamber's Information and Communication Technology (ICT) Working Group, focussing on security legislation, standardisation and enforcement that impact multiple industries.

### Recent Developments

#### Security Legislation

Effective as of 1<sup>st</sup> June 2017,<sup>1</sup> the Cybersecurity Law (CSL) outlines a series of general and specific compliance requirements for network operators. In recent years, other pieces of security legislation have been released to complement the CSL. They include, notably, the Data Security Law (DSL), the Personal Information Protection Law (PIPL) and the Cryptography Law. Over the coming year, the sub-working group expects the obligations defined in these laws and their implementing regulations to grow more complex and interlinked, and relevant enforcement efforts to intensify.

#### Critical Information Infrastructure (CII) Protection

On 1<sup>st</sup> September 2021, the *Critical Information Infrastructure (CII) Security Protection Regulation* came into force,<sup>2</sup> demanding strengthened protection of CII while leaving ambiguity on some key terms, its scope and obligations. It encourages the procurement of "secure and trustworthy" network products and services, which is of concern to the sub-working group. In practice, this request often translates into Chinese companies' products being favoured in public procurement, at the expense of products offered by foreign multinational corporations (MNCs). A CII-designation will also trigger other obligations under Chinese security legislation, such as mandatory certification and assessment, and cybersecurity review.

### Cybersecurity Review

On 4<sup>th</sup> January 2022, the *Cybersecurity Review Measures* (CSRM) were issued,<sup>3</sup> making it mandatory that CII operators procuring network products and services, and online platform operators conducting data handling activities that influence or may influence national security, proactively apply for a cybersecurity review. The review assesses several factors, including the "security, openness, transparency, and diversity of sources of products and services; the reliability of supply channels, as well as the risk of supply disruptions due to political, diplomatic, and trade factors". Many substantive and procedural aspects of the review remain unclear.

### Data Protection

On 1<sup>st</sup> September 2021, the DSL took effect,<sup>4</sup> aimed at establishing comprehensive systems for data security by calling for classified and hierarchical management of data, and establishing various risk assessment mechanisms. Notably, the DSL introduces the concept of "national core data" and states that the catalogues of important data will be formulated by relevant local governments and industry authorities.

On 1<sup>st</sup> November 2021, the PIPL took effect.<sup>5</sup> The PIPL serves to protect natural persons' personal information by setting mechanisms and legal liabilities for collection and processing activities. While containing many positive provisions, the law also raises questions regarding the broad and outcome-based definition of 'sensitive personal information', the emphasis on 'separate' consent, as well as restrictions relating to data localisation and cross-border data transfer.

The DSL and the PIPL will complement the CSL by serving as superordinate laws for China's data protection framework, and for industry authorities to base their data regulations on. Another important

1 Cybersecurity Law, National People's Congress Standing Committee (NPCSC), 7<sup>th</sup> November 2016, viewed 17<sup>th</sup> May 2022, <[http://www.gov.cn/xinwen/2016-11/07/content\\_5129723.htm](http://www.gov.cn/xinwen/2016-11/07/content_5129723.htm)>

2 *Critical Information Infrastructure Security Protection Regulations*, State Council, 17<sup>th</sup> August 2021, viewed 6<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2021-08/17/content\\_5631671.htm](http://www.gov.cn/zhengce/content/2021-08/17/content_5631671.htm)>

3 *Cybersecurity Review Measures*, Cyberspace Administration of China (CAC), 4<sup>th</sup> January 2022, viewed 22<sup>nd</sup> April 2022, <[http://www.cac.gov.cn/2022-01/04/c\\_1642894602182845.htm](http://www.cac.gov.cn/2022-01/04/c_1642894602182845.htm)>

4 Data Security Law of the People's Republic of China (PRC), NPCSC, 10<sup>th</sup> June 2021, viewed 17<sup>th</sup> May 2022, <<http://www.npc.gov.cn/npc/c30834/202106/7c9af12f51334a73b56d7938f99a788a.shtml>>

5 Personal Information Protection Law of the PRC, NPCSC, 20<sup>th</sup> August 2021, viewed 6<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202106/7c9af12f51334a73b56d7938f99a788a.shtml>>





horizontal regulatory development is the draft *Regulations on Network Data Security Management*, released by the Cyberspace Administration of China (CAC) in November 2021,<sup>6</sup> which apply to the use of networks that conduct data-handling activities within Mainland China, as well as to the supervision and management of network data security. Worryingly, the draft regulations contain several discrepancies with the upper-level laws, as well as additional requirements that go beyond them.

### Cross-border Data Transfer

Several regulations on the cross-border transfer of data have been released at the time of this paper's finalisation, bringing additional demand for compliance efforts.

On 24<sup>th</sup> June 2022, the National Information Security Standardisation Technical Committee (TC260) released the *Practice Guidelines for Cybersecurity Standards – Technical Specification for the Certification of Cross-border Handling of Personal Information*.<sup>7</sup> The guidelines flesh out a certification system for the cross-border processing of personal information within a MNC, or a similar economic or business entity, as well as for the handling of personal information of natural persons in China by foreign personal information handlers outside China. On 30<sup>th</sup> June, the CAC released the *Standard Contractual Provisions for Cross-border Personal Information Transfer (Draft for Comment)*,<sup>8</sup> unveiling the draft standard contract that can be signed by data handlers and overseas data recipients. On 7<sup>th</sup> July, the CAC published the *Measures on Security Assessment of the Cross-border Transfer of Data*, effective as of 1<sup>st</sup> September.<sup>9</sup> The measures lay out the requirements for cross-border transfer of important data and personal information by CII operators and other companies that reach certain thresholds of data.

### Sectoral Regulations

A host of sectoral security regulations are being rolled out in parallel to the abovementioned horizontal ones. One example is the revised draft *Measures on the Administration of Data Security in the Industrial and Information Technology Sector (Trial)*,<sup>10</sup> which puts forward a classification and grading method for those who handle data in this field, as well as specific obligations such as the need to file important data and core data catalogues, and to conduct various security assessments.

European companies in other sectors, such as automotive, banking and healthcare, are also taking notice of cybersecurity and data security development, as can be seen in the relevant chapters of the *Position Paper 2022/2023*.

## Key Recommendations

### 1. Ensure that Chinese Security Legislation Does Not Create Discriminatory Market Access Barriers 6

#### Concern

Certain security schemes may lead to the creation of an environment that is discriminatory towards international businesses, in which they are restricted or even prohibited from providing products and services to segments of the Chinese market.

#### Assessment

The Cybersecurity Sub-working Group perceives that certain requirements under Chinese security legislation, notably the CSL, the DSL, the PIPL and the Cryptography Law, may present *de facto* market access barriers for international businesses, and calls for a change.

### Classified Cybersecurity Protection System (CCPS)

The CCPS classifies networks into five ascending protection levels based on their sensitivity to individuals' rights and interests, as well as general public and national security, and specifies the corresponding security safeguards for each level. It is based on a draft CCPS regulation released by the Ministry of Public

6 *Regulations on Network Data Security Management (Draft for Comments)*, CAC, 14<sup>th</sup> November 2021, viewed 21<sup>st</sup> April 2022, <[http://www.cac.gov.cn/2021-11/14/c\\_1638501991577898.htm](http://www.cac.gov.cn/2021-11/14/c_1638501991577898.htm)>

7 *Practice Guidelines for Cybersecurity Standards – Technical Specification for the Certification of Cross-Border Handling of Personal Information*, TC260, 24<sup>th</sup> June 2022, viewed 30<sup>th</sup> June 2022, <<https://www.tc260.org.cn/front/postDetail.html?id=20220624175016>>

8 *Standard Contractual Provisions for Cross-border Personal Information Transfer (Draft for Comment)*, CAC, 30<sup>th</sup> June 2022, viewed 15<sup>th</sup> July 2022, <[http://www.cac.gov.cn/2022-06/30/c\\_1658205969531631.htm](http://www.cac.gov.cn/2022-06/30/c_1658205969531631.htm)>

9 *Measures on Security Assessment of the Cross-border Transfer of Data*, CAC, 7<sup>th</sup> July 2022, viewed 15<sup>th</sup> July 2022, <[http://www.cac.gov.cn/2022-07/07/c\\_1658811536396503.htm](http://www.cac.gov.cn/2022-07/07/c_1658811536396503.htm)>

10 *Call for Comments on the Measures for the Administration of Data Security in the Field of Industrial and Informatization (Trial)*, Ministry of Industry and Information Technology (MIIT), 13<sup>th</sup> February 2022, viewed 4<sup>th</sup> April 2022, <[http://www.gov.cn/hudong/2022-02/13/content\\_5673340.htm](http://www.gov.cn/hudong/2022-02/13/content_5673340.htm)>





Security (MPS) in June 2018,<sup>11</sup> as well as a number of already effective standards.

In addition to being burdensome, the CCPS is increasingly being leveraged to advance restrictions on ICT products and services. For example, it imposes limitations on network operators over a certain CCPS level, by requiring infrastructure for cloud computing to be kept within China, customer data and personal information to be stored within China, and operation and maintenance to be conducted within China. These limitations raise *de facto* barriers for businesses that want to manage cloud computing services, or for those that reach the CCPS level specified, especially those with an international presence and globally connected service networks, as they would have to spend more on local infrastructure. It also raises concern among companies accessing these services with regard to the reliability of these businesses' international connectivity.

Similarly, the draft CCPS regulation requires networks above level three to use cryptography technology, products and services accredited by the State Cryptography Administration (SCA). Obtaining such accreditation has long remained an obstacle for many MNCs in China. The revised draft of the *Commercial Cryptography Regulation* further requires that networks above CCPS level three undergo security assessment for commercial cryptography, a process that favours domestic technology. For more details, please refer to Key Recommendation (KR) 4 of the *Information and Communication Technology Position Paper 2022/2023*.

The draft CCPS regulation is also affecting market entry of ICT products and services, as it requires products and services purchased by network operators above level three to pass a security review when such purchases have the potential to impact national security, the specific assessment criteria of which remains unclear. The security review is further discussed in the section on the CSRM.

### Cybersecurity Review Measures (CSRM)

The CSRM mandates that CII operators must proactively apply for a non-transparent cybersecurity review when their purchases of network products and services affect or may affect national security. As a

newly imposed requirement, online platform operators holding personal information of more than one million users that are to be newly listed on foreign markets must also report for review.

The CSRM includes broadly defined triggers, as it will look at the security, openness, transparency and diversity of the supply source, as well as the effect of “political, diplomatic and trade factors” on supply chains.<sup>12</sup> These non-technical factors, as well as the review's lengthy processes and lack of transparency, pose potential market access restrictions for MNCs. Furthermore, the CSRM may put suppliers at risk of data exposure through the need to disclose confidential information and trade secrets, since disclosure of transactions and other documents may be required. Due to these considerations, the sub-working group is concerned that the CSRM creates an environment in which domestic companies are favoured over their international peers in the long-term.

### Cryptography Law

The Cryptography Law specifically requires that all business entities, including MNCs in China, be treated equally in research, production and sales of commercial cryptography. However, ambiguities in both the law and its implementing regulations have created serious concerns for the sub-working group, as they have given rise to requirements that are incompatible with existing and well-established international principles, which call for governments to avoid restrictive or burdensome licensing, certification and other obligations limiting or delaying the import, trade and export of mass-marketed ICT products to which commercial cryptography is ubiquitous.<sup>13&14</sup>

To avoid unnecessary market access barriers, it is important that the various regulatory mechanisms the law seeks to establish remain transparent and narrow in scope. This includes ensuring that commercial products with cryptography as a secondary feature are not subject to certification and import/export restrictions;

11 *Regulation on Classified Cybersecurity Protection (Draft for Comments)*, MPS, 27<sup>th</sup> June 2018, viewed 21<sup>st</sup> April 2022, <<http://www.mps.gov.cn/n2254536/n4904355/c6159136/content.html>>

12 *Cybersecurity Review Measures*, Cyberspace Administration of China (CAC), 4<sup>th</sup> January 2022, viewed 22<sup>nd</sup> April 2022, <[http://www.cac.gov.cn/2022-01/04/c\\_1642894602182845.htm](http://www.cac.gov.cn/2022-01/04/c_1642894602182845.htm)>

13 *Joint Statement of the 17<sup>th</sup> Meeting of the World Semiconductor Council*, World Semiconductor Council, 23<sup>rd</sup> May 2013, viewed 19<sup>th</sup> May 2022, <[http://www.semiconductorcouncil.org/wp-content/uploads/2016/07/May\\_2013\\_WSC\\_-\\_GAMS\\_version\\_Joint\\_Statement\\_of\\_the\\_17th\\_Meeting\\_of\\_the\\_WSC\\_Final\\_23\\_M-1.pdf](http://www.semiconductorcouncil.org/wp-content/uploads/2016/07/May_2013_WSC_-_GAMS_version_Joint_Statement_of_the_17th_Meeting_of_the_WSC_Final_23_M-1.pdf)>

14 For more information, please refer to KR 4 in the *Information and Communication Technology Working Group Position Paper 2022/2023*.





that terms such as ‘national security’, ‘national economy and people’s livelihood’, and ‘public interests’ are *not* interpreted extensively; that the category of mass consumer products exempted from import and export restrictions is broadly defined; that voluntary certification is not enforced as a *de facto* mandatory requirement; that requirements applicable only to CII and party/government organs are not expanded—through lower-level implementing regulations—to networks above level three under the CCPS; and that the adoption of international standards, protection of sensitive intellectual property and mutual recognition for certification and attestation are all taken into consideration.

#### Data Localisation and Cross-border Data Transfer

In view of the relatively low triggers of regulatory cross-border data transfer security assessment defined by the CAC, which are discussed in the next KR, data localisation and cross-border data transfer restrictions can essentially act as market access barriers for MNCs in China that have to transfer data across borders at a higher frequency for normal business reasons and in response to their headquarters’ requests.

MNCs in China generally find themselves at a competitive disadvantage, as they need to put in extra resources to comply with China-specific regulations, and their ability to provide innovative products and timely services is curtailed as a result of onerous data restrictions. They may also receive less favourable treatment compared to domestic competitors by being given lower security ratings in bidding processes because they have to transfer data across borders. In certain extreme circumstances, suppliers seeking certain qualifications are being pushed to localise their production in China on the grounds that the cross-border transfer of data during production processes poses unnecessary risks. Finally, such restrictions inhibit cross-border business activities,<sup>15</sup> thereby leading to a reduced need in the Chinese market for cross-border services, the provision of which by members of the Cybersecurity Sub-working Group are an essential part of today’s interconnected digital economy.

The Cybersecurity Sub-working Group is hopeful that Chinese regulators will develop policies and regulations

that encourage a sustainable and healthy flow of data across borders. This would also facilitate more effective and efficient cooperation between Chinese and international businesses, with a view to further promoting China’s digital economy.

Overall, the aforementioned elements of the various Chinese security schemes may pose obstacles to international companies. If the nationality of a product or service—which is in itself difficult to define in ICT—is taken as the foundation for security, and if data flows are disproportionately restricted, international companies will face insurmountable barriers across the entire Chinese market. China will incur problems if the most technologically advanced and secure products and services are banned or blocked from its market. Furthermore, conformity assessment requirements in China often differ from international standards, adding complexity and creating extra costs for international companies to either re-certify or tailor products and services. Uncertainties linked to security schemes also constitute a competitive disadvantage for international businesses as they plan their China market strategies, raising concerns that such schemes will put their trade secrets in jeopardy and harm the market’s perception of their credibility.

#### Recommendations

- Define the concepts of ‘national security’ and ‘CII’ as narrowly as possible, and differentiate them from ‘commercial security’ in a clear manner.
- Limit the applicability and influence of the various theoretically non-binding documents, such as recommended national standards, in such a manner that they do not go beyond binding legislation.
- Promote mutual recognition and adoption and reliance upon, applicable international standards and global industry best practices.
- Relax restrictions on cross-border data transfer to allow easier market access.
- Take steps to ensure that the terms negotiated in cross-national trade and investment deals are effectively implemented in practice.

<sup>15</sup> This is the case, for example, with the CSRM’s restriction on the overseas listing of online platform operators holding large amounts of personal information, which has been discussed further above.





## 2. Minimise Unnecessary Operational Burdens Created by Extensive, Ambiguous and Discretionary Security Schemes

### Concern

The ever-increasing complexity of the security regulatory environment is leading to administrative, operational and cost challenges for organisations, and may result in increased uncertainty as well as adverse effects on the security of information technology (IT) systems, competitiveness and innovation.

### Assessment

#### Data restrictions

China's PIPL sets forth different avenues for data handlers to transfer their data abroad, namely passing a regulatory security assessment, signing a standard contract, and being certified in respect of personal information protection. The details of these mechanisms were finally being fleshed out at the time of this paper's finalisation, notably with the release of the *Measures on Security Assessment of the Cross-border Transfer of Data (Measures)*,<sup>16</sup> the *Standard Contractual Provisions for Cross-border Personal Information Transfer (Draft for Comment)*,<sup>17</sup> and the *Practice Guidelines for Cybersecurity Standards – Technical Specification for the Certification of Cross-border Handling of Personal Information*.<sup>18</sup> While the sub-working group took note of several improvements in these regulations, some requirements are still overly stringent, and could lead to increased operational burdens.

For example, under the *Measures*, a regulatory security assessment must take place as long as one of the several easily attainable thresholds—considering that MNCs typically handle large volumes of customer and employee data—is reached by the data handler, including in cases where the personal information of over one million people is being handled; or where the personal information of over 100,000 people or the sensitive personal information of 10,000 people has

been cumulatively provided abroad by the handler since 1<sup>st</sup> January of the previous year.

The sub-working group sees several issues with these requirements. Firstly, once the regulatory security assessment is triggered, the data handler may no longer be able to resort to signing a standard contract or to being certified for cross-border handling of personal information, for transferring data across borders, even when it comes to low-risk scenarios, such as the intra-company transfer of employees' personal information by a large MNC. Secondly, for those that handle large amounts of personal information, even if only one piece of such information is transferred abroad, a regulatory security assessment will still be unnecessarily triggered. Thirdly, it would be beneficial for the CAC to clarify that, as the *Measures* only concern the cross-border transfer of data, any thresholds they define are irrelevant to local data storage obligations under the PIPL.

As the regulatory security assessment focusses, among other aspects, on the necessity of the purpose, scope and methods of the cross-border data transfer, the sub-working group also urges that the assessment give due consideration to MNCs' legitimate business and operation needs. While localisation of data might be technically feasible in some circumstances, setting up duplicate IT systems within China just to meet localisation requirements and service local employees, customers and business partners can be problematic. This is not only because of the extra infrastructure costs, but also because MNCs will need to custom build and maintain interfaces to synchronise data for reporting, analysis and other normal business operations purposes, hire staff with expertise to support the infrastructure, and even significantly alter their established global and local operation and production processes. This is not a scalable approach for running a global business, and could eventually hamper foreign investment, as well as the provision of innovative products in the China market.

Although the overarching framework for cross-border data transfer is in place, rules on the identification of 'important data', and the actual important data catalogues, have yet to be finalised, making it impossible for important data handlers to meaningfully comply with the general requirements. The sub-working group hopes that the scope of important data will be clearly and narrowly defined, and that the CAC

<sup>16</sup> *Measures on Security Assessment of the Cross-border Transfer of Data*, CAC, 7<sup>th</sup> July 2022, viewed 15<sup>th</sup> July 2022, <[http://www.cac.gov.cn/2022-07/07/c\\_1658811536396503.htm](http://www.cac.gov.cn/2022-07/07/c_1658811536396503.htm)>

<sup>17</sup> *Standard Contractual Provisions for Cross-border Personal Information Transfer (Draft for Comment)*, CAC 30<sup>th</sup> June 2022, viewed 15<sup>th</sup> July 2022, <[http://www.cac.gov.cn/2022-06/30/c\\_1658205969531631.htm](http://www.cac.gov.cn/2022-06/30/c_1658205969531631.htm)>

<sup>18</sup> *Practice Guidelines for Cybersecurity Standards – Technical Specification for the Certification of Cross-Border Handling of Personal Information*, TC260, 24<sup>th</sup> June 2022, viewed 30<sup>th</sup> June 2022, <<https://www.tc260.org.cn/front/postDetail.html?id=20220624175016>>





and other industry regulators can provide a sufficient grace period between any future release of important data identification guidelines and catalogues, and their implementation.

Besides data localisation and cross-border data transfer, improvements are needed when it comes to data collection and processing in general. For example, operational burdens may also increase as a result of the PIPL's requirement for separate consent, which can be very difficult to implement in the business context. Also, while the PIPL has broadened the legal grounds for personal-information handling from obtaining the individual's consent to concluding or performing a contract, implementing lawful human resources management and performing statutory duties, and allows handlers to choose between these grounds, the subsequent draft *Regulations on Network Data Security Management* risk turning the additional legal grounds into criteria that must be followed by personal information handlers when obtaining consent,<sup>19</sup> an inconsistency that needs to be rectified in the final version of the regulations.

The draft *Regulations on Network Data Security Management*, as well as several planned and released sectoral data protection rules in the automotive and industrial and IT sectors, require the submission of annual data security reports to, and the filing of important-data handling activities with, local cyberspace or industrial and IT authorities. The Cybersecurity Sub-working Group remains doubtful about the necessity for establishing the important data filing system, and about the system's ability to add to overall security. To the extent that the system must remain, the sub-working group calls on relevant authorities to ensure a central point of contact for all filing and reporting activities, which would be crucial for those that, due to the nature of their business, are subject to multiple regulators and therefore concurrent filing and reporting obligations.

Finally, the DSL includes general restrictions on data handlers seeking to provide data to foreign judicial and law enforcement authorities, which may lead to a

legal dilemma between compliance with Chinese and foreign laws. Clarification is needed on the conditions and necessary procedures for obtaining the regulatory greenlight.

### Cybersecurity vulnerability management and incident notification

China has put in place dedicated rules governing cybersecurity vulnerabilities. In July 2021, the Ministry of Industry and Information Technology (MIIT), the CAC and the MPS jointly released the *Administrative Provisions on Security Vulnerabilities of Network Products (Administrative Provisions)*.<sup>20</sup> The *Administrative Provisions* are complemented by a mandatory national standard titled *Critical Network Devices Security Common Requirements*,<sup>21</sup> which includes provisions related to coordinated vulnerability disclosure (CVD).

The *Administrative Provisions* appear to have unified—to a certain extent—the patchwork regulatory system proposed by a previous draft for public consultation. It also demonstrates willingness to increase cross-ministerial coordination, by calling for timely information sharing and joint assessment and handling of major vulnerabilities. However, it includes a specific provision mandating the reporting of vulnerabilities to the MIIT, an obligation that has not undergone proper public review, and which significantly diverges from well-established, broadly-adopted best practices and international standards in the field of CVD and vulnerability handling—as articulated in standards such as *ISO/IEC 29147 (2018)* and *ISO/IEC 30111 (2019)*. This is being monitored with concern by the international community.<sup>22</sup>

The process of CVD is a standardised, multi-step process through which stakeholders identify, develop, validate, distribute and deploy mitigations for security vulnerabilities. One key objective of CVD and vulnerability-handling processes is to minimise users' risk and potential harm and costs associated with the vulnerability. To minimise this risk, CVD

<sup>19</sup> According to Article 19, data handlers handling personal information shall have a clear and reasonable purpose and abide by the principles of legality, propriety and necessity. Where they handle personal information on the basis of individual consent, they shall satisfy a number of requirements, such as: 1) the handled personal information is necessary to provide services, or necessary to fulfil duties provided in laws or administrative regulations; and 2) it is limited to the shortest period and lowest frequency necessary to realise the handling purpose, and adopt methods minimising effects on individuals' rights and interests. See: *Ibid*.

<sup>20</sup> *Administrative Provisions on Security Vulnerabilities of Network Products*, MIIT, CAC and MPS, 12<sup>th</sup> July 2021, viewed 8<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-07/14/content\\_5624965.htm](http://www.gov.cn/zhengce/zhengceku/2021-07/14/content_5624965.htm)>

<sup>21</sup> *Critical Network Devices Security Common Requirements*, MIIT, 20<sup>th</sup> February 2021, viewed 28<sup>th</sup> June, <<http://std.samr.gov.cn/gb/search/gbDetailed?id=BBE32B661B848FC8E05397BE0A0AB906>>

<sup>22</sup> *Coordinated Vulnerability Disclosure Policies in the EU*, European Union Agency for Cybersecurity, p. 37, 13<sup>th</sup> April 2022, viewed 22<sup>nd</sup> April 2022, <<https://www.enisa.europa.eu/publications/coordinated-vulnerability-disclosure-policies-in-the-eu>>





directs the recipient of a vulnerability to only disclose information about the vulnerability to other parties that are absolutely required to develop and deploy a mitigation, fix or 'patch'. Disclosure to unnecessary parties increases the likelihood of information leakage that could enable malicious actors and harm users. Requiring disclosure to specific parties assumes that all are necessary. In this regard, the sub-working group applauds that a relevant recommended national standard—*GB/T 30276-2020 Specification for Cybersecurity Vulnerability Management*—removed references to 'vulnerability management organisation'—a concept that appeared in the draft for public consultation, and which includes the CAC and other sectoral authorities—from the final release, as these parties are unnecessary during CVD.

However, this ambiguous requirement reemerged in the *Administrative Provisions*. As discussed earlier, unmitigated vulnerability information should only be communicated on a need-to-know basis, to prevent it from being exploited. This is particularly important considering the interdependencies between products nowadays. The sub-working group strongly urges a clear clarification that "reporting vulnerabilities to the MIIT within two days" is only required after remediations and mitigations are made available, and recommends disclosing information related to unmitigated vulnerabilities in a confidential manner, and only to the parties necessary to develop and test the proposed remediation or mitigation during the CVD process.

It should also be recognised that in certain limited cases, disclosure of information on an unmitigated vulnerability can support users' response when, for example, the vendor no longer exists or the vulnerability concerns an open-source software/module or a commonly-used protocol, and there is no owner of the technology or a different coordinator that is developing a mitigation and leading a CVD process.

Another concern is that of incident notification. While the CSL requires that cyber incidents be notified to the "relevant competent authorities",<sup>23</sup> the PIPL<sup>24</sup> and the

DSL<sup>25</sup> also provide that mandatory notifications must be provided to the "relevant authorities" in cases of data breaches, which are, incidentally, cyber incidents. In this regard, it is important to have a unified regulatory framework, with one agency coordinating the different authorities on incident notification. Multiple notifications to different authorities on the same incident may result in potentially different—if not conflicting—responses or demands in response, which will increase both the administrative burden and the level of uncertainty over the potential outcome.

Overall, these recommendations aim to ensure that China's cybersecurity vulnerability management framework is both effective and business friendly. This is particularly important for small and medium-sized enterprises (SMEs), which lack the resources to efficiently tackle the associated increasing breadth and number of mandatory requirements.

### CII protection

China's security legislation, including the CSL, the PIPL, the DSL and the Cryptography Law, all contain specific obligations for the protection of CII. These requirements are being broadened in ways that bring about significant operational burdens to the business community.

For example, the addressees of such CII protection requirements have been expanded in many instances regardless of whether the networks/infrastructure in question are truly critical for the normal functioning of the core business. Also, many requirements that originally were only destined for CII have been gradually expanded to cover networks with classified cybersecurity protection above level three, or even broader network operators, as is the case with the data localisation and cross-border data transfer security assessment obligation outlined above, as well as with commercial cryptography application security assessment.<sup>26</sup>

The Cybersecurity Sub-working Group strongly believes it is important for regulators to clearly delineate the boundaries between what falls within the scope of CII and what falls outside, and to avoid interpreting and applying relevant requirements in an expansive

23 Cybersecurity Law, NPCSC, Article 25, 7<sup>th</sup> November 2016, viewed 9<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2016-11/07/content\\_5129723.htm](http://www.gov.cn/xinwen/2016-11/07/content_5129723.htm)>

24 Personal Information Protection Law, NPCSC, Article 57, 20<sup>th</sup> August 2021, viewed 9<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202108/a8c4e3672c74491a80b53a172bb753fe.shtml>>

25 Data Security Law, NPCSC, 10<sup>th</sup> June 2021, viewed 9<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202106/7c9af12f51334a73b56d7938f99a788a.shtml>>

26 Please refer to KR 4 of the *Information and Communication Technology Position Paper 2022/2023*.





manner, in order to increase legal certainty, reduce burdensome obligations and leave room for normal business activities as well as international exchange and cooperation.

#### Recommendations

- Ensure consistency between upper-level legislation and relevant implementing regulations, and follow the least interference principle in the course of legitimate international business operations.
- Ensure a coordinated and unified approach for oversight and enforcement among the government authorities involved.
- Reduce security-related administrative burdens on companies, including those due to duplicative or fragmented requirements.

### 3. Ensure Transparency, Consistency, Non-discrimination and Proportionality in Security Rulemaking and Law Enforcement

#### Concern

Transparency, consistency, non-discrimination and proportionality are becoming increasingly important in order to create a healthy security environment for domestic companies and MNCs alike, but are not always ensured in current rule-making and law enforcement.

#### Assessment

China's security regulatory landscape has been undergoing rapid changes over the past few years as a result of such legislation as the CSL, the DSL, the PIPL and the Cryptography Law. To reassure the business community that the country's security environment will remain predictable in the face of a rapidly evolving regulatory framework, it is of paramount importance when formulating and implementing laws, regulations and standards that China ensures the following:

#### Transparency

The sub-working group recognises and appreciates the efforts made by relevant government agencies to communicate with the industry, such as in the making of the data regulations in the industrial and IT sector. It hopes that transparency can be further improved by increasing communication with industry associations in the development of broader rules, as is endorsed by the State Council in its *Notice on Fully Listening to Opinions*

*of Enterprises, Industry Associations and Chambers of Commerce in the Making of Administrative Measures, Provisions and Normative Documents.*<sup>27</sup>

In addition to data regulations, transparency is also needed in the development of other laws, regulations and standards that can be disruptive to normal business operations, including those relating to CCPS, cybersecurity review, cybersecurity vulnerability management and commercial cryptography. Proper public consultation needs to be guaranteed, in particular if new legal obligations are being introduced, or if there is major disagreement with the previous draft. In this regard, the sub-working group calls on the Ministry of Justice to ensure that the forthcoming *CCPS Regulation* and the *Commercial Cryptography Regulation* undergo an additional round of public consultation before being finalised.

#### Consistency

It is laudable that the PIPL allows for processing to take place not only when consent has been obtained, but also when it is necessary for executing a contract, performing a legal obligation, responding to an emergent public health event, protecting the life or property of an individual, publishing news or carrying out “media supervision for the public interest”. Such alignment with the *Personal Information Security Specification* demonstrates consistency between regulatory requirements at different levels.

Consistency is also important in delineating the roles and responsibilities of different government authorities. Worryingly, a growing number of government agencies—including but by no means limited to the CAC, the MPS and the MIIT—are having their say in cyber and data protection, with overlapping or at least unclear responsibilities. As European experience has shown, the co-existence of different, unsupervised regulators may lead to serious difficulties, inconsistencies and adverse effects and, if maintained, will necessitate an effective, clear and transparent coordination mechanism, with one central leading authority.

With respect to commercial cryptography, consistency is

<sup>27</sup> *Notice on Fully Listening to Opinions of Enterprises, Industry Associations and Chambers of Commerce in the Making of Administrative Measures, Provisions and Normative Documents*, State Council, 13<sup>th</sup> March 2019, viewed 20<sup>th</sup> May 2022, <[http://www.gov.cn/zhengce/content/2019-03/13/content\\_5373423.htm](http://www.gov.cn/zhengce/content/2019-03/13/content_5373423.htm)>





needed at different levels. First, it is necessary between the Cryptography Law and its own implementing regulations, in particular the *Commercial Cryptography Regulation*;<sup>28</sup> and second, between the CSL and the Cryptography Law, with regard to the various security assessments, reviews and testing and certification systems. One notable example of inconsistency is the fact that certain cybersecurity standards currently mandate compliance with recommended national and industry standards related to cryptography, as well as the use of commercial cryptography products that have been approved or certified by the State Cryptography Administration, although such products are not included in the product catalogue for mandatory certification.

### Non-discrimination

The sub-working group calls on China to eliminate any elements in laws, regulations, standards and practices that risk discriminating against foreign-invested companies. One example of this is that it is currently impossible for international companies to access certain security-related standardisation bodies, and to implement domestic Chinese algorithms which are nonetheless mandated by an increasing number of government agencies. Also, despite reassurances from the CAC that the emphasis on “secure and trustworthy” (and other similar terms) ICT products and services is not targeting international companies, in reality this term still has a close connotation with indigenous innovation.

### Proportionality

Security laws and regulations need to be technically credible and innovation-friendly. Intervention at all levels, from national regulations to business security measures, should be appropriate to and commensurate with the risk, and not limit the opportunities offered by digital transformation nor create unreasonable costs for businesses. One telling example of the lack of proportionality is the fact that a regulatory cross-border transfer security assessment is currently needed for handlers of large amounts of personal information, even if only one piece of such information is being transferred abroad.

While China—like all other countries and regions—has a legitimate right to strengthen the resilience of its supply chains, such efforts should remain inclusive and not place an overly strong emphasis on

indigenous innovation and supply chain controls to the extent that normal business activities are significantly jeopardised, as detailed in KR 1 of the *Information and Communication Technology Working Group Position Paper 2022/2023*.

Overall, the Cybersecurity Sub-working Group hopes these process-related recommendations could lead to the removal of excessive market access barriers and operational burdens discussed in the preceding key recommendations, and to more business-friendly security rules being promulgated nationwide across all sectors.

### Recommendations

- Provide in a timely and meaningful manner an open and transparent platform that allows European businesses to engage in security rulemaking.
- Review existing and planned security-related laws and regulations, and release unambiguous implementation guidelines to ensure consistent requirements and enforcement.
- Clarify the roles and responsibilities of government authorities involved in security rulemaking.
- Recognise MNCs with operations in China as Chinese companies and avoid extensive interpretations of “national security”.
- Ensure security regulations are appropriate and commensurate with the risk.

<sup>28</sup> For more details, please refer to KR 4 of the *Information and Communication Technology Working Group Position Paper 2022/2023*.





## Abbreviations

CAC	Cyberspace Administration of China
CCPS	Classified Cybersecurity Protection Scheme
CII	Critical Information Infrastructure
CSL	Cybersecurity Law
CSRM	Cybersecurity Review Measures
CVD	Coordinated Vulnerability Disclosure
DSL	Data Security Law
EU	European Union
ICT	Information and Communication Technology
IEC	International Electrotechnical Commission
ISO	International Standardization Organization
IT	Information Technology
KR	Key Recommendation
MIIT	Ministry of Industry and Information Technology
MNC	Multinational Corporation
MPS	Ministry of Public Security
NPCSC	National People's Congress Standing Committee
PIPL	Personal Information Protection Law
SCA	State Cryptography Administration
SME	Small and Medium-sized Enterprise
TC260	National Information Security Standardization Technical Committee
WSC	World Semiconductor Council





# Logistics Working Group

## Key Recommendations

### 1. Customs Issues

#### 1.1 Continue Normal Clearance Procedures even if the Clearance Lead Time has been Reached



- Continue to follow normal clearance procedures instead of requesting the return of shipments that are not cleared within the stipulated time period.

#### 1.2 Establish Detailed and Enforceable Implementation Guidelines for Voluntary Disclosures and Use of the Customs Declaration Sheet



- Establish detailed voluntary disclosure guidelines and executable processes.
- Establish clear rules and requirements that allow enterprises to make amendments to declared information.

#### 1.3 Enable 'Full-paperless' Customs Declarations via All Platforms



- Enable 'full-paperless' customs declarations as common practice via all platforms and only require paperwork in specific situations, such as when the shipment is categorised as high-risk.

#### 1.4 Implement a National Declaration Model (NDM) for Low-value Shipments

- Further facilitate trade by extending NDM for low-value shipments, in order to support remote declarations and allow shipments to transit through Chinese cities for clearance.
- Support greater network efficiency and optimise distribution networks within China.

#### 1.5 Clarify the Jurisdiction for Dangerous Goods Regulations (DGR)



- Clarify the jurisdiction for DGR to facilitate transportation of dangerous goods..
- Adopt a standard on DGR that is consistent with industrial regulations and international rules.

#### 1.6 Optimise the Authorised Economic Operator (AEO) Programme

- Simplify the AEO re-verification audit requirements.
- Introduce penalty criteria for a downgraded AEO status that are proportional to the yearly actual value of import and export declarations.
- Allow companies that have underpaid duty and import taxes to preserve their AEO status and customs rating without suspension or downgrading—except for non-compliance cases related to smuggling—by paying extra duty and import taxes, when the amount underpaid does not exceed a defined threshold.
- Grant more beneficial treatment to AEO companies.
- Establish more AEO mutual recognition agreements with other countries.

#### 1.7 Develop Smart Customs and Innovative Customs Management Methods

- Put more strategic efforts into driving Smart Import/Export via technology innovations by further adopting advanced technologies such as artificial intelligence, Internet of Things and blockchain.

### 2. Express Delivery Services (EDS)

#### 2.1 Classify EDS as 'Essential' to Ensure Uninterrupted Door-to-Door Delivery of Key Shipments

- Promote understanding of the need for 'essential services', including EDS, both domestic and





international services.

- Take into account the long-term nature of the COVID-19 pandemic, and the importance of EDS to people's daily lives and supply chains in crisis situations.
- Establish measures to maintain the smooth flow of express deliveries and transportation of goods under COVID-19 conditions.

### 2.2 Clarify the Standards and Guidance for the EDS Industry under the Cybersecurity Law 3

- Fully consider the nature of international express delivery, and involve international express carriers in the policymaking process to increase policy transparency.
- Provide clear standards and guidance for the EDS industry, as well as reasonable transition periods.

### 2.3 Simplify the Licensing and Management Requirements for International Express Companies



- Revert to the previous geographical scope requirement for obtaining international express licences in China.
- Avoid directly applying the management requirements of the franchise model to the agency model, including the duplicated licence requirement.

### 2.4 Implement More Measures to Encourage Green and Sustainable Development in the EDS Industry 2

- Facilitate the implementation of new energy vehicles in the EDS industry.
- Encourage collaboration along the supply chain to promote green packaging.

## International Liner Shipping Sub-working Group

### 1. Adhere to the Principle of Reciprocity when Issuing Cargo Relay Permissions and Simplify Customs Declaration Procedures

- Adhere to the principle of reciprocity by granting permission to carry out cargo relay at Yangshan to vessels' countries of registration whose cabotage or international cargo relay conditions are in line with China's partial opening, and work towards a further relaxation of rules in line with China's commitment to reform and open up.
- Simplify customs declaration procedures by treating relay cargo as international transshipment.

### 2. Establish Sound and Transparent Principles for Ocean Freight 3

- Publish detailed guidelines specifying that filings of new charges, or increments of existing charges, will be approved by the Ministry of Transport (MOT) / Shanghai Shipping Exchange (SSE) within a specific timeline if reasonable justification is provided.
- Create certainty for commercial carriers in commercial operations by providing clear guidance on how to comply with SSE filing requirements and by making transparent the rationales for container liner shipping charges.
- Impose tariff filing and audit requirements on non-vessel common carriers, freight forwarders and booking agents, similar to those imposed on carriers.





### 3. Provide Flexibility when Determining Non-compliance during Freight Filing Audits 3

- Establish guidance for exceptional cases and allow a reasonable ratio of tolerance when determining non-compliance during freight filing audits conducted by the MOT/SSE.

### 4. Amend Current Regulations that Hold Carriers of Dangerous Goods (DG) Liable for Misdeclarations by Shippers

- Amend current regulations that hold carriers liable for DG misdeclarations, and impose administrative/civil/criminal liabilities upon the party that initially submits false information.

### 5. Ratify the Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships 3

- Ratify the Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships.

### 6. Monitor the Impact that the Integration of Coastal Ports Has on Fair Competition 3

- Closely monitor potential infringement of competition law by port groups.
- Implement measures and controls to prevent post-merger port groups creating monopolies.

### 7. Facilitate the Use of Foreign Carriers' Empty Containers for Transportation of Domestically-traded Goods during Container Repositioning

- Facilitate the use of foreign carriers' empty containers for the transportation of domestic goods during container repositioning.

### 8. Collaborate with the International Liner Shipping Community to Decarbonise the Industry

- Build partnerships between research institutions, shipping companies, shipbuilders and their suppliers in China and Europe to develop and adapt carbon neutral technologies.
- Agree on technical standards to avoid potential inefficiencies and waste, through approaches such as enhanced cooperation within the International Maritime Organization.
- Cooperate on the establishment of a global infrastructure ensuring availability of carbon neutral fuels.
- Extend until 31<sup>st</sup> March 2023 the grace period for dual side Alternative Marine Power installations for vessels calling at Shanghai.

### 9. Provide Flexibility in COVID-19 Policies to Facilitate Seafarer Crew Changes and Dry Docking by Foreign-flagged Vessels

- Provide flexibility in COVID-19 policies to facilitate seafarer crew changes in China and to reduce the detention period of infected seafarers.



## Introduction to the Working Group

The Logistics Working Group was founded in 2003 and represents a wide range of logistics service providers in freight forwarding, including sea, air, land and express delivery, as well as warehousing and distribution. The Logistics Working Group is also composed of the International Liner Shipping Sub-working Group, with core members from leading international maritime transport enterprises.

## Recent Developments

### Logistics Under the COVID-19 Pandemic

The COVID-19 pandemic has had an enormous impact on the logistics industry, especially due to lockdowns in port cities disrupting supply chains. Due to quarantine measures in various cities, transborder transportation suffered a shortage of labour in both manufacturing and logistics. According to the Ministry of Transport (MOT), the foreign trade volume from January to February 2022 witnessed, a decrease of 3.9 per cent year-on-year.<sup>1</sup>

Though COVID-19 also brought many challenges to the express delivery services (EDS) sector, the industry still saw growth in 2021 due to its supporting role in people's daily lives as well as supply chains. According to preliminary statistics released by the State Post Bureau (SPB),<sup>2</sup> in 2021, the volume of deliveries increased by 30 per cent year-on-year to 108.5 billion items, and total revenue by 18 per cent to just over CNY 1 trillion. This growth is expected to continue in 2022; with delivery volume forecast to increase by another 13 per cent (122.5 billion items), and business revenue by 12 per cent to CNY 1.16 trillion. However, Omicron variant outbreaks in early 2022 led to the EDS industry facing inconsistent COVID-19 containment requirements for express shipments, obstruction of the passage of express vehicles, and a large backlog of express shipments at airports and operation centres, which may negatively impact industry growth this year.

### Logistics Under China's Carbon Neutrality Goals

On 14<sup>th</sup> December 2020, the State Council issued the *Notice on Accelerating Green Packaging Transformation*,<sup>3</sup> aimed at reforming the packaging

1 *Economic Operation of Transportation in January and February*, MOT, 25<sup>th</sup> March 2022, viewed 31<sup>st</sup> March 2022, <[https://xxgk.mot.gov.cn/2020/jigou/zghgs/202203/t20220325\\_3647807.html](https://xxgk.mot.gov.cn/2020/jigou/zghgs/202203/t20220325_3647807.html)>  
2 *China's postal industry business revenue has reached 1.27 trillion in 2021*, SPB, 6<sup>th</sup> January 2022, viewed 26<sup>th</sup> April 2022, <<http://www.spb.gov.cn/gjyzj/c204534/202201/92ddd33fc7ac4db68955b87043ea2a1f.shtml>>  
3 *Concerning Accelerating Green Packaging Transformation Notice*, State Council,

used by the industry in order to build a greener modern logistics system.

The standardisation of packaging is vital to ensure as much of the materials used can be recycled at their final destination as possible. Meanwhile, although the SPB has rolled out several directives and regulations on green packaging for the EDS in the past two to three years, the measures are aimed at domestic deliveries. Packaging required to safely ship goods overseas is generally of different material, therefore international express items often do not comply with domestic packaging and shipping requirements, which impacts the efficiency of the service. Also, some recent policies require express companies to refuse self-packaging express items that fail to meet green packaging requirements.<sup>4</sup> As the EDS industry cannot afford to take on all obligations relating to green packaging requirements, regulators should encourage collaboration along the supply chain to promote green packaging.

As part of China's '1+N' policy system for its carbon peaking and carbon neutrality goals (30/60 Goals),<sup>5</sup> the MOT issued the *14<sup>th</sup> Five-year Development Plan for Green Transportation*,<sup>6</sup> which emphasises the importance of new energy vehicles (NEVs). This development plan stipulates that NEVs should account for no less than 80 per cent of public transportation, taxis and logistics vehicles. While many cities have already introduced NEVs in the EDS industry, the charging infrastructure available is not adequate to also cater for suitable NEVs for the EDS industry, such as electric tricycles.

### Internationalising Chinese Logistics Rules, Strengthening Chinese Industry Business Participation in International Markets

Coordinating China's logistics rules with international standards is an important step for opening up. This encompasses actions like promoting cooperation through schemes like the Regional Comprehensive

14<sup>th</sup> December 2020, viewed 31<sup>st</sup> March 2022, <[http://www.gov.cn/zhengce/content/2020-12/14/content\\_5569345.htm](http://www.gov.cn/zhengce/content/2020-12/14/content_5569345.htm)>

4 *Measures for the Administration of Mail Express Packaging*, MOT, 8<sup>th</sup> February 2022, viewed 29<sup>th</sup> June 2022, <[https://xxgk.mot.gov.cn/2020/jigou/fgs/202102/t20210225\\_3527950.html](https://xxgk.mot.gov.cn/2020/jigou/fgs/202102/t20210225_3527950.html)>

5 *China's 1+N Climate Policy System: The Path to Carbon Neutrality*, Seneca ESG, 4<sup>th</sup> November 2022, viewed 29<sup>th</sup> June 2022, <<https://www.senecaesg.com/insights/chinas-1n-climate-policy-system-way-to-carbon-neutrality/>>

6 *14<sup>th</sup> Five-year Development Plan for Green Transportation*, MOT, 21<sup>st</sup> January 2022, viewed 31<sup>st</sup> March 2022, <[https://xxgk.mot.gov.cn/2020/jigou/zghgs/202201/t20220121\\_3637584.html](https://xxgk.mot.gov.cn/2020/jigou/zghgs/202201/t20220121_3637584.html)>





Economic Partnership, and strengthening implementation of Chinese industry regulations. Coordinating domestic standards is also urgently required. Taking dangerous goods regulations (DGR) as an example, the lack of consistency among different local customs creates difficulties when items are being transported.

## Key Recommendations

### 1. Customs Issues

#### 1.1 Continue Normal Clearance Procedures even if the Clearance Lead Time has been Reached 2

##### Concern

Due to the strict adherence of some local customs authorities to the lead-time indicator, they request shipments that have not been cleared within the specified clearance lead time be returned, which increases companies' costs and administrative burdens.

##### Assessment

In recent years, the General Administration of Customs of China (GACC) has made great strides in reducing customs clearance lead-times to further facilitate trade. In line with this effort, local customs administrations have been setting specific goals to manage clearance, for example, by stipulating that shipments must be released within a specified time period. However, in cases where clearance has not been made by the specified lead-time, local customs authorities will often request shipments to be returned, necessitating that the entire process be re-done, instead of following normal clearance procedures and extending the clearance time.

##### Recommendation

- Continue to follow normal clearance procedures instead of requesting the return of shipments that are not cleared within the stipulated time period.

#### 1.2 Establish Detailed and Enforceable Implementation Guidelines for Voluntary Disclosures and Use of Customs Declaration Sheet (CDS) 3

##### Concern

The current customs voluntary disclosure rule in China is very general and lacks actionable guidance and process, while the CDS amendment to the *Customs Inspection Regulations* has increased compliance risks for enterprises.

##### Assessment

The GACC made great progress on voluntary disclosure in 2022, with the announcement of *Circular No. 54* on the voluntary disclosure process for dutiable imports.<sup>7</sup> However, the existing customs voluntary disclosure rule in China is still very strict and lacks actionable guidance and processes. The rules and consequences of voluntary disclosure are unclear, and local customs authorities enforce them differently. Enterprises are more than willing to undertake voluntary disclosure, yet the inconsistency of enforcement prevents them from doing so.

At the same time, the CDS amendment to the *Customs Inspections Regulations* remains a challenge for enterprises, and important issues have not been addressed in new regulations released in 2022.<sup>8</sup> For example, while enterprises may unintentionally make wrong declarations due to mistakes introduced by overseas suppliers, local customs administrations will not allow them to update the declaration, even through voluntary disclosure. This creates non-compliance risks for enterprises.

##### Recommendations

- Establish detailed voluntary disclosure guidelines and executable processes.
- Establish clear rules and requirements that allow enterprises to make amendments to declared information.

#### 1.3 Enable 'Full-paperless' Customs Declarations via All Platforms 2

##### Concern

Although clearance documents can be sent to customs authorities via the single-window platform, as the process is still not fully paperless via all platforms, it increases the burden on enterprises' operations.

##### Assessment

Thanks to the efforts of the GACC, China's customs declaration procedure has been simplified during the past few years, which has facilitated international trade. Importers, exporters and customs brokers can now

<sup>7</sup> GACC 2022 Circular No. 54 (Announcement on the Handling of Matters Related to Voluntary Disclosures of Tax-related Violations), GACC, 1<sup>st</sup> July 2022, viewed 5<sup>th</sup> July 2022, <<http://www.customs.gov.cn/customs/302249/2480148/4447524/index.html>>

<sup>8</sup> Decision on Amending and Cancelling some Laws and Regulations, State Council, 29<sup>th</sup> March 2022, viewed 12<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2022-04/07/content\\_5683886.htm](http://www.gov.cn/zhengce/content/2022-04/07/content_5683886.htm)>



scan clearance documents and send them to customs authorities via the digital single-window platform instead of providing them on paper, as was the previous practice. However, the declaration process is not yet fully paperless. For instance, certain documents, such as invoices, cannot be completed online; the declarant still has to print the necessary documents, fill them out and then scan them into the customs declaration system.

To further improve customs clearance efficiency and better protect the environment, the working group strongly recommends adopting a fully paperless customs declaration model as common practice via all platforms. Paperwork should be only required when absolutely necessary, such as when a shipment is categorised as high risk.

#### Recommendation

- Enable 'full-paperless' customs declarations as common practice via all platforms and only require paperwork in specific situations, such as when the shipment is categorised as high-risk.

### 1.4 Implement a National Declaration Model (NDM) for Low-value Shipments

#### Concern

Low-value shipments through the express delivery channel are unable to enjoy NDM benefits, such as allowing remote declarations across China, mutual recognitions and applying consistent customs standards, which impacts efficiency and increases companies' workloads.

#### Assessment

The GACC initiated national customs clearance integration reform in 2017 with the release of *Announcement No. 25 [2017]*.<sup>9</sup> Since then, national customs risk prevention and control centres and tariff collection administration centres have been set up to support remote declarations and allow shipments to transit through Chinese cities for clearance. However, low-value shipments, including samples and low-value items under Chinese yuan (CNY) 5,000 (Category C) items through the express delivery channel, were not included in this system.

<sup>9</sup> *GACC Announcement No. 25 [2017] (Announcement on Promoting the Reform of National Customs Clearance Integration)*, GACC, 28<sup>th</sup> June 2017, viewed 29<sup>th</sup> June 2022, <<http://guangzhou.customs.gov.cn/custo/302249/302266/302267/711020/index.html>>

The rapid development of international trade and cross-border e-commerce has resulted in a substantial increase in the volume of low-value goods being shipped. The majority of low-value shipments are samples and advertising materials, which are very time-sensitive and require fast customs clearance.

While the GACC recently expanded the national customs clearance integration reform to include Category C items through the express delivery channel, they are still not eligible for NDM. In consideration of the increasing volumes of low-value shipments, extending NDM to Category C items would greatly reduce the administrative burden on businesses and improve customs clearance efficiency.

#### Recommendations

- Further facilitate trade by extending NDM for low-value shipments, in order to support remote declarations and allow shipments to transit through Chinese cities for clearance.
- Support greater network efficiency and optimise distribution networks within China.

### 1.5 Clarify the Jurisdiction for Dangerous Goods Regulations (DGR)

#### Concern

It is unclear whether jurisdiction for DGR falls under the Civil Aviation Administration of China (CAAC) or customs, which impacts the efficiency of the transportation of dangerous goods.

#### Assessment

Since China re-joined international aviation activity in 1974, the global industry's *Technical Instructions* have improved the safety of transportation of dangerous goods.<sup>10</sup> However, due to the lack of consistent regulation, the jurisdiction for classification and transport requirements of dangerous goods remains unclear, which creates confusion for companies.

At present, the *Provisions of the Civil Aviation Administrations of China on the Administration of the Transport of Dangerous Goods by Air* states in Article 17 that a permit for air transport of dangerous goods granted by a CAAC regional administration shall specify the type of dangerous goods approved for transport

<sup>10</sup> *Technical Instructions for the Safe Transport of Dangerous Goods by Air (Doc-9284)*, International Civil Aviation Organization, viewed 29<sup>th</sup> June 2022, <<https://www.icao.int/safety/dangerousgoods/pages/technical-instructions.aspx>>





and the validity period of the permit.<sup>11</sup> Meanwhile, *the Regulations on the Safety Management of Hazardous Chemicals* only require the CAAC to take responsibility for safety management of the transport of hazardous chemicals by air, the enterprises conducting the transportation and the transport vehicles.<sup>12</sup> It does not clarify whether the CAAC is responsible for specifying the categories of goods that will be considered dangerous. Therefore, the working group strongly advises that the jurisdiction for DGR be clearly outlined, to facilitate the timely and safe transportation of dangerous goods.

### Recommendations

- Clarify the jurisdiction for DGR to facilitate transportation of dangerous goods..
- Adopt a standard on DGR that is consistent with industrial regulations and international rules.

## 1.6 Optimise the Authorised Economic Operator (AEO) Programme 5

### Concern

Despite the significant investments that companies have made in applying for and obtaining the AEO qualification, the benefits are not immediately apparent, which restricts these companies' operational efficiency.

### Assessment

An AEO is defined in the World Customs Organization's (WCO) Framework of Standards to Secure and Facilitate Global Trade (SAFE Framework) as "a party involved in the international movement of goods in whatever function that has been approved by or on behalf of a national customs administration when complying with WCO or equivalent supply chain security standards".<sup>13</sup> This concept, which originally appeared in the Community Customs Code,<sup>14</sup> is one of the core concepts in the SAFE Framework. In the AEO system,

customs authorities work with qualified business partners to gain additional competitiveness and effectiveness in the facilitation of international supply chains by reducing customs clearance lead time and cost. The AEO certification system is an important part of the national credit system, and customs authorities can use it to reduce any conflict that may arise between customs supervision and trade facilitation.

The working group welcomes the efforts of the GACC to enhance China's AEO programme in recent years, and recommends it continue its efforts to provide more benefits for enterprises in the future. For instance, based on the GACC's current AEO rules, AEO enterprises need to be re-verified by customs authorities every five years to maintain their qualification, which costs enterprises greatly in terms of money, manpower, time and resources. In order to reduce the burden on enterprises and improve efficiency, some of these re-verification requirements or processes should be simplified. For example, as the internal policies, systems or structure of most multinational companies (MNCs) do not change very frequently, repeating certain processes each time during re-verification is a waste of resources for all parties.

Furthermore, the AEO rules also clearly state that any enterprise will be downgraded and lose their AEO qualification if they are penalised with a single fine over CNY 30,000 or fines that exceed CNY 50,000 within a year (a single fine over CNY 10,000 or fines that exceed CNY 30,000 for brokerage enterprises). In other words, a relatively small fine imposed as a consequence of minor non-compliance can result in the loss of AEO qualification for MNCs, which would significantly impact their daily operations. In addition, AEO enterprises that have demonstrated considerable internal control and compliance capabilities should be eligible for more preferential treatment.

It is very encouraging to see the progress China has made in signing AEO mutual recognition agreements with other countries. China should continue to establish such agreements, as they will be very beneficial in improving the efficiency and reducing the expense of cross-border activities.

### Recommendations

- Simplify the AEO re-verification audit requirements.
- Introduce penalty criteria for a downgraded AEO

<sup>11</sup> *Provisions of the Civil Aviation Administrations of China on the Administration of the Transport of Dangerous Goods by Air*, MOT, 13<sup>th</sup> April 2016, viewed 12<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2016/content\\_5103153.htm](http://www.gov.cn/gongbao/content/2016/content_5103153.htm)>

<sup>12</sup> *Regulations on the Safety Management of Hazardous Chemicals*, State Council, 2<sup>nd</sup> March 2011, viewed 12<sup>th</sup> April 2022, <[http://www.gov.cn/jfjfg/2011-03/11/content\\_1822902.htm](http://www.gov.cn/jfjfg/2011-03/11/content_1822902.htm)>

<sup>13</sup> *AEO Template*, WCO, June 2018, viewed 27<sup>th</sup> April 2022, <[http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/aeo-template.pdf?la=en#:~:text=AEO%3A%20Authorized%20Economic%20Operator%20\(AEO,equivalent%20supply%20chain%20security%20standards](http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/facilitation/instruments-and-tools/tools/safe-package/aeo-template.pdf?la=en#:~:text=AEO%3A%20Authorized%20Economic%20Operator%20(AEO,equivalent%20supply%20chain%20security%20standards)>

<sup>14</sup> *Community Customs Code*, European Union regulations | European Encyclopedia of law, viewed 1<sup>st</sup> July 2022, <<https://europeanlaw.lawlegal.eu/community-customs-code/>>





status that are proportional to the yearly actual value of import and export declarations.

- Allow companies that have underpaid duty and import taxes to preserve their AEO status and customs rating without suspension or downgrading—except for non-compliance cases related to smuggling—by paying extra duty and import taxes, when the amount underpaid does not exceed a defined threshold.
- Grant more beneficial treatment to AEO companies.
- Establish more AEO mutual recognition agreements with other countries.

### 1.7 Develop Smart Customs and Innovative Customs Management Methods

#### Concern

In order to realise its ambition to become a major international trade hub, China should develop similar levels of smart customs and innovative customs supervision methods being adopted by other international hubs.

#### Assessment

The rapid rate of technological development has opened up opportunities for China Customs to strategically explore and drive digital innovations (artificial intelligence (AI), blockchain, Internet of Things (IoT), big data, cloud technology, among others) that can enable smart customs clearance in the future.

In recent years, there have been many assessments of the potential application of IoT and other advanced technology in import and export processes, with some highly advantageous initiatives having already undergone pilot testing rounds. These innovative technologies could assist in areas such as real-time tracking of bonded goods, smart inspection, smart declaration, and delivery of dangerous or sensitive goods. As future Smart Import/Export processes will heavily rely on such technology innovations, the Chinese authorities should collaborate with European companies with experience in these fields and in other international trade hubs to develop domestic applications.

#### Recommendation

- Put more strategic efforts in driving Smart Import/Export via technology innovations by further adopting advanced technologies such as AI, IoT and blockchain.

## 2. Express Delivery Services (EDS)

### 2.1 Classify EDS as 'Essential' to Ensure Uninterrupted Door-to-Door Delivery of Key Shipments

#### Concern

EDS and the transportation of goods have been severely affected by domestic COVID-19 containment measures in 2022, which in turn caused disruption to international supply chains.

#### Assessment

Since the beginning of 2022, as a result of strict COVID-19 prevention measures introduced in some regions of China, the EDS industry was often unable to make door-to-door deliveries, and even experienced service restrictions and business suspension in certain areas. Nationwide, the EDS industry also faced inconsistent COVID-19 containment requirements for express shipments, obstruction of the passage of express vehicles, and a large backlog of express shipments at airports and operation centres.

EDS have shown extraordinary resilience throughout the pandemic. They have also been proven as essential for the continuity of global supply chains and for the door-to-door supply of urgently needed goods such as medical equipment, medicine and food. Express delivery has an important role to play in China's efforts to contain COVID-19, as EDS supply the public with daily necessities, facilitate the smooth operations of the manufacturing industry and maintain the stability of the supply chain both domestically and internationally.

The State Council and various ministerial government agencies have repeatedly made clear in recent policies that EDS is one of the key sectors for important material transportation.<sup>15</sup> However, when it comes to implementation, some industry regulators or local governments still do not recognise the importance of EDS as an essential service, especially the international services. Therefore, to prepare for any future resurgence of COVID-19 or other potential disasters, coordination between all levels of government, including national agencies, must be improved to ensure uninterrupted delivery of essential goods, and

<sup>15</sup> Notice of the Special Class for Traffic Control and Transportation Support of the Comprehensive Group of the Joint Prevention and Control Mechanism of the State Council on Making Every Effort to Ensure the Smooth Flow of Freight Logistics, MOT, 14<sup>th</sup> April 2022, viewed 29<sup>th</sup> June 2022, <[http://www.gov.cn/xinwen/2022-04/14/content\\_5685295.htm](http://www.gov.cn/xinwen/2022-04/14/content_5685295.htm)>





measures introduced that reflect the vital nature of the EDS industry.

#### Recommendations

- Promote understanding of the need for ‘essential services’, including EDS, both domestic and international services.
- Take into account the long-term nature of the COVID-19 pandemic, and the importance of EDS to people’s daily lives and supply chains in crisis situations.
- Establish measures to maintain the smooth flow of express deliveries and transportation of goods under COVID-19 conditions.

## 2.2 Clarify the Standards and Guidance for the EDS Industry Under the Cybersecurity Law 3

#### Concern

While many laws and regulations on cybersecurity, data security and personal information protection have been recently introduced, there is still a lack of relevant standards and guidelines for the EDS industry, posing a huge challenge to express delivery companies’ cybersecurity compliance.

#### Assessment

The Cybersecurity Law came into effect in June 2017, with subsequent supporting implementing regulations and policies that regulate the information-sharing of stakeholders. The *Measures for Security Assessment of Cross-border Data Transfer* formulated by the Cyberspace Administration of China (CAC), which will take effect on 1<sup>st</sup> September 2022, specified a six-month transitional period.<sup>16</sup> The international express industry expects that the competent authorities can give specific guidance on the process of security assessment, help enterprises fully understand the specific requirements of security assessment, and promote the whole industry to quickly and efficiently implement the regulatory requirements of the CAC.

By its nature, the international EDS industry involves a large amount of personal information (such as name, phone number, address, information on package contents), most of which inevitably needs to be provided outside China for cross-border trade and transportation.

<sup>16</sup> *Measures for Security Assessment of Cross-border Data*, CAC, 7<sup>th</sup> July 2022, viewed 26<sup>th</sup> August 2022, <[http://www.gov.cn/zhengce/zhengceku/2022-07/08/content\\_5699851.htm](http://www.gov.cn/zhengce/zhengceku/2022-07/08/content_5699851.htm)>

According to current regulations, express delivery companies must transmit data to the GACC and the SPB on a daily basis. However, the industry requires further clarification on how security assessments will be implemented, which organisations and regulatory agencies will be responsible for implementation, and their responsibilities. If, due to lack of clarification on these issues, the security assessment process affects customs clearance efficiency, it will negatively impact the entire industry and its customers. Specifying the detailed threshold that may trigger a security assessment as well as related standards and guidance is required to enable data processors to comply accordingly.

#### Recommendations

- Fully consider the nature of international express delivery, and involve international express carriers in the policymaking process to increase policy transparency.
- Provide clear standards and guidance for the EDS industry, as well as reasonable transition periods.

## 2.3 Simplify the Licensing and Management Requirements for International Express Companies 3

#### Concern

The geographical scope requirement for obtaining international express licences in China and applying the management requirements of the franchise model to the agency model constitute access barriers to the industry for international express companies.

#### Assessment

At present, neither the Postal Law, the *Interim Regulations on Express Delivery* nor the *Administrative Measures for the Management of Express Delivery Business Licences* define the geographical scope of international express delivery business licences.

In 2012, the revised Postal Law introduced new requirements for international express delivery enterprises, including the need to obtain an International Express Delivery Business Licence issued by the industry’s regulatory authorities. From this point, the geographical scope of international express delivery business licences was restricted to the provincial level, including autonomous regions and provincial-level municipalities.



However, in 2019 and 2020, when some express companies applied to renew their expiring licences, they found that the SPB had adjusted the geographical scope for express licensing from province/autonomous-region/municipality level to city/district/prefecture and autonomous prefecture level. For example, in 2020, the scope for international express delivery in the Zhejiang Pilot Free Trade Zone was expanded to Hangzhou, Ningbo and Jinyi Districts in addition to Zhoushan District, whereas originally international EDS were not limited to the city/district/prefecture and autonomous prefecture level.<sup>17</sup> The SPB also issued a declaration that implied the international express delivery services should implement the changes immediately.<sup>18</sup>

However, no amendment in the Postal Law was issued to support this adjustment, and the geographical scope requirement remained unclear. Consequently, the lack of information and prior notice constitute an additional market access barrier to the EDS industry. It is also inconsistent with the State Council's repeated requirements for the expansion, opening up and improvement of the business environment for foreign-invested enterprises, as mentioned in *Circular No. 23*. It is also incompatible with China's commitments to the World Trade Organization on market opening.

On a different note, express industry regulatory bodies in China treat the agency model adopted by international express delivery enterprises in the same way as the franchise model operated by domestic express enterprises. In the franchise model, both the franchisor and franchisee are required to hold an international express licence at the city level, where the franchisee will leverage the franchisor brand to conduct business locally. In the agency model, the agency holds its city-level express licence to serve last-mile pick-up and delivery for multiple international express enterprises, which cover cross-border delivery with their own international express licence at the port city. However, under the agency model in China, the international express enterprise is also required to hold a city-level licence in the agency city. In terms of

actual operation, the express company cooperates with the local agency because it has limited local business scale. When the regulator requires express companies to also have a licence in the areas where it cooperates with an agency, it goes against the business logic of the agency model and results in duplicated licences.

### Recommendations

- Revert to the previous geographical scope requirement for obtaining international express licences in China.
- Avoid directly applying the management requirements of the franchise model to the agency model, including the duplicated licence requirement.

## 2.4 Implement More Measures to Encourage Green and Sustainable Development in the EDS Industry

### Concern

The EDS industry is eager to fulfil the requirements set in order to realise China's 30/60 Goals, but implementation will take time and companies need more guidance to be able to start now.

### Assessment

In 2021, the MOT and other regulators rolled out a number of policies concerning sustainable measures in the EDS industry, following the guidance on achieving China's 30/60 Goals.<sup>19</sup>

The EDS industry supports China's efforts to promote green transportation options and is willing to expand its use of NEVs. In the international EDS sector, transport vehicles not only have to contend with the challenges of transporting packages over long distances, but must also be able to make deliveries within a city. They must consider not only issues of energy conservation and environmental protection but also be able to adapt their transportation fleet to address a range of circumstances, including 'last mile' delivery.

Local transportation agencies and municipal governments should consider the needs of the EDS industry when formulating relevant policies on NEVs. Reducing restrictions on such vehicles used for express delivery in cities, and accelerating the construction of infrastructure to support NEVs (for example, charging stations and

<sup>17</sup> *Expanding the Applicable Scope of Delegation of the Approval Item for International Express Delivery Business Permits to Lower Levels within the Scope of China (Zhejiang) Pilot Free Trade Zone*, SPB, 30<sup>th</sup> November 2020, viewed 29<sup>th</sup> June 2022, <<https://zfwf.spb.gov.cn/zfwf/zfwfDetail?uid=f0318a4b173744588197fe809c59b80e&code=90000&flag=false&type=gb>>

<sup>18</sup> *Determining upon Declaration the Satisfaction of the Supervisory Requirements of the Customs in the Verification of the Territorial Scope of International Express Delivery Business Licensing*, SPB, 3<sup>rd</sup> March 2020, viewed 13<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2020-03/27/content\\_5496225.htm](http://www.gov.cn/zhengce/zhengceku/2020-03/27/content_5496225.htm)>

<sup>19</sup> *Working Guidance for Carbon Dioxide Peaking and Carbon Neutrality in Full and Faithful Implementation of the New Development Philosophy*, State Council, 22<sup>nd</sup> September 2021, viewed 14<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/2021-10/24/content\\_5644613.htm](http://www.gov.cn/zhengce/2021-10/24/content_5644613.htm)>





parking lots for delivery vehicles) would enable greater adoption of NEVs in the EDS industry without imposing undue burdens.

Several policies and draft regulations published for comment have included provisions that consumers' own packaging materials should meet established requirements regarding the use of green packaging for express delivery mail. For example, according to the *Green Packaging Specification for Express Mail* issued in June 2020, express delivery enterprises cannot accept items for shipping by express mail from consumers whose own packaging fails to meet green packaging requirements and who refuse to replace the packaging materials. If such a situation persists, it is likely to increase the incidence of disputes with consumers, decrease consumer confidence in EDS, and oblige express delivery entities to communicate the need for green packaging to consumers. Building public awareness around these new green packaging requirements and working together with the EDS industry to increase public understanding would reduce the incidence of disputes between consumers and industry stemming from the use of packaging materials that fail to meet environmental requirements.

#### Recommendations

- Facilitate the implementation of NEVs in the EDS industry.
- Encourage collaboration along the supply chain to promote green packaging.

## Abbreviations

AEO	Authorised Economic Operator
AI	Artificial Intelligence
CAAC	Civil Aviation Administration of China
CDS	Customs Declaration Sheet
CNY	Chinese Yuan
DGR	Dangerous Goods Regulations
EDS	Express Delivery Services
GACC	General Administration of Customs of China
IoT	internet of things
MNC	Multinational Company
MOT	Ministry of Transport
NDM	National Declaration Model
NDRC	National Development and Reform Commission
NEV	New Energy Vehicle
SAFE	Standards to Secure and Facilitate Global Trade
SPB	State Post Bureau
WCO	World Customs Organization





## International Liner Shipping Sub-working Group

### Introduction to the Working Group

Transporting more than 80 per cent of global trade,<sup>1</sup> ocean shipping is the most efficient and cost-effective method of international transportation for most goods, and helps to create prosperity among nations and peoples.<sup>2</sup> The maritime industry has been a key enabler of economic growth in, and an indispensable partner to, China as it developed into the world's largest trading nation, meaning that both the Chinese and global economies are dependent on a well-functioning and healthy maritime transport industry.

The International Liner Shipping Sub-working Group—originally the Maritime Transport Working Group—was established in 2000 to represent international maritime transport enterprises operating in China. The objective of the working group is to work towards a more efficient, environmentally sustainable and competitive maritime transport environment in China by engaging in dialogue with relevant government institutions.

### Recent Developments

#### The impact of the COVID pandemic on the industry and lessons to take forward

The COVID-19 pandemic has resulted in serious disruptions to trade flows and unprecedented swings in demand for shipping services. Demand collapsed during the first half of 2020, only to rebound very strongly in the second half of the year. Carriers have been impacted by COVID-19 restrictions imposed in overseas markets, which resulted in delays and congestion in ports, equipment imbalances and market volatility. The liner shipping industry responded by mobilising all available tonnage and equipment. However, this cannot resolve the bottlenecks that have been created, as simply adding more vessels just further adds to congestion, both in overseas ports and further inland. To address the challenges effectively, all links in the transport chain must work together.

Market forces will restore balance to supply and demand, provided markets are not obstructed, but the main challenge for companies will be to make supply chains more resilient and efficient. A major lesson learnt is that pre-COVID supply chains had become too lean through an excessive focus on cost over durability, and relationships between shippers and carriers had become too opportunistic in many cases. To enhance efficiency, investments in digitalisation and in increasing transparency and flexibility must be made collectively throughout the entire transport chain. More committed relations must also be forged, for example through two-way commitments that apportion costs to both parties in the event that agreements, such as bookings, are not kept or if cargoes are not leaving ports as promised.

#### The pursuit of carbon neutrality

In September 2020, President Xi Jinping announced that China will become carbon neutral by 2060, while the European Union (EU) has committed to doing so by 2050. In many industries, maritime transport in particular, there are limits to the carbon emission reductions that can be achieved by using existing technologies. New technologies therefore need to be developed in order to ensure carbon neutrality, whether by 2050 or 2060. Developing and implementing entirely new maritime propulsion technologies and fuels requires international collaboration, due to the scale and urgency of the challenge. In this respect, China and the EU are natural partners as they are global leaders within the maritime industry, with the world's five largest container shipping companies being based in either China or Europe. China is also the world's largest shipbuilding nation, accounting for about 50 per cent of all tonnage being built globally, while many European companies and institutions are leaders in maritime technology. Paramount to achieving carbon reduction targets will be agreeing on technical standards so that global efforts to reduce emissions are truly cooperative and not mutually exclusive. With this in mind, the International Liner Shipping Sub-working Group strongly suggests that China, Europe and other stakeholders in the maritime industry, prioritise collaboration on research and development, standard-setting and implementation.

<sup>1</sup> *How Soaring Shipping Costs Raise Prices Around the World*, International Monetary Foundation (IMF), 28<sup>th</sup> March 2022, viewed 19<sup>th</sup> April 2022 <<https://blogs.imf.org/2022/03/28/how-soaring-shipping-costs-raise-prices-around-the-world/>>

<sup>2</sup> *Introduction to IMO*, International Maritime Organization (IMO), 2019, viewed 19<sup>th</sup> April 2022, <<http://www.imo.org/en/About/Pages/Default.aspx>>



## Cargo relay

The announcement in late 2021 that foreign carriers would be allowed to engage in international relay in Shanghai as part of a pilot project constituted a major breakthrough. Carriers have been discussing this market opening with relevant authorities for many years, as it would potentially create significant operational efficiencies, lower the cost of transport, reduce the emission of greenhouse gases and create added business for Chinese ports. While the liner shipping community is grateful for this significant policy development, the pilot opening in Shanghai retains a number of significant restrictions on foreign carriers, which limits the benefits of the opening and, for some carriers, make it impossible to utilise this important change.

## Key Recommendations

### 1. Adhere to the Principle of Reciprocity when Issuing Cargo Relay Permissions and Simplify Customs Declaration Procedures

#### Concern

A lack of reciprocal treatment with regard to cabotage rights between China and both vessels' countries of registration and their home countries, in combination with complex customs rules, are resulting in difficulties implementing international relay.

#### Assessment

The State Council announced permission for foreign carriers vessels to carry out cargo relay from three northern China ports for transshipment at Yangshan on 18<sup>th</sup> November 2021.<sup>3</sup> Following this announcement, foreign-flagged vessels meeting certain requirements were told they would be allowed to participate in this pilot on a reciprocal basis.<sup>4</sup> However, during the application process, member carriers encountered a requirement that a full opening-up of cabotage restrictions by the home country of the applicant carrier, as well as the vessel's country of registration, is pre-requisite for obtaining a cargo relay licence. These requirements

<sup>3</sup> *Approval of the Temporary Adjusted Implementations of Relevant Administrative Regulations in Shanghai Pilot Free Trade Zone Lingang New Area by State Council*, Central Government of the People's Republic of China (PRC), 18<sup>th</sup> November 2021, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2021-11/18/content\\_5651689.htm](http://www.gov.cn/zhengce/content/2021-11/18/content_5651689.htm)>

<sup>4</sup> *Notice of the MOT on the Pilot International Cargo Relay of Non-five star Flagged Foreign Vessels*, MOT, 13<sup>th</sup> December, 2021, viewed 19<sup>th</sup> April 2022, <[https://xxgk.mot.gov.cn/2020/jigou/syj/202112/t20211213\\_3631052.html](https://xxgk.mot.gov.cn/2020/jigou/syj/202112/t20211213_3631052.html)>

go well beyond the requirements of Chinese carriers in the EU. Member carriers also encountered situations in which the customs declaration process for cargo relay could be further simplified, such as the processing for international transshipment.

If China only allows cargo from three ports in northern China to be transhipped at Yangshan, this can only be defined as partial opening up of its cabotage restrictions. Under the principle of reciprocity, a vessel's registration country should therefore be eligible to obtain permission for cargo relay if that country also adopts a partial opening-up policy.

The General Administration of Customs (GAC) has published customs declaration procedures in connection with cargo relay.<sup>5</sup> Customers can only apply for tax refunds once the relay shipment has exited China from Shanghai, which is contrary to international practices. For instance, if cargo is transhipped at Busan from Tianjin or Dalian, the cargo leaving Tianjin and Dalian is deemed as having left the Chinese border, meaning tax refunds can be triggered. Yangshan is currently considered a domestic port, however, if it can be regarded as a foreign port, tax refunds can also be triggered after leaving Tianjin/Dalian en route to Yangshan. Nevertheless, it should be noted that, for historical reasons, Qingdao has already acquired the status that triggers immediate tax refunds, even if the next port call is Yangshan.

#### Recommendation

- Adhere to the principle of reciprocity by granting permission to carry out cargo relay at Yangshan to vessels' countries of registration whose cabotage or international cargo relay conditions are in line with China's partial opening, and work towards a further relaxation of rules in line with China's commitment to reform and open up.
- Simplify customs declaration procedures by treating relay cargo as international transshipment.

### 2. Establish Sound and Transparent Principles for Ocean Freight

#### Concern

Charges collected by other parties in the international container liner shipping logistics supply chain are not

<sup>5</sup> *Decree No. 12 of 2022*, GAC, 28<sup>th</sup> January 2022, viewed 4<sup>th</sup> July 2022, <<http://www.customs.gov.cn/customs/302249/302266/302267/4172300/index.html>>





regulated in the way as charges collected by carriers, which creates a lack of transparency with regard to Shanghai Shipping Exchange (SSE) filing criteria.

#### Assessment

Regulators in China have acknowledged the consensus reached between the EU and the MOT that “ocean freight rates should be determined by the market, not by government interventions or instructions.”<sup>6</sup> This consensus underpins the collection of charges by carriers, including freight, surcharges, behavioural charges and fees for value-added services. However, the regulations are still vague, which makes it difficult for carriers to achieve compliance. It also causes misunderstandings among shippers and makes it difficult for carriers to file their freight rates and charges with the SSE. For instance, Article 15 of the revised *Regulations of the PRC on International Maritime Transportation* only indicates the classification of filing freight rates;<sup>7</sup> and the SSE only mentions that ocean freight and maritime-related surcharges, including terminal handling charges (THC), are included, without defining categories of charges nor specifying the criteria under which filings will be accepted.<sup>8</sup>

Additionally, due to high demand and congestion at ports as a consequence of COVID-19 measures, ocean freight rates grew to historically high levels. This situation, in conjunction with the vagueness of relevant regulations, makes it difficult for carriers to file rate increases with the SSE.

It is important to note that the extremely high rates that some shippers experienced, which was reported by the media, were likely due to players in the logistics chain other than carriers, which are not subject to ceiling rates as filed by carriers with the SSE. This led to unfair and misdirected criticism of carriers. In the interests of fairness and transparency, non-vessel common carriers (NVOCCs), freight forwarders and booking agents should therefore be subject to tariff filing and audit requirements, similar to those imposed on carriers.

<sup>6</sup> The long-term consensus reached between the EU and the MOT that “ocean freight rates should be determined by the market, not by government interventions or instructions,” was quoted in the media press release concerning the MOT’s responses to recent high freight rates on the Chinese Government website: 24<sup>th</sup> June 2021, viewed 8<sup>th</sup> July 2022, <[http://www.gov.cn/hudong/2021-06/24/content\\_5620615.htm](http://www.gov.cn/hudong/2021-06/24/content_5620615.htm)>

<sup>7</sup> *Regulations of the PRC on International Maritime Transportation*, Central Government of PRC, 2019, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2019/content\\_5468927.htm](http://www.gov.cn/gongbao/content/2019/content_5468927.htm)>

<sup>8</sup> *About Freight Filing System*, SSE, viewed 19<sup>th</sup> April 2022, <<https://en.sse.net.cn/filingen/aboutfiling.jsp>>

#### Recommendations

- Publish detailed guidelines specifying that filings of new charges, or increments of existing charges, will be approved by the MOT/SSE within a specific timeline if reasonable justification is provided.
- Create certainty for commercial carriers in commercial operations by providing clear guidance on how to comply with SSE filing requirements and by making transparent the rationales for container liner shipping charges.
- Impose tariff filing and audit requirements on NVOCCs, freight forwarders and booking agents, similar to those imposed on carriers.

### 3. Provide Flexibility when Determining Non-compliance During Freight Filing Audits



#### Concern

The zero-tolerance standard applied to data reporting and filing errors has made it almost impossible for carriers to achieve full compliance during freight filing audits conducted by the SSE.

#### Assessment

International carriers have made significant efforts to increase the accuracy of their freight rate filings, and considerable improvements have been achieved so far. However, considering the large amount of data filed with the SSE on daily basis, it is inevitable that human error and/or information technology (IT) system malfunctions will sporadically result in erroneous data filings. In such situations, it is neither fair nor reasonable to attribute all such errors to a single reporting subject, as it not the intention of either IT systems or personnel to make compliance mistakes. During audits of carriers’ data, there is no flexibility provided by the SSE in acknowledging carriers’ explanations as to the root cause of the mistake, and even in cases when a minimal number of unintentional mistakes have been made, all liner operators in question will be subject to a penalty of no less than Chinese yuan (CNY) 20,000 but no more than CNY 100,000.<sup>9</sup> The working group believes that carriers would be encouraged to further improve filing accuracy if the authorities took a more collaborative approach instead of taking punitive action when unintentional mistakes are made.

<sup>9</sup> *Regulations of People’s Republic of China on International Maritime Transportation*, Central Government of PRC, 2019, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2019/content\\_5468927.htm](http://www.gov.cn/gongbao/content/2019/content_5468927.htm)>

#### Recommendation

- Establish guidance for exceptional cases and allow a reasonable ratio of tolerance when determining non-compliance during freight filing audits conducted by the MOT/SSE.

### 4. Amend Current Regulations that Hold Carriers of Dangerous Goods (DG) Liable for Misdeclarations by Shippers

#### Concern

It is not rational to hold carriers liable and impose penalties on them for the misdeclaration of dangerous goods by shippers, as they have no means of detecting such cases or preventing them from occurring.

#### Assessment

The current *Regulation on Safety Administration of Dangerous Goods (DG) in Ports*, issued by the MOT, stipulates that carriers are the ultimate entrusted parties for terminal operation, which makes them liable for misdeclarations of DG and therefore subject to penalties. However, carriers only receive cargo information from shippers, booking agents or freight forwarders during the booking stage and have neither right nor ability to check a container's content upon cargo receipt. As such, asking carriers to take responsibility and bear the legal consequence of any DG misdeclaration is both unfair and contrary to international practice.

#### Recommendation

- Amend current regulations that hold carriers liable for DG misdeclarations, and impose administrative/civil/criminal liabilities upon the party that initially submits false information.

### 5. Ratify the Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships

#### Concern

The Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships is yet to enter into force due to the lack of ratification by IMO members including China.

#### Assessment

The Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships (Hong

Kong Convention) was adopted by the IMO in 2009.<sup>10</sup> It will have a profound positive impact on the environment once it enters into force, however a threshold exists with regard to the number of IMO member states needed to ratify the convention before it can take effect.

China is a responsible and active country in setting out environmental targets and is also the biggest shipbuilding country in the world. The ratification by China of the Hong Kong Convention would therefore constitute a decisive step for the convention to finally enter into force.

#### Recommendation

- Ratify the Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships.

### 6. Monitor the Impact that the Integration of Coastal Ports has on Fair Competition

#### Concern

The integration of coastal ports and the formation of port groups over the past three years may erode free market competition and lead to monopolies, which would ultimately undermine the competitiveness and efficiency of Chinese ports and, by extension, China's foreign trade.

#### Assessment

The integration of ports in China over the past three years may weaken free market competition. These integrations create monopolies and limit terminal operator choices, as they are all controlled by the same operator. This could result in ports increasing handling charges, dictating terms of service agreements and offering little room for negotiating claims from carriers. Such abuse of their dominant positions would leave carriers with no alternatives.

#### Recommendations

- Closely monitor potential infringement of competition law by port groups.
- Implement measures and controls to prevent post-merger port groups creating monopolies.

<sup>10</sup> *The Hong Kong International Convention for the Safe and Environmentally Sound Recycling of Ships*, IMO, viewed 19<sup>th</sup> April 2022, <<http://www.imo.org/en/About/Conventions/ListOfConventions/Pages/The-Hong-Kong-International-Convention-for-the-Safe-and-Environmentally-Sound-Recycling-of-Ships.aspx>>



## 7. Facilitate the Use of Foreign Carriers' Empty Containers for Transportation of Domestically-traded Goods During Container Repositioning

### Concern

Current limitations on using foreign carriers' empty containers for domestic transportation during repositioning decreases efficiency and wastes resources.

### Assessment

It is common practice for foreign carriers to arrange empty container repositioning.<sup>11</sup> However, according to China's current customs regulations, these containers should remain empty during repositioning from one place to another within Chinese territory. Given the shortage of containers since the outbreak of COVID-19, leaving a container empty during repositioning is a waste of scarce transportation resources. Combining repositioning of international empty containers with domestic transportation of goods would reduce costs not only for carriers but also for domestic traders. Furthermore, it would reduce the carrier's carbon footprint.

### Recommendation

- Facilitate the use of foreign carriers' empty containers for the transportation of domestic goods during container repositioning.

## 8. Collaborate with the International Liner Shipping Community to Decarbonise the Industry

### Concern

International collaboration and alignment are critical for the maritime industry to deliver decarbonisation targets prescribed by governments in China and Europe.

### Assessment

China has committed to becoming carbon neutral by 2060 and the EU has committed to being so by 2050. In order to achieve those ambitious targets, new technologies need to be adopted, and multiple stakeholders need to work together, be it government authorities, industry and consumers.

<sup>11</sup> *What is Empty Container Repositioning (and What Causes It)?*, Shipsta, 20<sup>th</sup> May 2021, viewed 19<sup>th</sup> April 2022, <<https://blog.shipsta.com/en/empty-containerrepositioning>>

There have been signs of technological decoupling in some industries, and different standards emerging in different geographies. If that were to happen in the shipping industry it would lead to a significant waste of resources and, in the worst case, prevent global decarbonisation targets from being achieved. Global collaboration among multiple stakeholders is critical for technology development and aligning standards. As China and Europe are global maritime leaders they are natural partners to collaborate on developing technologies, establishing infrastructure and agreeing standards for carbon neutral shipping.

On a side note, local transport authorities in Shanghai are pushing for the use of shore power in the port of Shanghai by means of dual side Alternative Marine Power (AMP) installations. There is a strict deadline for vessels that are currently equipped with single side AMP facilities to achieve dual side installations by 1<sup>st</sup> October 2022. However, due to global bottlenecks in shipyard capacity, as well as within China, as a result of the pandemic, it is recommended that the deadline be extended until 31<sup>st</sup> March 2023.

### Recommendations

- Build partnerships between research institutions, shipping companies, shipbuilders and their suppliers in China and Europe to develop and adapt carbon neutral technologies.
- Agree on technical standards to avoid potential inefficiencies and waste, through approaches such as enhanced cooperation within the IMO.
- Cooperate on the establishment of a global infrastructure ensuring availability of carbon neutral fuels.
- Extend until 31<sup>st</sup> March 2023 the grace period for dual side AMP installations for vessels calling at Shanghai.

## 9. Provide Flexibility in COVID-19 Policies to Facilitate Seafarer Crew Changes and Dry Docking by Foreign-flagged Vessels

### Concern

Excessively strict COVID-19 policies have made it *de facto* impossible for international crew change in China and a timely release of seafarers who are infected by COVID-19.



### Assessment

China has made great achievements in containing the spread of COVID-19 throughout the country, thereby making significant contributions towards global trade. However, trade is still being hindered because China continues to apply extremely stringent restrictions on international seafaring crews.

For seafarer crew changes in China to be permitted, current regulations demand all-crew COVID-19 tests, as well as no foreign port calls within 14 days. Criteria for identifying positive cases are also excessively strict, resulting in the detention of seafarers at Chinese ports for unnecessarily long periods. The same criteria also apply to vessels dry docking at Chinese shipyards. In the interests of restoring global trade to pre-pandemic levels, it is recommended that flexibility be applied to COVID-19 test standards for seafarers onboard foreign-flagged vessels in a way that is proportionate to the diminishing effect of the COVID-19 virus.

### Recommendation

- Provide flexibility in COVID-19 policies to facilitate seafarer crew changes in China and to reduce the detention period of infected seafarers.

## Abbreviations

AMP	Alternative Marine Power
CNY	Chinese Yuan
COVID-19	Coronavirus Disease 2019
DG	Dangerous Goods
ETS	Emissions Trading System
EU	European Union
GAC	General Administration of Customs
IMO	International Maritime Organization
MOT	Ministry of Transport
NVOCCs	Non-Vessel Operating Common Carriers
PRC	People's Republic of China
SSE	Shanghai Shipping Exchange
THC	Terminal Handling Charges





European Chamber  
中国欧盟商会

# 5

## Section Five

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### Financial Services



## Financial Services

The European Chamber has three separate working groups that cover the financial services sector:

- Banking and Securities
- Non-banking Financial Institutions
- Insurance

European financial service companies in China have witnessed an overall acceleration of opening-up in the financial sector, with the issuing of a series of financial industry and capital market policies, and further relaxing of market access restrictions.

On 15<sup>th</sup> July 2021, the Chinese Communist Party's Central Committee and the State Council issued guidelines on supporting reform and opening up in the Pudong New Area and making it a 'pioneer' area for socialist modernisation. The guidelines aim to support the Pudong in exploring the implementation of capital account convertibility; *renminbi* (RMB) and foreign exchange futures trading in the China Foreign Exchange Trading System (CFETS); and developing offshore RMB trading on the condition that any related risks are controllable. In September 2021, the Bond Connect programme between the Mainland China and Hong Kong was launched, allowing domestic investors access to bonds traded and circulated in the Hong Kong bond market through relevant institutions in the Mainland and Hong Kong. In October 2021, the Cross-boundary Wealth Management Connect Scheme in the Greater Bay Area (GBA) was launched, with 20 banks participating.<sup>1</sup> This scheme will allow Hong Kong and Macao investors to access qualified investment products or wealth management products of the corresponding bank in Mainland China and the GBA, and vice-versa for Mainland investors, through the closed-loop capital channel of the banking system in the GBA. The total volume of the scheme will be up to a total of CNY 150 billion.

On 21<sup>st</sup> July 2021, Premier Li Keqiang stressed during a State Council executive meeting China's intention to continue to deepen financial reform and opening, and to optimise market access for foreign banks, insurance and other financial institutions. Meanwhile, foreign exchange management pilot projects took place in the Shanghai Free Trade Zone, the GBA and the Hainan Free Trade Port, among other areas, to prepare for more high-level institutional openings.

The working groups appreciate China's continuous efforts to reform and open its financial services sector, and welcome the policies and measures taken to stabilise the financial market under the dual pressures of the pandemic and economic downturn. However, members of the working groups report that they are still facing restrictions and barriers in terms of market access and competition with local enterprises.

According to the European Chamber *Business Confidence Survey 2022* (BCS 2022), a considerable number of European enterprises (36 per cent) believe they have received unequal treatment in terms of market access, communication with the Chinese Government and access to subsidies. More than

<sup>1</sup> *Cross-Boundary Wealth Management Connect Scheme in the Greater Bay Area*, Hong Kong Monetary Authority, 20<sup>th</sup> June 2020, viewed 13<sup>th</sup> July 2022, <<https://www.hkma.gov.hk/eng/news-and-media/insight/2020/06/20200629/>>



40 per cent of respondents report that they missed business opportunities in 2021 due to market access restrictions or regulatory barriers, a continuation of a trend that has changed little over the past seven years.<sup>2</sup>

For the banking sector, foreign banks' access to the CFETS interbank market is capped at two times their operative capital in China, which heavily impacts their operations as these banks only have limited capital compared with their local competitors. This issue has been raised in the *Banking and Securities Working Group Position Paper* for 15 consecutive years. Lifting this restriction would result in a more active and liquid RMB interbank market that would benefit all banks. In addition, the Carbon Emission Reduction Facility programme, launched in November 2021 by the People's Bank of China (PBOC) is in its initial pilot stage, with only Chinese banks eligible for application as of the time of writing. Not giving foreign banks equal treatment to apply will restrict both foreign banks' and their clients' capabilities to fulfill their zero-emission pledges.<sup>3</sup>

For the non-banking sector, on 31<sup>st</sup> December 2021, the PBOC issued the *Regulations on Local Financial Supervision and Administration (Draft for Comments) (Draft Regulation)*.<sup>4</sup> If the *Draft Regulation* were to be enforced as proposed, financial leasing companies would in principle not be allowed to engage in cross-provincial business. Meanwhile, 'golden' financial leasing companies—all majority-owned by Chinese banks or state-owned enterprises—would be excluded from the scope of the *Draft Regulation* and could continue to work nationwide.<sup>5</sup>

China's cybersecurity and data governance landscape is becoming increasingly difficult for many businesses to navigate, especially foreign financial service providers. Data localisation requirements force foreign banks to partly disconnect their China operations from their global systems, which is increasingly constraining their ability to provide cross-border services – one of the few areas in which they can currently add value in the Chinese market. This is also a negative outcome for their foreign clients in China and their Chinese clients looking to expand overseas. According to the BCS 2022, more than 60 per cent of respondents in the financial services industry report that China's critical information infrastructure requirements create obstacles for further investment, and 54 per cent expect 'secure/autonomous and controllable' technologies guidelines to have a similar negative impact.<sup>6</sup> Therefore, the working groups advocate refraining from mandating banks and financial institutions to localise their data or their entire information technology systems, and instead adopt a risk-based approach that is aligned with global best practices.

The financial services working groups will continue to monitor progress in the opening up of China's financial sector. Through careful observations and detailed recommendations in the following papers, the working groups hope to make meaningful contributions to this end.

<sup>2</sup> *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 30<sup>th</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>

<sup>3</sup> *The People's Bank of China launched a carbon reduction support tool*, PBOC, 9<sup>th</sup> November 2021, viewed 30<sup>th</sup> June 2022, <<http://chengdu.pbc.gov.cn/chengdu/129314/4385264/index.html>>

<sup>4</sup> *Regulations on Local Financial Supervision and Administration (Draft for Comments)*, PBOC, 31<sup>st</sup> December 2021, viewed 30<sup>th</sup> June 2022, <[http://jr.jl.gov.cn/jrzc/gjbgzjwj/202201/t20220104\\_627855.html](http://jr.jl.gov.cn/jrzc/gjbgzjwj/202201/t20220104_627855.html)>

<sup>5</sup> Under the current regulatory framework, leasing institutions fall into two categories: the so-called 'golden' financial leasing companies (金融租赁公司) regulated from the beginning by the China Banking and Insurance Regulatory Commission, and the financial leasing companies (融资租赁公司) originally regulated by the Ministry of Commerce.

<sup>6</sup> *European Business in China Business Confidence Survey 2022*, European Union Chamber of Commerce in China, 20<sup>th</sup> June 2022, viewed 30<sup>th</sup> June 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>



## Banking and Securities Working Group

### Key Recommendations

#### 1. Lift Constraints that have a Disproportionate Impact on Foreign Banks' Business Development

##### 1.1 Allow Foreign Banks to Become Bond Connect Market Makers Without the Precondition of Being a Chinese Interbank Bond Trial Market Maker 3

- Grant qualified foreign banks the status of Bond Connect market makers without them first having to become a Chinese Interbank Bond trial market maker.

##### 1.2 Address Funding Limitations for Foreign Banks 15

- Ease the 'two-times' capital restriction for small and medium-sized banks in China.
- Allow foreign banks to borrow money overseas and swap directly to *renminbi* (RMB) to fund themselves or their loan portfolio.
- Simplify the procedures for foreign banks to issue RMB-denominated bonds (panda bonds), 'Chinese yuan (CNY bonds)' and asset-backed securities for funding purposes.
- Permit foreign bank branches to issue 'CNY bonds'.
- Remove the requirement to provide two years' worth of financial data for China operations when a new branch applies to participate in the National Interbank Lending Market and trade on the RMB Money Market on the China Foreign Exchange Trade System platform.

##### 1.3 Address the Major Impacts of Macro Prudential Policy on the Foreign Banking Industry

- Provide flexibility to small-sized banks' Macro Prudential Assessment capital adequacy ratio (CAR) calculations to relax growth pressure in China.
- Set a CAR threshold for large or systemically important banks.
- Allow netting in cross-border financing exposure calculations.
- Ease the long-term foreign debt quota for foreign financial institutions well as foreign-invested enterprises in China.

##### 1.4 Provide More Flexibility on Ratios, Especially Monitoring Ones, and Allow Proper Justification 3

- Consider local tier-1 capital as a stable resource in liquidity ratios (liquidity matching ratios (LMRs) and loan-to-deposit ratios (LDRs)), and treat deposits from parent institutions as corporate deposits.
- Afford intragroup funding the same value as 'corporate deposits' in the liquidity ratio.
- Give full exemption for intragroup exposure during large exposure management.
- Increase the weight for bonds and certificates of deposit in the LMR for a residual maturity below three months, and include intragroup funding in the LDR at a reasonable weight.
- Consider foreign banks' situation and provide flexibility or waive the requirement of deposit deviation ratio for banks with a small balance sheet.
- Treat deposits from consumer finance companies as corporate deposits in the liquidity ratio





calculation, taking into account their stability.

- Treat auto finance company loans as corporate loans in the LMR.
- Increase the single borrower limit for acquisition finance loans to the same as those for other loans at 10 per cent of the tier-1 capital.

### **1.5 Draw on Foreign Banks' Knowledge and Experience, and Extend Them Equal Access to Apply for the People's Bank of China's (PBOC's) Carbon Emission Reduction Facility**

- Extend equal access to foreign banks to apply for the PBOC's Carbon Emission Reduction Facility.

## **2. Reduce Entry Barriers and Optimise the Regulatory System for Foreign Entities' Participation in China's Capital Markets**

### **2.1 Adhere to the Same Securities Custody Licence Requirement in Implementation and Use Clear Wording for Securities Fund Custody Licence Application Requirements**

- Establish coordination between the China Securities Regulatory Commission (CSRC) and the China Securities Depository and Clearing Corporation Limited (CSDC) to remove the requirement on paid-in capital of no less than CNY 8 billion.
- Clarify foreign bank subsidiaries' eligibility to rely on their parent company's net assets value and other financial indicators when applying for a securities fund custody licence.

### **2.2 Allow Qualified Foreign Fund Service Providers to Offer Fund Accounting (FA) and Transfer Agency (TA) Services to Private Fund Managers Registered with the Asset Management Association of China (AMAC)**

- Allow qualified foreign fund service providers to offer FA and TA services to private fund managers registered with the AMAC.

## **3. Develop China's Futures and Derivatives Market**

### **3.1 Allow Qualified Foreign Banks to Trade China Government Bond Futures**

- Allow qualified foreign banks to trade China government bond futures.

### **3.2 Allow Onshore Banks to Engage in Non-hedging, Cross-border Derivatives Transactions with Parent Banks**

- Allow onshore banks to engage in non-hedging, cross-border derivatives and either remove the relative prohibition from Article 17 of the *Draft Guidance* or define certain cross-border derivatives transactions that could be carved out from the prohibition.

### **3.3 Remove the Three Per Cent Market Risk Capital Ratio Limit**

- Adhere to the principle of reciprocity and cancel the three per cent market risk capital ratio limit.

## **4. Limit Data Localisation and Prescriptive Cybersecurity Requirements**

### **4.1 Allow Free Cross-border, Intra-group Data Flows, Reduce the Scope of 'Important Data' and Facilitate Cross-affiliate Information Sharing**

- Refrain from mandating banks to localise their data or their entire information technology systems.
- Define clear compliance guidance with regard to 'data localisation/copy' versus 'system





localisation' for the banking industry.

- Allow companies and their headquarters/subsidiaries to conduct intra-party, cross-border data transfers and uphold the principles of free movement of data that China signed up to in the Group of 20 Osaka Leaders Declaration.
- Remove unnecessary information-sharing firewall rules and allow cross-affiliates to share information.
- Define clearly critical data category in banking industry as guidance for FIs on critical data identification, to avoid creating unreasonable compliance risks and costs for multinational financial institutions.
- Promulgate clear implementation rules on both the Personal Information Protection Certificate and the Standard Template to facilitate sharing of personal information among cross-affiliates.

#### 4.2 Adopt International Best Practices on Cybersecurity and Technology, and Reduce the Scope of Critical Information Infrastructure (CII) 3

- Adopt a regulatory approach to cybersecurity and CII management that is risk-based, aligned with global best practices and avoids mandating the adoption of certain products or services.
- Issue a CII operator identification rule for the banking industry to ensure efficient and effective protection.

#### 4.3 Adopt Safe and Sound Cybersecurity and Technology Supervisory Practices 3

- Recognise risks associated with mandated penetration testing and allow for firm-led penetration testing for firms with such capabilities and resources.
- Adopt industry best practices for penetration testing as outlined in the updated Global Financial Market Association's *Framework for the Regulatory Use of Penetration Testing in the Financial Services Industry*.

## Introduction to the Working Group

The Banking and Securities Working Group represents around 40 banking and securities financial institutions (FIs) in China. The working group engages with the China Banking and Insurance Regulatory Commission (CBIRC) and other financial services regulators to improve the operating environment for European banking and securities enterprises in China.

## Recent Developments

Although there has been greater opening of financial services sector since 2018, and the 2020 *Negative List for Foreign Investment* abolished the investment limits for foreign banks, the sector is still strictly controlled. Foreign banks' market share in terms of total assets continued to decline in recent years from a peak of

2.38 per cent in 2007 to 1.2 per cent in 2019,<sup>1</sup> which is significantly lower than in other emerging markets. However, within this confined environment, foreign banks continue to develop steadily.

Moving forward, China's financial sector will need regulators to take a more systematic approach to implementing essential reforms, such as: setting up a clearer market governance framework; encouraging greater integration of international experiences; allowing more international rating agencies into the market; and implementing better auditing regulations.

### The United States (US)-China 'Phase One' Trade Deal

<sup>1</sup> The latest figures show that total assets of foreign banks in China are Chinese yuan (CNY) 3.37 trillion, less than 1.2 per cent of total assets of the Chinese banking industry. See: *Foreign Banks Establish 41 Legal Person Lenders in China, Total Assets Approach \$480 Billion*, *China Banking News*, 12<sup>th</sup> December 2019, viewed 26<sup>th</sup> April 2022, <<http://www.chinabankingnews.com/2019/12/12/foreign-banks-establish41-legal-person-lenders-in-china-total-assets-approach-480-billion/>>





in 2020 was seen as a small step forward in cementing market opening for foreign banks in China, particularly with regard to custody licences, underwriting and the elimination of foreign equity limits. Nevertheless, the outbreak of COVID-19, and the subsequent introduction of stringent measures to try and contain the Omicron variant—in particular the shutdown of Shanghai, China's financial centre—delayed further opening up.

### First Basic Law for China's Futures and Derivatives Market

On 21<sup>st</sup> April 2022, the Standing Committee of the National People's Congress passed the Futures and Derivatives Law, which took effect on 1<sup>st</sup> August 2022. This is a milestone in the legal construction of a Chinese futures and derivatives market and further opening to international integration. Article 32 and Article 37 of this law recognise the legal certainty and enforceability of the 'single agreement' and 'close-out netting' mechanisms respectively. This is a positive move and should precipitate: 1) the incorporation of 'close-out netting' in the calculation method under the macro prudential framework; and 2) clear supplementary provisions concerning the suspension of netting in the draft Financial Stability Law.

### The Development of Carbon Trading and Environment, Social Responsibility And Corporate Governance (ESG) in China's Capital Markets

The United Nations-supported Principles for Responsible Investment (UN PRI) was initiated in 2006,<sup>2</sup> to promote responsible investments in global capital markets as well as the sustainable development of the global financial system. Under the guidance of this initiative, the concept of ESG has been gradually penetrating global markets and gaining increasing attention from both investors and financial institutes. There are now more than 4,800 global signatories to the UN PRI, including asset holders, asset managers and financial service providers, with total assets under management (AUM) exceeding US dollar (USD) 120 trillion.

From 2018, the pace of Chinese institutions signing up to the UN PRI accelerated significantly as enthusiasm for investments based on ESG principles increased. In the securities market, ESG-related information

disclosure by listed companies is encouraged by regulators, with the aim of helping investors pre-judge listed companies' future sustainability.

Although China established its basic ESG information disclosure framework in September 2018, currently, listed companies in China are only required by the China Securities Regulatory Commission (CSRC) to disclose ESG information voluntarily. Furthermore, although the *Governance Guidelines of Listed Companies*,<sup>3</sup> revised by the CSRC, is a fundamental legal framework to regulate disclosure activities, it does not contain specific provisions for disclosure standards and formats. The overall disclosure system is still yet to take shape and disclosure standards still need to be unified. More guidelines are therefore needed to further improve the ESG information disclosure regulatory system.

China began carbon emissions trading in 2010. The development of its carbon market can be roughly divided into two stages. Carbon emissions trading was first piloted in eight cities and provinces from September 2010 to June 2021; since July 2021, carbon emissions have been traded nationwide, with the pilots still functioning concurrently.

In preparation for the second stage, on 19<sup>th</sup> April 2021, the Guangzhou Futures Exchange (GFE) was officially inaugurated. The China National Energy Trading System (ETS) - Shanghai Environment and Energy Exchange (SHEEX) launched the national-level Carbon Emission Allowance (CEA) on 22<sup>nd</sup> June 2021.

As the national ETS matures and expands to cover more sectors, it is likely that the provincial-level ETSs will be gradually phased out. In the meantime, given their more than 15 years' worth of experience in risk management, establishing pricing mechanisms and liquidity setup, allowing foreign banks to participate in these two carbon trading markets would help to accelerate the sustainable development of the ETS.

<sup>2</sup> *The Principles for Responsible Investment (UN PRI)*, Nomura, viewed 4<sup>th</sup> July 2022, <<https://global.nomura-am.co.jp/responsibility-investment/investors/un-pri.html>>

<sup>3</sup> *Governance Guidelines of Listed Companies*, CSRC, 30<sup>th</sup> September 2018, viewed 26<sup>th</sup> May 2022, <<http://www.csrc.gov.cn/csrc/c101864/c1024585/content.shtml>>



## Key Recommendations

### 1. Lift Constraints That Have a Disproportionate Impact on Foreign Banks' Business Development

#### 1.1 Allow Foreign Banks to Become Bond Connect Market Makers Without the Precondition of Being a Chinese Interbank Bond Trial Market Maker 3

##### Concern

Foreign banks encounter difficulties qualifying to become Bond Connect market makers, and thus cannot serve their offshore clients' needs for bond price quotes on this channel.

##### Assessment

Foreign banks—which very often face stricter compliance requirements and are smaller than their Chinese peers in terms of balance sheet size—cannot easily compete on bond-trading turnover and inventory size. However, foreign banks usually have bigger overseas client bases that are eager to trade with them via Bond Connect, and to get market updates and recommendations to access the onshore Chinese Interbank Bond Market (CIBM). Therefore, difficulties in qualifying to become Bond Connect market makers are limiting foreign banks' ability to develop business and bring investment into China.

##### Recommendation

- Grant qualified foreign banks the status of Bond Connect market makers without them first having to become a CIBM trial market maker.

#### 1.2 Address Funding Limitations for Foreign Banks 15

##### Concern

Foreign banks face funding restrictions due to stringent regulatory approvals, have limited access to the China Foreign Exchange Trade System (CFETS) interbank market and also encounter problems associated with the issuance of *renminbi* (RMB)-denominated debt instruments in China, all of which stifle their growth.

##### Assessment

Access to the CFETS interbank market for foreign banks is capped at two times their operative capital in China, which heavily impacts their operations as these

banks have limited capital. Lifting this restriction would result in a more active and liquid RMB interbank market that would benefit all banks.

In addition to the 'two-times' capital restriction, State Administration of Foreign Exchange (SAFE) approval is required before the foreign debt of international FIs can be exchanged to RMB or sold on through a swap deal. Considering foreign banks' limited access to onshore liquidity (due to small balance sheet size, limited corporate deposits base, no retail banking activity), allowing them to swap overseas sources into RMB would help the origination of commercial loans to Chinese clientele and support the local economy.

Foreign banks—depending on whether they are incorporated in China or operating as a branch—face problems associated with the issuance of any of the three distinct types of RMB-denominated debt securities: onshore bonds issued by onshore Mainland-based issuers; onshore bonds issued by offshore issuers ('panda bonds'); and bonds issued offshore by both onshore and offshore issuers (for example, Dim Sum, Lion City).<sup>4</sup>

Qualifying locally-incorporated, foreign banks are allowed to issue debt securities and onshore asset-backed securities (ABS) in the CIBM for funding purposes once pre-approved by the CBIRC and the People's Bank of China (PBOC).<sup>5</sup> However, foreign banks' branches are still not allowed to do so.

##### Recommendations

- Ease the 'two-times' capital restriction for small and medium sized banks in China.
- Allow foreign banks to borrow money overseas and swap directly to RMB to fund themselves or their loan portfolio.
- Simplify the procedures for foreign banks to issue RMB-denominated bonds (panda bonds), 'Chinese yuan (CNY bonds)' and ABS for funding purposes.
- Permit foreign bank branches to issue 'CNY bonds'.
- Remove the requirement to provide two years' worth of financial data for China operations when a new branch applies to participate in the National Interbank

<sup>4</sup> *Emerging Market Focus – Panda: From Zero to a USD 2trn Market in Ten Years [Client Note]*, Crédit Agricole Corporate & Investment Bank, 3<sup>rd</sup> May 2016, viewed 26<sup>th</sup> April 2022. Please note, this was a non-public client note courtesy of Crédit Agricole.

<sup>5</sup> *National Bond Market Issuance Regulations for Financial Bonds*, ChinaBond, 1<sup>st</sup> June 2005, viewed 26<sup>th</sup> April 2022, <<http://www.chinabond.com.cn/Info/843356>>





Lending Market and trade on the RMB Money Market on the CFETS platform.

### 1.3 Address the Major Impacts of Macro Prudential Policy on the Foreign Banking Industry

#### Concern

The calculation of broad credit growth under the Macro Prudential Assessment (MPA) framework has a negative impact on foreign banks' ability to grow business in China.

#### Assessment

##### 1) Cross-border financing updates

Effective from 25<sup>th</sup> May 2021, the PBOC lifted the cross-border financing leverage ratio under the MPA for relatively small-sized banks (including subsidiaries and branches of foreign banks)—whose capital size is below CNY 100 billion—from 0.8 to 2.0, with an additional initial financing quota of CNY 10 billion for each bank provided for. This encouraging move addresses the constraints set by *Circular YF [2020] No. 301*, and demonstrates the PBOC's sensible and sound use of its counter-cyclical policy tool.

##### 2) Broad credit growth

The calculation of broad credit growth under the PBOC is linked to targeted M2 money creation.<sup>6&7</sup> That being said, both government bonds and policy banks' bonds will remain incorporated into the calculation of broad credit growth year-on-year. However, according to the MPA requirement, even though the positive deviation of broad credit growth from targeted M2 growth falls within the range of 20–25 per cent, failure to meet the minimum requirements for capital adequacy ratio (MPA CAR) will lead to foreign banks' MPA assessment result being completely rejected, no matter if the bank is large or small.

In order to provide more space for broad credit growth, it would be preferable to adopt different MPA CAR calculations for banks of different sizes.

6 Broad credit growth refers to credit growth that covers all credit activities from depository/lending institutes and banks, inclusive of deposit, loan and settlement business.

7 M2 refers to the standard measures of the money supply. The sum of M2 is M1 (the sum of currency held by the public and transaction deposits at depository institutions, which are FIs that obtain their funds mainly through deposits from the public, such as commercial banks, savings and loan associations, savings banks and credit unions) plus savings deposits, small-denomination time deposits (those issued in amounts of less than USD 100,000) and retail money market mutual fund shares.

##### 3) Long-term foreign debt quota limit

The *Circular YF [2017] No. 9* set the upper limit of the cross-border financing risk-weighted balance for both foreign FIs as well as foreign-invested enterprises in China. However, it does not allow additional foreign debt registration above the upper limit unless otherwise approved by relevant foreign debt management departments. This current framework represents an obstacle to banks that want to service businesses with genuine financing needs.

#### Recommendations

- Provide flexibility to small-sized banks' MPA CAR calculations to relax growth pressure in China.
- Set a CAR threshold for large or systemically important banks.
- Allow netting in cross-border financing exposure calculations.
- Ease the long-term foreign debt quota for foreign FIs as well as foreign-invested enterprises in China.

### 1.4 Provide More Flexibility on Ratios, Especially Monitoring Ones, and Allow Proper Justification

#### Concern

Close control exercised over many ratios, including the loan-to-deposit ratio, the deviation ratio and intra-group large exposure, disrupts foreign banks' daily activities.

#### Assessment

According to the *Administrative Measures on Liquidity Risk of Commercial Banks*,<sup>8</sup> banks must maintain a liquidity matching ratio (LMR) and a high-quality liquid asset adequacy ratio (HQLAAR) of over 100 per cent, as well as a low loan-to-deposit ratio (LDR). However, the development of a bank's corporate lending capabilities for its local clients could be improved by modifying some constraints on the local liquidity ratio imposed on subsidiaries:

- Local tier-1 capital is not considered a stable resource

8 *CBIRC Issues Measures to Manage Liquidity Risk for Commercial Banks*, Moody's Analytics, 25<sup>th</sup> May 2018, viewed 26<sup>th</sup> April 2022, <<http://www.cbrc.gov.cn/chinese/newShouDoc/8189EEE949DB48F8993ACCA638ED24B.html>>





for 'sources of weighted funds' in the LMR.<sup>9&10</sup> Tier-1 capital is also not counted as a resource for the LDR, whereas in practice it is a stable source of funding used to develop a foreign bank's corporate lending capacity.

- For the LMR, 'interbank lending' does not distinguish between intragroup and 'external/market' interbank borrowing, although the funding comes from different types of sources.<sup>11</sup>
- In the HQLAAR, the intragroup deposit is treated as an interbank deposit for financing purposes, with a less favourable weight (100 per cent) than a corporate deposit (35 per cent). However, the intragroup deposit is very stable and tends to stay with the subsidiary in China for longer periods than normal corporate deposits.<sup>12</sup>
- In the LMR, an auto finance company (AFC) is treated as interbank instead of a 'corporate' counterpart, which requires higher LMR funding. However, the banking relation with AFCs is driven more by a corporate relation rather than an interbank relation and should therefore be treated as such.
- In the LMR, the weight for bonds issued and certificates of deposit (CD) below three months (zero per cent), similar to interbank borrowing or deposits from banks, are too low and would not favour the market of bonds or CD issuances from foreign banks.

While initially the CBIRC had allowed some flexibility for small foreign banks in cases of DDR ratio overshoots resulting from passive deposit-taking from customers, this was prohibited as of June 2018.<sup>13</sup> As a result, it is more difficult for small banks to control the DDR ratio variation due to passive deposit banking. Sometimes banks have to sacrifice customers' deposit needs and service quality to meet the DDR ratio requirement, or

face regulatory penalties such as access restrictions, downgraded ratings, business restrictions and punitive DDR requirements.

On 2<sup>nd</sup> April 2021, the CBIRC announced through the *Circular on Clarifying the Regulatory Requirements for Foreign funded Banks on Large Risk Exposures of Their Parent Bank Groups* that it would exempt foreign FIs in China from intragroup exposure during large exposure management.<sup>14</sup> However, the intra-group ratio is now considered a monitoring ratio and banks are being asked to work on lowering it.

Foreign direct investment in China has increased substantially over the past few years, and inflows hit a record high in 2021 with a 14.9 per cent surge from the previous year.<sup>15</sup> This has created numerous opportunities in the onshore acquisition finance market, which remains attractive for foreign capital. However, according to CBIRC's *Guidelines to Risk Management of Commercial Banks' Merger and Acquisition Loans*,<sup>16</sup> loans dedicated for acquisition finance cannot exceed five per cent of the bank's tier-1 capital for a single borrower, while other loans are allowed up to 10 per cent, which limits development of this investment market.

### Recommendations

- Consider local tier-1 capital as a stable resource in liquidity ratios (LMRs and LDRs), and treat deposits from parent institutions as corporate deposits.
- Afford intragroup funding the same value as 'corporate deposits' in the liquidity ratio.
- Give full exemption for intragroup exposure during large exposure management.
- Increase the weight for bonds and certificates of deposit in the LMR for a residual maturity below three months, and include intragroup funding in the LDR at a reasonable weight.
- Consider foreign banks' situation and provide flexibility or waive the requirement of deposit deviation ratio for banks with a small balance sheet.

9 Tier-1 capital describes the capital adequacy of a bank and refers to core capital that includes equity capital and disclosed reserves. From a regulator's point of view, tier-1 capital is the core measure of the financial strength of a bank because it is composed of core capital. See *What Is Tier 1 Capital?*, Investopedia, 9<sup>th</sup> May 2019, viewed 25<sup>th</sup> March 2021, <<https://www.investopedia.com/terms/t/tier1capital.asp>>

10 *CBIRC Issues Measures to Manage Liquidity Risk for Commercial Banks*, Moody's Analytics, 25<sup>th</sup> May 2018, viewed 26<sup>th</sup> April 2022, <<http://www.cbirc.gov.cn/chinese/newShouDoc/8189EEE949DB48F8993ACCCA638ED24B.html>>

11 Intra-group funding is more stable than interbank funding given the relation between the subsidiary and its parent entity.

12 In the same fashion, in the HQLAAR, corporate finance companies (CFCs) deposits are treated as interbank deposits. However, CFCs' funding is largely made up of deposits of group member entities that are more than three months old, and hence are very stable.

13 *Order [2018] No. 48*, CBIRC, 18<sup>th</sup> June 2018, viewed 26<sup>th</sup> April 2022, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=181941&itemId=928&generalType=0>>

14 *Circular of the General Office of the China Banking and Insurance Regulatory Commission on Clarifying the Regulatory Requirements for Foreign-funded Banks on Large Risk Exposures of Their Parent Bank Groups*, CBIRC, 2<sup>nd</sup> April 2021, viewed 26<sup>th</sup> May 2022, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=981215&itemId=928&generalType=0>>

15 *China's FDI inflow up 14.9% to record high in 2021*, State Council, viewed 20<sup>th</sup> June 2022, <[http://english.www.gov.cn/archive/statistics/202201/13/content\\_WS61e011f5c6d09c94e48a394c.html](http://english.www.gov.cn/archive/statistics/202201/13/content_WS61e011f5c6d09c94e48a394c.html)>

16 *Guidelines to Risk Management of Commercial Banks' Merger and Acquisition Loans*, CBIRC, 12<sup>th</sup> March 2015, viewed 12<sup>th</sup> July 2022, <<https://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=70196&itemId=915&generalType=0>>





- Treat deposits from consumer finance companies (CFCs) as corporate deposits in the liquidity ratio calculation, taking into account their stability.
- Treat AFC loans as corporate loans in the LMR.
- Increase the single borrower limit for acquisition finance loans to the same as those for other loans at 10 per cent of the tier-1 capital.

### 1.5 Draw on Foreign Banks' Knowledge and Experience, and Extend them Equal Access to Apply for the PBOC's Carbon Emission Reduction Facility

#### Concern

Not giving foreign banks equal access to apply for the PBOC's carbon emission reduction facility will restrict both foreign banks' and their clients' capability to fulfil net-zero emission pledges.

#### Assessment

The Carbon Emission Reduction Facility programme, launched in November 2021 by the PBOC, is in its initial pilot stage, with only Chinese banks eligible to apply to participate. The aim of the programme is to support enterprises registered in China—mainly in the field of clean energy, energy saving and carbon abatement technology at the initial pilot phase—to meet their pledges of achieving net-zero carbon emissions by 2060.

The working group understands that the facility is being piloted in a closed testing environment, but since it offers a favourable condition of one-year lending rate of 1.75 per cent—which can be rolled over twice and is much lower than the benchmark loan rate—this represents unequal treatment for foreign banks, which are unable to compete when it comes to supporting Chinese international clients' green financing demands. Additionally, foreign banks have to meet performance indicators set by the CBIRC on harmonising green financing activities in China, so it is reasonable to expect that they are treated equally in order for them to fulfil this regulatory requirement.

#### Recommendation

- Extend equal access to foreign banks to apply for the PBOC's Carbon Emission Reduction Facility.

## 2. Reduce Entry Barriers and Optimise the Regulatory System for Foreign Entities' Participation in China's Capital Markets

### 2.1 Adhere to the Same Securities Custody Licence Requirement in Implementation and Use Clear Wording for Securities Fund Custody Licence Application Requirements

#### Concern

Contradictory requirements from different regulators and unclear wording in the requirements constitute obstacles for banks applying for custody licences.

#### Assessment

The CSRC's requirement for paid-in capital to be no less than CNY 8 billion for Qualified Foreign Institutional Investors (QFII) and RMB Qualified Foreign Institutional Investor (RQFII) custodian licence applicants was removed in 2020. However, in practice it is still in force due to a contradictory guideline released by the China Securities Depository and Clearing Corporation Limited (CSDC).

In addition, the CSRC requires applicants for the Securities Investment Funds Custody Licence to have a minimum net capital of CNY 20 billion. Foreign bank branches are allowed to use their parent company's net assets value and other financial indicators, however it is not clear if foreign bank subsidiaries are allowed to do the same.

#### Recommendations

- Establish coordination between the CSRC and the CSDC to remove the requirement for paid-in capital of no less than CNY 8 billion.
- Clarify foreign bank subsidiaries' eligibility to rely on their parent company's net assets value and other financial indicators when applying for a securities fund custody licence.

### 2.2 Allow Qualified Foreign Fund Service Providers to Offer Fund Accounting (FA) and Transfer Agency (TA) Services to Private Fund Managers Registered with the Asset Management Association of China (AMAC)

#### Concern

Foreign fund service providers are not afforded equal treatment in China's asset management market.





### Assessment

The Qualified Domestic Limited Partner (QDLP) pilot programme, introduced in 2013 as the first programme allowing global asset managers to launch funds in China, only allows three global FIs to provide fund administration services to global asset managers' wholly foreign-owned enterprises in China. Prior to the change of the Asset Management Association of China's (AMAC's) *Administrative Measures* in 2017, the programme had been attracting many global asset managers for both alternative and traditional investments, and global service providers had facilitated the initial launch of global asset managers' businesses in China.

In March 2017, the AMAC published the *Administrative Measures on Private Investment Fund Service Business (Trial) (Trial Administrative Measures)*, requesting fund administrators that provide fund accounting and transfer accounting services in China to register with them. As of mid-2022, there are around 45 domestic fund service providers registered with the AMAC, with no foreign fund service providers approved yet.

Since the AMAC is still updating the *Trial Administrative Measures* with regard to the registration qualifications for fund service providers, it is not yet clear whether foreign-invested FIs will be allowed to provide FA and TA services.

It would be beneficial to China to allow global asset service providers into the market, as it would not only enhance competition between institutions, but also lift the whole industry's service level, which would help to develop a healthy and sustainable eco-system for its fund industry.

### Recommendation

- Allow qualified foreign fund service providers to offer FA and TA services to private fund managers registered with the AMAC.

## 3. Develop China's Futures and Derivatives Market

### 3.1 Allow Qualified Foreign Banks to Trade China Government Bond Futures

#### Concern

Foreign banks are not treated equally in the pilot

programme to trade China Government Bond Futures on the China Financial Futures market.

#### Assessment

On 21<sup>st</sup> February 2020, the Ministry of Finance (MOF) and the CSRC launched a pilot programme for eligible commercial banks and insurance companies to trade China government bond futures on the China Financial Futures Exchange. While the five major Chinese banks have been allowed to participate in this pilot, no foreign bank has yet been included.

Some leading foreign banks in China have become major holders and traders of China government bond futures, having provided liquidity in the market, and at the same time accumulating significant government bond exposure. Allowing these foreign banks to trade government bond futures will help them improve risk management and further benefit the market with a broader investor base and improved pricing mechanisms.

#### Recommendation

- Allow qualified foreign banks to trade China government bond futures.

### 3.2 Allow Onshore Banks to Engage in Non-hedging, Cross-border Derivatives Transactions with Parent Banks

#### Concern

Prohibiting onshore banks from carrying out cross-border, over-the-counter (OTC) derivatives transactions for non-hedging purposes may have a negative impact on the market.

#### Assessment

Regulators' recognition of foreign banks' legitimate and traditional business needs on cross-border derivatives hedging transactions between their onshore entities (inclusive of incorporated banks and branches) and their offshore affiliates (normally their head office, or parent banks) was a welcome development.

However, under the terms set out in Article 2 and Article 17 of the *Guidance on Promoting the Proper Development of Derivatives Business (Draft for Comments) (Draft Guidance)*, jointly issued by the PBOC, the CBIRC, the CSRC and the SAFE on 3<sup>rd</sup>





December 2021,<sup>17</sup> cross-border OTC derivatives transactions for non-hedging purposes are clearly prohibited to all onshore licensed FIs in China, except when otherwise provided.

In accordance with Article 4 of the *Revised Interim Administrative Measures for Derivative Business of Banking Financial Institutions*, issued by the CBIRC in 2011,<sup>18</sup> derivatives for non-hedging purposes include:

1. RMB/forex derivatives initiated by foreign banks' institutional clients;
2. cross-border derivatives embedded in structured deposits and traded between the onshore banks and their offshore counterparties; and
3. cross-border derivatives transacted intra-group, although intra-group exposure already has been exempted in the *Circular on Clarification of Supervisory Requirement of Large Amount Exposure of Foreign Invested Legal Person Banks to Parent Bank Group*, which was issued by the CBIRC on 2<sup>nd</sup> April 2021.<sup>19</sup>

Because foreign banks need to provide robust risk management products and services to their onshore clients, allowing onshore banks to engage in these non-hedging, cross-border derivatives would be essential for the healthy development of risk management capabilities of FIs. In addition, foreign-invested banks in China have actual business needs for cross-border derivatives transactions. It is therefore a concern that the prohibition of these cross-border derivatives for non-hedging purposes may result in related risk exposures remaining with onshore banks.

#### Recommendation

- Allow onshore banks to engage in non-hedging, cross-border derivatives and either remove the relative prohibition from Article 17 of the *Draft Guidance* or define certain cross-border derivatives transactions that could be carved out from the prohibition.

<sup>17</sup> *Guidance on Promoting the Proper Development of Derivatives Business (Draft for Comment)*, PBOC, CBIRC, CSRC and SAFE, 3<sup>rd</sup> December, 2021, viewed 26<sup>th</sup> May 2022, <<http://www.pbc.gov.cn/tiaofa/si/144941/144979/3941920/4406767/2021120317533996960.pdf>>

<sup>18</sup> *Revised Interim Administrative Measures for Derivative Business of Banking Financial Institutions*, CBIRC, 27<sup>th</sup> January 2011, viewed 26<sup>th</sup> May 2022, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=3830&itemId=928&generaltype=0>>

<sup>19</sup> *Circular on Clarification of Supervisory Requirement of Large Amount Exposure of Foreign Invested Legal Person Banks to Parent Bank Group*, CBIRC, 2<sup>nd</sup> April 2021, viewed 26<sup>th</sup> May 2022, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=981215&itemId=928&generaltype=0>>

### 3.3 Remove the Three Per Cent Market Risk Capital Ratio Limit

#### Concern

Setting the market risk capital ratio within three per cent will hinder foreign banks' development in China's financial markets.

#### Assessment

Based on the *Measures for Administration of Derivative Product Transactions of Banking Financial Institutions (2011 Revision)* circulated by the CBIRC,<sup>20</sup> the market risk capital of banking FIs engaged in non-hedging derivative product transactions under the Basel framework's current standardised approach may not exceed three per cent of their core capital.<sup>21</sup> Regulatory departments of the CBIRC may implement dynamic differential management within such capital ratio limits based on the operational situation of the banking financial institution in question. Calculating market risk capital under the standardised approach must be implemented in accordance with the relevant provisions of the *Measures for Administration of the Capital Adequacy Ratio of Commercial Banks*.

For most locally-incorporated foreign banks, the loan asset scale is still limited due to their lack of retail business, with their strength usually derived from derivative business allowing them to leverage global risk management experience and resources. This means that the CAR can be still maintained at a high-level when the market risk capital ratio utilisation exceeds three per cent. Giving foreign banks the flexibility to allocate capital in the areas they would like to invest in is important for their development in China. Foreign banks have robust market risk management frameworks to ensure the market risk exposure is monitored within the defined limits. The major market risk exposure of foreign banks are CNY risks managed locally, while non-CNY risk is back-to-back hedged with their regional/global centre.

<sup>20</sup> *Measures for Administration of Derivative Product Transactions of Banking Financial Institutions (2011 Revision)*, CBIRC, 27<sup>th</sup> January 2011, viewed 26<sup>th</sup> May 2022, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=3830&itemId=928&generaltype=0>>

<sup>21</sup> The Basel framework's current standardised approach prescribes the use of external credit ratings to determine certain exposures' risk weights. The current standardised approach for credit risk is set out in *Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version*, BIS, 30<sup>th</sup> June 2006, viewed 5<sup>th</sup> July 2022, <[www.bis.org/publ/bcbs128.htm](http://www.bis.org/publ/bcbs128.htm)>



Foreign banks are very active players that not only provide diversified hedging solution to domestic clients, but also introduce offshore investors to the onshore market to boost RMB internationalisation. Capping the market risk capital ratio would limit the contribution that foreign banks make in providing derivatives to offshore investors. It is notable that Chinese banks with a presence in Europe do not face such ratio controls.

#### Recommendation

- Adhere to the principle of reciprocity and cancel the three per cent market risk capital ratio limit.

## 4. Limit Data Localisation and Prescriptive Cybersecurity Requirements

### 4.1 Allow Free Cross-border, Intra-group Data Flows, Reduce the Scope of 'Important Data' and Facilitate Cross-affiliate Information Sharing

#### Concern

Stringent data localisation requirements put financial institutions' global operating models risk while increasing foreign banks' operational risks and associated costs, constituting the main barriers for market entry.

#### Assessment

European banks continue to encounter a host of problems in relation to data localisation and prescriptive cybersecurity requirements in China, in both financial regulations and the Cybersecurity Law (CSL), Data Security Law (DSL), and the Personal Information Protection Law (PIPL), as well as associated implementation measures.<sup>22</sup>

<sup>22</sup> Those measures include, but are not limited to: the CBIRC's *Banking FIs Anti-money Laundering and Counter Terrorist Financing Management Measures (2019)*, State Council, 29<sup>th</sup> January 2019, viewed 25<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2019/content\\_5446227.htm](http://www.gov.cn/gongbao/content/2019/content_5446227.htm)>; the *Notice on the Measures for Cybersecurity Censorship*, Cyberspace Administration of China (CAC), 28<sup>th</sup> December 2021, viewed 25<sup>th</sup> April 2022, <[http://www.cac.gov.cn/2022-01/04/c\\_1642894602182845.htm](http://www.cac.gov.cn/2022-01/04/c_1642894602182845.htm)>; the *Notice on Soliciting Public Opinions on the Measures for Cybersecurity Censorship (Draft)*, CAC, 24<sup>th</sup> May 2019, viewed 26<sup>th</sup> April 2022, <[https://www.cac.gov.cn/201905/24/c\\_1124532846.htm](https://www.cac.gov.cn/201905/24/c_1124532846.htm)>; the *Notice on Soliciting Public Comments on the Administrative Measures on Data Security (Draft)*, CAC, 28<sup>th</sup> May 2019, viewed 26<sup>th</sup> April 2022, <[https://www.cac.gov.cn/2019-05/28/c\\_1124546022.htm](https://www.cac.gov.cn/2019-05/28/c_1124546022.htm)>; *Notice on Seeking Public Comments on the Measures on the Security Assessment of Data Cross-border Transfer (Draft)*, CAC, 29<sup>th</sup> October 2021, <[http://www.cac.gov.cn/2021-10/29/c\\_1637102874600858.htm](http://www.cac.gov.cn/2021-10/29/c_1637102874600858.htm)>; *Notice on Seeking Public Comments on GB/T XXXXX – XXXX Information Security Technology – Guideline for Identification of Critical Data*, National Public Service Platform for Standards Information, 13<sup>th</sup> January 2022, viewed 25<sup>th</sup> April 2022, <<https://www.tc260.org.cn/file/2022-01-13/bce09e6b-1216-4248-859b-ec3915010f5a.pdf>>; and the *Notice on Seeking Public Comments on the Administrative Measures on Network Data Security (Draft)*, CAC, 14<sup>th</sup> November 2021, viewed 25<sup>th</sup> April 2022, <[http://www.cac.gov.cn/2021-11/14/c\\_1638501991577898.htm](http://www.cac.gov.cn/2021-11/14/c_1638501991577898.htm)>

## Cybersecurity Law and Data Security Law

The CSL and DSL's lack of clearly defined key terms, such as 'important data', and inconsistencies among subsequent draft regulations and implementation measures, create huge uncertainties and unpredictability for European FIs investing in China. For more information on CSL and DSL-related measures, please refer to the *Cybersecurity Sub-working Group Position Paper 2022/2023* on page 347.

## Data localisation

Data localisation and limitations on the free flow of data can seriously hinder financial service firms' ability to deliver core products and services to customers, manage risk, and comply with financial regulatory requirements in various jurisdictions. Unfortunately, data localisation requirements are pervasive in the financial sector. Those requirements, in particular relating to the Anti-money Laundering Law and counter-terrorism financing regulations, are challenging for FIs operating in China and make it impossible for multinational FIs to use their global operating models. This also raises the threshold for new FIs attempting to enter the Chinese market.

While the working group recognises China's endorsement of the Group of 20 (G20) Osaka Leaders Declaration promoting free data flow with trust,<sup>23</sup> and China's interests in promoting digital trade through applications to the Digital Economy Partnership Agreement (DEPA), it urges China to uphold those principles and explicitly allow cross-border transfer of data. For the financial sector, allowing cross-border data transfer is a first step to truly open up the domestic financial sector.

## Data-sharing among affiliates

Regulatory restrictions on information-sharing among affiliates are costly for foreign FIs as different IT systems are required, which discourages foreign investment. Unnecessary information-sharing firewall rules should be rescinded and the importance of information-sharing among cross-affiliates within the same financial group should be recognised.

Item 2 of Article 38 of the PIPL clarifies that personal information protection needs to be certified by specialised agencies in accordance with the regulations

<sup>23</sup> *G20 Osaka Leaders' Declaration*, European Council, 29<sup>th</sup> June 2019, viewed 26<sup>th</sup> April 2022, <[https://www.consilium.europa.eu/media/40124/final\\_g20-osaka\\_leaders\\_declaration.pdf](https://www.consilium.europa.eu/media/40124/final_g20-osaka_leaders_declaration.pdf)>





released by the Cyberspace Administration of China (CAC); item 3 of the same article outlines the condition that a standard contract is needed.<sup>24</sup> However, both provisions appear in the basic law only, and in the absence of further detailed guidelines, banks face compliance risks.

### Recommendations

- Refrain from mandating banks to localise their data or their entire IT systems.
- Define clear compliance guidance with regard to 'data localisation/copy' versus 'system localisation' for the banking industry.
- Allow companies and their headquarters/subsidiaries to conduct intra-party, cross-border data transfers and uphold the principles of free movement of data that China signed up to in the G20 Osaka Leaders Declaration.
- Remove unnecessary information-sharing firewall rules and allow cross-affiliates to share information.
- Define clearly critical data category in the banking industry as guidance for FI on critical data identification, to avoid creating unreasonable compliance risks and costs for multinational financial institutions.
- Promulgate clear implementation rules on both the Personal Information Protection Certificate and the standard template to facilitate sharing of personal information among cross-affiliates.

## 4.2 Adopt International Best Practices on Cybersecurity and Technology, and Reduce the Scope of Critical Information Infrastructure (CII) 3

### Concern

Prescriptive cybersecurity requirements and mandatory requirements on technology severely limit firms' ability to optimise their cybersecurity strategies and negatively impacts their cybersecurity capabilities.

### Assessment

The CSL requires multi-level protection scheme 2.0 compliance from all network operators in China, which imposes the requirement for maintenance and support for systems rated Level 3 and above to be localised, mandates the use of certain products and

requires national security reviews under Article 27 of the Cryptography Law, in accordance with the CSL.<sup>25</sup> These requirements will have significant implications for FIs' global systems and operating models. A regulatory approach to cybersecurity therefore should be risk-based, aligned with global best practices and avoid mandating the adoption of certain products or services. The same principle should apply to CII management.

It would also be beneficial for the development of the financial services industry for scope of the CII to be reduced, with CII operator identification rules established by the banking industry regulator so that the protection of truly critical systems can be prioritised. In view of foreign FIs' already limited market share, including them in the scope of CII would deviate from the 'prioritised protection' approach demanded by the CSL, and would be counter-productive in terms of security and cost-effectiveness.

### Recommendations

- Adopt a regulatory approach to cybersecurity and CII management that is risk-based, aligned with global best practices and avoids mandating the adoption of certain products or services.
- Issue a CII operator identification rule for the banking industry to ensure efficient and effective protection.

## 4.3 Adopt Safe and Sound Cybersecurity and Technology Supervisory Practices 3

### Concern

Increasing cybersecurity inspections and penetration testing requirements brings unintentional risks to FIs and interconnected global financial systems.

### Assessment

In 2020, the CBIRC kicked off a round of penetration testing (also known as pen-testing) on banks' IT systems. The working group has also noticed requirements for penetration testing in the CSRC's *Measures for the IT Management of Securities and Fund Operators* (2019) and the draft *Cybersecurity Measures in Securities and Futures Industries (2022)*.<sup>26</sup> While the regulators' intention of underpinning FIs' cyber

<sup>24</sup> Personal Information Protection Law, National People's Congress (NPC), 20<sup>th</sup> August 2021, viewed 5<sup>th</sup> July 2022, <<http://www.npc.gov.cn/npc/c30834/202108/a8c4e3672c74491a80b53a172bb753fe.shtml>>

<sup>25</sup> Cryptography Law of People's Republic of China, NPC, 26<sup>th</sup> October 2019, viewed 7<sup>th</sup> July 2022, <<http://www.npc.gov.cn/npc/c30834/201910/6f7be7dd5ae5459a8de8baf36296bc74.shtml>>

<sup>26</sup> Order No. 152, CSRC, 19<sup>th</sup> December 2018, viewed 26<sup>th</sup> April 2022, <[http://www.csrc.gov.cn/pub/zjhpublic/zjh/201812/t20181221\\_348485.htm](http://www.csrc.gov.cn/pub/zjhpublic/zjh/201812/t20181221_348485.htm)>





resiliency is understandable, this approach may increase or exacerbate existing risks, as pen-testing has the potential to introduce new vulnerabilities and unintentionally, or needlessly, expose FIs' most sensitive information to a third party.<sup>27</sup>

It would be preferable to adopt the Global Financial Market Association's Framework for the Regulatory Use of Penetration Testing in the Financial Services Industry instead, as it would allow them to conduct a firm-led test if they have the capability to do so. Notably, firm-led testing results have been shown to be far more informative for regulatory purposes.

It is important that the relevant authorities understand the potential sensitivity of some data that can be revealed in pen-testing reports, so that regulators limit the collection of sensitive data to that which is directly relevant and necessary to accomplish a specific purpose.

#### Recommendations

- Recognise risks associated with mandated penetration testing and allow for firm-led penetration testing for firms with such capabilities and resources.
- Adopt industry best practices for penetration testing as outlined in the updated Global Financial Market Association's Framework for the Regulatory Use of Penetration Testing in the Financial Services Industry.

## Abbreviations

ABS	Asset Backed Securities
AFC	Auto Finance Company
CAC	Cyberspace Administration of China
CBIRC	China Banking and Insurance Regulatory Commission
CD	Certificate of Deposit
CFC	Corporate Finance Company
CFETS	China Foreign Exchange Trade System
CIBM	China Interbank Bond Market
CII	Critical Information Infrastructure
CNY	Chinese Yuan
COVID-19	Coronavirus Disease 2019
CSDC	China Securities Depository and Clearing Corporation Limited
CSL	Cybersecurity Law
CSRC	China Securities Regulatory Commission
DSL	Data Security Law
ETS	Energy Trading System
EU	European Union
FI	Financial Institution
FIE	Foreign-invested Enterprise
GFE	Guangzhou Futures Exchange
HQLAAR	High-quality Liquid Asset Adequacy Ratio
LDR	Loan to Deposit Ratio
LMR	Liquidity Matching Ratio
MPA	Macro-prudential Assessment
NAFMII	National Association of Financial Market Institutional Investors
PBOC	People's Bank of China
PIPL	Personal Information Protection Law
SAFE	State Administration of Foreign Exchange
SCH	Shanghai Clearing House
SHEEX	Shanghai Environment and Energy Exchange

<sup>27</sup> 'Penetration testing' is the practice of testing a computer system, network or web application to find security vulnerabilities that an attacker could exploit. Pen-testing can be automated with software applications or performed manually. The process involves gathering information about the target beforehand, identifying possible entry points, attempting to break in—either virtually or in reality—and reporting back the findings. See pen test (penetration testing), TechTarget, viewed 26<sup>th</sup> April 2022, <<https://searchsecurity.techtarget.com/definition/penetration-testing>>





# Non-Banking Financial Institutions Working Group

## Key Recommendations

### 1. Lift Geographical Restrictions on Financial Leasing Companies' Cross-provincial Operations

- Revise Article 11 of the draft *Local Financial Supervision and Administration Regulation* to lift geographical restrictions on financial leasing companies.

### 2. Secure the Protection of Ownership of Leased Assets 3

- Confirm that when an equipment leasing company (ELC) is financing a vehicle by sale and leaseback (SALB) contract, the asset registration on the Zhongdengwang platform is sufficient to protect the ownership right of the ELC.
- Confirm that when an ELC is financing equipment other than vehicles under a SALB contract, the sole asset registration on the Zhongdengwang platform protects the ownership right of the ELC.
- Ensure that the transfer of the vehicle registration certificate cannot be completed by any local bureaus of the Department of Motor Vehicles without properly checking the Zhongdengwang platform.
- Improve the Zhongdengwang platform by creating a dedicated field to fill out the serial number of an asset instead of a general comment box as of today.

### 3. Promote Innovation in Financial Services by Enabling ELCs to Finance Intangible Assets / Supply Chains Using Factoring 3

- Promote innovation in financial services by maintaining ELCs' right to use factoring to finance intangible assets / supply chains and by enabling ELCs to develop new intangibles leasing solutions.

### 4. Ensure Consistent Tax Schemes Between ELCs and 'Golden' Financial Leasing Companies

#### 4.1 Clarify the Basis for Value-added Tax (VAT) Deductions between Headquarters and the Branch Office of an ELC 2

- Clarify that the branch office of an ELC whose main operation is financial leasing is qualified to deduct loan interest, bond interest and vehicle purchase tax from its sales amount.
- Recognise returned vehicles as goods with partial-use value, allowing for simplified VAT calculation at two per cent for remarketing income.

#### 4.2 Align Taxation of ELCs with Financial Institutions

- Issue specific guidance and procedures for financial control of the leasing industry.
- Apply a 5:1 related-party debt-to-equity ratio for ELCs.

### 5. Allow ELCs to Obtain Cross-border Corporate Guarantees and Cross-border Bank Guarantees 3

- Allow ELCs to obtain cross-border corporate guarantees and cross-border bank guarantees.





## 6. Include Consumer Finance Companies (CFCs) and Automotive Finance Companies (AFCs) in the Pilot Programme to Sell Non-Performing Loans (NPLs) in Batches to Asset Management Companies

- Lift restrictions on batch transfers of NPLs in the consumer finance industry and the automotive finance industry, and issue clear supportive guidance on this process.
- Include CFCs and AFCs in the NPL pilot project and set up relevant rules and policies to support/facilitate the sale of NPLs by CFCs and AFCs, including an end-to-end process for realising NPL transfer to sale.

## Introduction to the Working Group

The Non-banking Financial Institutions (NBFI) Working Group was established in 2008. It includes leading European consumer finance specialists who operate consumer finance companies (CFCs), auto finance companies (AFCs), small loan companies and other entities engaged in consumer finance services in cooperation with third parties (for example, guarantee companies) in China. As of 2020, the working group also includes equipment leasing companies (ELCs).

### Consumer Finance Companies (CFCs)

In 2009, the China Banking Regulatory Commission (CBRC)—now the China Banking and Insurance Regulatory Commission (CBIRC)—issued the *Pilot Management Measures for Consumer Finance Companies*, marking the formal entry of consumer finance into the regulatory era.<sup>1</sup>

Licensed CFCs operate under the comprehensive supervision of the CBIRC, and are permitted to provide consumption-purpose loans—excluding car loans and mortgages—nationwide.<sup>2</sup> CFCs can directly pay loans on behalf of consumers to merchants selling personal durable consumer goods such as household appliances or electronic products (excluding houses and cars), or provide direct loans to consumers for personal uses and services, such as travel, weddings and education,

among others.<sup>3&4</sup>

### Automotive Finance Companies (AFCs)

In October and November 2003, the CBRC successively issued the *Administrative Measures for Auto Finance Companies* and the *Detailed Rules for the Implementation of Administrative Measures for Auto Finance Companies*,<sup>5&6</sup> officially opening up China's automotive consumer credit industry and allowing qualified Chinese and foreign institutions to establish AFCs in China.<sup>7&8</sup>

3 By the end of 2020, a total of 30 licensed CFCs had been approved for establishment with assets reaching Chinese yuan (CNY) 524.65 billion and a collective loan balance of CNY 492.78 billion: *Chinese Consumer Finance Set for Reshuffle amidst Window Guidance Pressure on Rates*, *China Banking News*, 3<sup>rd</sup> August 2021, viewed 19<sup>th</sup> April 2022, <<https://www.chinabankingnews.com/2021/08/03/chinese-consumer-finance-set-for-reshuffle-amidst-window-guidance-pressure-on-rates/>>

4 Fitch Ratings expects rising consumer lending activities in China despite regulatory tightening to reduce financial risks and increase overall consumer protection: *The Rise of Consumer Finance in China to Bolster Consumption*, Fitch Ratings, 28<sup>th</sup> January 2021, viewed 19<sup>th</sup> April 2022, <<https://www.fitchratings.com/research/corporate-finance/the-rise-of-consumer-finance-in-china-to-bolster-consumption-28-01-2021>>

5 *Administrative Measures for Auto Finance Companies*, State Council, 3<sup>rd</sup> October 2003, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2004/content\\_62732.htm](http://www.gov.cn/gongbao/content/2004/content_62732.htm)>

6 *Detailed Rules for the Implementation of Administrative Measures for Auto Finance Companies*, Ministry of Commerce (MOFCOM), 12<sup>th</sup> November 2003, viewed 19<sup>th</sup> April 2022, <<http://www.mofcom.gov.cn/aarticle/b/f/200311/20031100150937.html>>

7 Licensed AFCs operate under comprehensive supervision of the CBIRC and can provide car loans nationwide: *Ibid.*

8 By the end of 2021, a total of 25 AFCs had been approved for establishment with total assets of CNY 977.48 billion. There is huge potential for development in China's automotive finance industry, as the penetration rate is still below the global average of 70 per cent: *Global and China Automotive Finance Markets 2020–2026 Featuring Profiles of 14 OEM-related Automotive Finance Companies, 5 Dealership Auto Finance Companies and 11 Other Auto Finance Companies*, Research and Markets, 3<sup>rd</sup> September 2020, viewed 19<sup>th</sup> April 2022, <<https://www.globenewswire.com/news-release/2020/09/03/2088231/28124/en/Global-and-China-Automotive-Finance-Markets-2020-2026-Featuring-Profiles-of-14-OEM-related-Automotive-Finance-Companies-5-Dealership-Auto-Finance-Companies-and-11-Other-Auto-Financ.html>>

1 *Pilot Management Measures for Consumer Finance Companies*, State Council, 22<sup>nd</sup> July 2009, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2010/content\\_1539397.htm](http://www.gov.cn/gongbao/content/2010/content_1539397.htm)>

2 *Ibid.*





## Equipment Leasing Industry (ELCs)

China has around 12,000 leasing companies,<sup>9&10</sup> 70 of which were licensed by the CBIRC, with the remaining, such as the ELCs, by the MOFCOM. As a result, under the current regulatory framework, leasing institutions fall into two categories: the so-called 'golden' financial leasing companies regulated from the beginning by the CBIRC, and the financial leasing companies originally regulated by the MOFCOM,<sup>11</sup> although the two types essentially conduct the same business.

## Recent Developments

'Common prosperity' was widely discussed in 2021, and repeatedly brought up in official meetings and documents, starting with the 14<sup>th</sup> Five-year Plan (14FYP).<sup>12</sup> With the "completion of the building of a moderately prosperous society in all respects", achieving common prosperity has become a new goal guiding some of China's policymaking since the release of the 14FYP. In addition, at the 10<sup>th</sup> meeting of the Central Committee for Financial and Economic Affairs in August 2021, Chinese President Xi Jinping associated common prosperity with promoting fairness, making regional development more balanced, stressing people-centred growth and boosting the wealth of low-income groups.<sup>13</sup>

Ensuring economic stability has been another recent priority for the Chinese Government; adhering to its "proactive fiscal policy and a prudent monetary policy", providing more targeted and sustainable fiscal incentives and support for micro, small and medium-sized enterprises (MSMEs) and individuals.<sup>14</sup> On 28<sup>th</sup>

February 2022, the National Development and Reform Commission released a list of measures to provide fiscal and logistical support for businesses that have been hit particularly hard by the COVID-19 pandemic, such as the extension of tax reductions and exemptions as well as better access to loans, guarantees, financing and credit support for MSMEs.<sup>15</sup>

NBFIs are an important source of alternative financial services, such as investment, risk pooling, financial consulting, brokering, money transmission and consumer credit. They play an important role in boosting domestic consumption and economic development by providing individuals and businesses—MSMEs in particular—with access to financing.<sup>16</sup> By supporting individuals and MSMEs, NBFIs can contribute to people-centred development and reducing regional disparities, thus helping the Chinese Government reach its common prosperity goals.

## Key Recommendations

### 1. Lift Geographical Restrictions on Financial Leasing Companies' Cross-provincial Operations

#### Concern

Restricting cross-provincial operations of financial leasing companies will have significant negative consequences for European financial leasing companies because only a limited volume of their business happens within their province of registration.

#### Assessment

On 31<sup>st</sup> December 2021, the People's Bank of China (PBOC) issued the *Local Financial Supervision and Administration Regulation (Draft for Comments) (Draft Regulation)*.<sup>17</sup> The purpose of the *Draft Regulation* is to further clarify the responsibilities and missions of local financial authorities and improve the local financial supervision system, to ensure the implementation of the central government's requirements on serving the

9 Until 20<sup>th</sup> April 2018, China's leasing companies were either supervised by the CBIRC as NBFIs or by the MOFCOM and its authorised provincial-level commerce departments as corporations: Herrera Tio, Bernadette, *Moody's: China's financial leasing sector to benefit from new supervisory regime*, S&P Global, 17<sup>th</sup> May 2018, viewed 19<sup>th</sup> April 2022, <<https://www.spglobal.com/marketintelligence/en/news-insights/trending/tjaqbuyafski2hqbalyhdw2>>

10 The MOFCOM regulated the financial leasing business in accordance with the *Measures for Supervision and Administration of Financial Leasing Enterprises* and relevant law before transferring the responsibilities and duties to the CBIRC in 2018: *Measures for Supervision and Administration of Financial Leasing Enterprises*, MOFCOM, 24<sup>th</sup> September 2013, viewed 19<sup>th</sup> April 2022, <<http://ltfzs.mofcom.gov.cn/article/ae/201309/20130900320558.shtml>>

11 'Golden' financial leasing companies, 金融租赁公司在中文和财务租赁公司, 融资租赁公司在中文.

12 *Outline of the People's Republic of China 14<sup>th</sup> Five-year Plan for National Economic and Social Development and Long-Range Objectives for 2035*, National People's Congress (NPC), 12<sup>th</sup> March 2021, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/xinwen/2021-03/13/content\\_5592681.htm](http://www.gov.cn/xinwen/2021-03/13/content_5592681.htm)>

13 *Xi Urges Financial Risk Prevention while Seeking High-quality Growth*, CGTN, 17<sup>th</sup> August 2021, viewed 19<sup>th</sup> April 2022, <[http://eng.mod.gov.cn/news/2021-08/17/content\\_4892182.htm](http://eng.mod.gov.cn/news/2021-08/17/content_4892182.htm)>

14 *Li Keqiang Meets the Press with the Leaders of Major International Economic Institutions*, Ministry of Foreign Affairs, 7<sup>th</sup> December 2021, viewed 19<sup>th</sup> April 2022, <[https://www.fmprc.gov.cn/mfa\\_eng/topics\\_665678/kjgzbdfyyq/202112/120211207\\_10463489.html](https://www.fmprc.gov.cn/mfa_eng/topics_665678/kjgzbdfyyq/202112/120211207_10463489.html)>

15 *Several Policies on Promoting the Recovery and Development of Service Industries in Difficulty*, National Development and Reform Commission, 28<sup>th</sup> February 2022, viewed 19<sup>th</sup> April 2022, <<https://www.ndrc.gov.cn/xxgk/zcfb/tz/202202/P020220218522078793799.pdf>>

16 *Nonbanking Financial Institution*, World Bank, viewed 19<sup>th</sup> April 2022, <<https://www.worldbank.org/en/publication/gfdr/gfdr-2016/background/nonbank-financial-institution>>

17 *Local Financial Supervision and Administration Regulation (Draft for Comments)*, PBOC, 31<sup>st</sup> December 2021, viewed 25<sup>th</sup> March 2022, <<http://www.pbc.gov.cn/rmyh/105208/4436903/index.html>>





real economy, preventing and controlling financial risks, and deepening financial reform.<sup>18</sup> However, the working group is deeply concerned about Article 11 of the *Draft Regulation*, which restricts financial leasing companies' cross-provincial business and operations.<sup>19</sup>

Although the so-called 'golden' financial leasing companies and financial leasing companies essentially carry out the same business nationwide, if the *Draft Regulation* were to be enforced as proposed, financial leasing companies would be, in principle, not allowed to engage in cross-provincial business. Meanwhile, the 'golden' financial leasing companies—all majority-owned by Chinese banks or state-owned enterprises—would be excluded from the scope of the *Draft Regulation* and could continue to work nationwide. The working group believes this would have negative consequences for European financial leasing companies, which fall under the financial leasing companies' category, for several reasons.

First, quite a few European financial leasing companies are registered either in Beijing or in Shanghai. Only a limited volume of their business happens within the province of registration as their customers, mainly small and medium-sized enterprises (SMEs), are scattered across the country. Preventing financial leasing companies from operating across provinces would lead to a substantial increase of their operating and compliance costs; companies would either lose the income from other provinces, or be forced to open new branches – and it remains unclear from the *Draft Regulation* if that will be an option. Financial leasing companies would also have to spend a tremendous amount of time and energy on communication with the different provincial regulators. Non-compliance or delays in complying with the requirements might create difficulties for European leasing companies to carry out their normal operations, or force them to leave the Chinese market altogether. This is contrary to the original intention of European leasing companies in China, which is to serve the Chinese real economy by financing their Chinese and international customers wherever they are based in China.

18 *Annex 2: Draft Instructions for the Local Financial Supervision and Administration Regulation (draft for comments)*, PBOC, 31<sup>st</sup> December 2021, viewed 5<sup>th</sup> May 2022, <<http://www.pbc.gov.cn/rmyh/105208/4436903/index.html>>

19 *Local Financial Supervision and Administration Regulation (Draft for Comments)*, PBOC, 31<sup>st</sup> December 2021, viewed 25<sup>th</sup> March 2022, <<http://www.pbc.gov.cn/rmyh/105208/4436903/index.html>>

More importantly, the business model of European financial leasing companies is often vendor-orientated, meaning they support the sales of vendor partners by providing financing solutions attached to the sale of new equipment. European financial leasing companies have particularly strong expertise in asset collateralisation and in sectors in which their partner's equipment is used, enabling good control of risk and operations. Therefore, restricting cross-provincial operations is not directly related to preventing financial risks. In fact, limiting European financial leasing companies' ability to support their vendors could be perceived by some as unintentionally favouring Chinese state-owned and Chinese bank-owned 'golden' financial leasing companies.

Historically, there has never been any mention of imposing geographical restrictions on financial leasing companies' operations in regulations published by the MOFCOM or the CBIRC,<sup>20&21</sup> nor in any local interim measures introduced in Beijing and Shanghai.<sup>22&23</sup> In fact, when European financial companies entered the Chinese market and established their leasing subsidiaries, they did so based on a nationwide business plan.

The working group welcomes the policies and measures taken by the Chinese Government and financial regulators to address current economic challenges and ensure financial market stability. However, financial leasing transactions are not purely financial activities, they also have the characteristics of combining financing and assets. As China is a unified market, cross-provincial transactions in the real economy are a normal phenomenon and the financial leasing transactions that are closely linked to

20 This has been the case since the earliest supervision by the Ministry of Foreign Trade and Economic Cooperation, to supervision by the MOFCOM with the *Measures for the Administration of Foreign Investment in the Leasing Industry*, MOFCOM, 17<sup>th</sup> February 2005, viewed 25<sup>th</sup> March 2022, <<http://tfs.mofcom.gov.cn/article/date/ir/cx/200503/20050300022951.shtml>>; Nor is the imposition of geographical restrictions mentioned in the *Measures for Supervision and Administration of Financial Leasing Enterprises*, MOFCOM, 24<sup>th</sup> September 2013, viewed 25<sup>th</sup> March 2022, <<http://tfs.mofcom.gov.cn/article/ae/201309/20130900320558.shtml>>

21 *Interim Measures for the Supervision and Administration of Financial Leasing Companies*, CBIRC, 26<sup>th</sup> May 2020, viewed 25<sup>th</sup> March 2022, <[http://www.gov.cn/gongbao/content/2020/content\\_5537939.htm](http://www.gov.cn/gongbao/content/2020/content_5537939.htm)>

22 *Guidelines for the Supervision and Administration of Beijing Financial Leasing Companies (for Trial Implementation)*, Beijing Local Financial Supervision and Administration Bureau, 16<sup>th</sup> April 2020, viewed 25<sup>th</sup> March 2022, <[http://jrj.beijing.gov.cn/zcfg/bjszcfg/202004/t20200416\\_1805595.html](http://jrj.beijing.gov.cn/zcfg/bjszcfg/202004/t20200416_1805595.html)>

23 *Interim Measures for the Supervision and Administration of Financial Leasing Companies in Shanghai (Draft for Comment)*, Shanghai Local Financial Supervision and Administration Bureau, 1<sup>st</sup> February 2021, viewed 25<sup>th</sup> March 2022, <<http://jrj.sh.gov.cn/zwdt-gg/20210201/0c0e8f2715cb4bba8c2d797a867308d3.html>>



assets and the real economy cannot simply be divided among different regions. The working group believes the financial leasing business does not align with the concept of 'regional' or 'local' finance, from its nature, its characteristics, its status of operations and from the historical continuity of supervision. In Europe, there is no such regional limitation within a member state. The working group therefore does not recommend inhibiting the development of the financial leasing industry for the convenience of supervision. Furthermore, the working group believes this is not in line with the central government's requirements for serving the real economy, preventing and controlling financial risks, and deepening financial reform.<sup>24</sup>

#### Recommendation

- Revise Article 11 of the draft *Local Financial Supervision and Administration Regulation* to lift geographical restrictions on financial leasing companies.

## 2. Secure the Protection of Ownership of Leased Assets

#### Concern

Registration of an asset with the Department of Motor Vehicles (DMV) under the Vehicle Administrative Office (VAO) is not recognised as registration of ownership, therefore the owning leasing company is at significant risk of a leased asset title being transferred without its consent or knowledge to one or multiple third parties.

#### Assessment

When leasing a vehicle, registration with the DMV is done in the name of the lessee (the customer/permit holder). The name of the lessor is not mentioned in the registration certificate, which places the ELC at risk of the registration certificate being transferred without consent to one or multiple third parties. The lessor could potentially lose ownership of the vehicle due to the *bona fide* position of the new registered party with the DMV, despite the ELC's ownership of the vehicle being stipulated under the sale and leaseback (SALB) contract. To guard against this, ELCs follow the practice of registering a mortgage on the vehicle in the DMV platform (mortgage of self-owned property) as well as registering the vehicle in the PBOC's Credit Reference Centre of the Movable Financing Registry Platform

<sup>24</sup> Annex 2: Draft Instructions for the Local Financial Supervision and Administration Regulation (Draft for Comments), PBOC, 31<sup>st</sup> December 2021, viewed 5<sup>th</sup> May 2022, <<http://www.pbc.gov.cn/rmyh/105208/4436903/index.html>>

(Zhongdengwang).<sup>25&26</sup> However, this double registration process increases the administrative and financing costs of ELCs, and negatively impacts financing pricing.

On 28<sup>th</sup> May 2020, the National People's Congress (NPC) adopted the *Civil Code*, which took effect on 1<sup>st</sup> January 2021.<sup>27</sup> Article 745 states that, "The lessor's ownership over the leased object shall, without being registered, not be asserted against a *bona fide* third person."

Following the promulgation of the *Civil Code*, the State Council issued the *Decision of the State Council on the Implementation of Unified Registration of Guarantee over Chattels and Rights (Decision)* on 22<sup>nd</sup> December 2020.<sup>28</sup> In this document, the Zhongdengwang is designated as the unified centre for registering financial leasing transactions. By registering financial leasing transactions on Zhongdengwang, the lessor's ownership should be protected. This policy intends to cover all leasing types (regardless of whether direct lease or SALB) and leased assets (regardless of whether general equipment or vehicles).

As a result, on 29<sup>th</sup> December 2020, China's Supreme People's Court (SPC) amended some earlier judicial interpretations.<sup>29</sup> For instance, Article 9 of the *Decision* recommended that the mortgage self-owned leasing assets option, as in the *Interpretation of the Supreme People's Court on Issues Concerning the Application of Law in the Trial of Cases Involving Disputes over Financial Leasing Contracts*, promulgated on 24<sup>th</sup> February 2014,<sup>30</sup> be deleted.

After all these recent legal developments, the working group is questioning whether the ownership of an ELC is sufficiently protected by registering the financial

<sup>25</sup> Credit Reference Centre of the PBOC website, 14<sup>th</sup> January 2013, viewed 19<sup>th</sup> April 2022, <[http://www.pbccrc.org.cn/crc/dsj/index\\_list\\_list.shtml](http://www.pbccrc.org.cn/crc/dsj/index_list_list.shtml)>

<sup>26</sup> CCRC Movable Financing Registration Platform (Zhongdengwang), 2015, viewed 19<sup>th</sup> April 2022, <<https://www.zhongdengwang.org.cn/>>

<sup>27</sup> *People's Republic of China Civil Code*, NPC, 2<sup>nd</sup> June 2020, viewed 19<sup>th</sup> April 2022, <<http://www.npc.gov.cn/npc/c30834/202006/75ba6483b8344591abd07917e1d25cc8.shtml>>

<sup>28</sup> *Decision of the State Council on the Implementation of Unified Registration of Guarantee over Chattels and Rights*, State Council, 22<sup>nd</sup> December 2020, viewed 19<sup>th</sup> April 2022, <[https://www.pkulaw.com/en\\_law/6938bfb6624beb87bdfb.html](https://www.pkulaw.com/en_law/6938bfb6624beb87bdfb.html)>

<sup>29</sup> *Decision to Amend 27 Civil Judicial Interpretations Including the Interpretation of the SPC on Several Issues Concerning the Application of the Trade Union Law of the People's Republic of China in Civil Trials*, SPC, 29<sup>th</sup> December 2020, viewed 19<sup>th</sup> April 2022, <[https://www.pkulaw.com/en\\_law/6938bfb6624beb87bdfb.html](https://www.pkulaw.com/en_law/6938bfb6624beb87bdfb.html)>

<sup>30</sup> *Interpretation of the Supreme People's Court on Issues concerning the Application of Law in the Trial of Cases Involving Disputes over Financial Leasing Contracts*, SPC, 24<sup>th</sup> February 2014, viewed 20<sup>th</sup> June 2022, <<https://www.court.gov.cn/fabuxiangqing-6314.html>>





leasing on Zhongdengwang under SALB transactions of general equipment. If so, there would be no need to register an additional mortgage on Zhongdengwang of the self-owned leased assets. This uncertainty is particularly pressing for leasing of vehicles, as it remains unclear whether ELCs still need to register a mortgage at the DMV in order to avoid losing the position of *bona fide* third party. In addition, the working group is concerned a mortgage of leased assets by ELCs under the current new legal environment may become counter-productive, as it may lead to a different interpretation of the transaction nature from financial leasing to mortgage loans.

This concern was highlighted in a 2020 case of vehicle financing in the city of Ningbo, whereby an ELC financed a vehicle by SALB and registered a mortgage on the DMV platform to protect its ownership rights. However, the court rejected the claim that the lessor had obtained vehicle ownership because there was no registration under the lessor's name in the DMV and thus reclassified the financing from SALB to a mortgage loan.<sup>31</sup>

This case has raised concern among industry players that there is no proper methodology for an ELC to have its ownership recognised unconditionally through SALB. In May 2021, the PBOC released the *Uniform Registration Measures for Moving Property and Rights Guarantees (Revised Draft for Comments)*, which are implementation measures of the *Civil Code*.<sup>32</sup> However, as vehicles are excluded from the draft regulation, the working group has submitted comments advocating for this to be amended in the final draft.

In the EU and other mature markets, the interests of ELCs are legally protected through registration on

similar platforms.<sup>33,34&35</sup> The Zhongdengwang has the same potential because it provides a favourable basis for the process of taking back defaulted vehicles and indirectly supports the development of a healthy market. In addition, the platform already allows for a serial number to be entered or the uploading of invoice documents when registering, but it is neither a mandatory nor a recommended field.

In addition, the Zhongdengwang and the DMV's identification codes for vehicles currently do not correspond, which could lead to the same vehicle being registered by different parties. The working group therefore recommends that DMV bureaus be granted access to the Zhongdengwang platform for the purpose of checking the existence of any right privilege on a vehicle, and that they be permitted to obtain consent from the legal owner prior to authorising any change to or transfer of the registration certificate. The working group also suggests that the VAO confirms whether the sole asset registration on the Zhongdengwang is sufficient to protect the ownership of an ELC under SALB contract.

It is notable that the financing of equipment/assets other than vehicles is also of concern, as mortgage registration in the DMV is limited to vehicles only. The working group stresses the need to clarify whether the registration of an asset on the Zhongdengwang platform by an ELC is sufficient to protect its ownership rights under a SALB contract.

### Recommendations

- Confirm that when an ELC is financing a vehicle by SALB contract, the asset registration on the Zhongdengwang platform is sufficient to protect the ownership right of the ELC.

<sup>31</sup> *Summary of Financial Lease Contract Dispute*, Ningbo Intermediate People's Court, 28<sup>th</sup> September 2020, viewed 12<sup>th</sup> April 2021, <<https://wenshu.court.gov.cn/website/wenshu/181010CARHS5BS3C/index.html>>

<sup>32</sup> *Uniform Registration Measures for Moving Property and Rights Guarantees (Revised Draft for Comments)*, PBOC, 19<sup>th</sup> May 2021, viewed 27<sup>th</sup> April 2022, <<http://www.pbc.gov.cn/tiaofasi/144941/144979/3941920/4251286/index.html>>

<sup>33</sup> In Spain, a property register in communication with the Traffic Department ensures that there is a limitation over the vehicle in the name of the leasing company until the contract period is terminated. To remove this limitation, a special document from the leasing company has to be sent to the register or the customer. See: *Register of Movable Property*, Registradores de España, 2022, viewed 29<sup>th</sup> April 2022, <<https://www.registradores.org/el-colegio/registro-de-bienes-muebles>>

<sup>34</sup> In Portugal, registration is done directly in the Traffic Department. See: *Vehicles*, Instituto da Mobilidade e dos Transportes, 1<sup>st</sup> January 2012, viewed 29<sup>th</sup> April 2022, <<http://www.imt-ip.pt/SITES/IMTT/PORTUGUES/VEICULOS/Paginas/Veiculos.aspx>>

<sup>35</sup> A by-the-book example is the Personal Properties Security Register (PPSR) Platform covering Australia and New Zealand. The platform includes a direct link from the enterprise resource planning software to the government website to register pledges. ELCs may also register their encumbrance on the vehicle using the vehicle identification number and register it against the customer. The PPSR Platform allows for registration by multiple customers, for example, borrower and operator. The customer still registers the vehicle in their name, but ELCs maintain the legal rights to the vehicle. See the PPSR Platform website: <<https://www.ppsr.gov.au/>>



- Ensure that vehicle registration certificate transfers cannot be completed by local DMV bureaus without first checking the Zhongdengwang platform.
- Improve the Zhongdengwang platform by creating a dedicated field for the serial number of an asset instead of the general comment box that is currently presented.
- Confirm that when an ELC is financing equipment other than vehicles under a SALB contract, the sole asset registration on the Zhongdengwang platform protects the ownership right of the ELC.

### 3. Promote Innovation in Financial Services by Enabling ELCs to Finance Intangible Assets / Supply Chains Using Factoring



#### Concern

Preventing ELCs from using factoring to finance intangible assets / supply chains limits both innovation and Chinese consumers' access to advanced methods of financing.

#### Assessment

Financing of intangible assets, such as licence-based software and supply chains, is an emerging trend that is crucial for ELCs. Indeed, ELC members of the Non-banking and Financial Institutions Working Group report that intangible assets and supply chain financing represent a substantial proportion of their business, accounting for up to 40 per cent of their overall financing.<sup>36</sup>

The working group believes these product offerings are consistent with the spirit of the State Council's *Guiding Opinions on Accelerating the Development of the Financial Leasing Industry (Guobanfa [2015] No. 68)*, which seeks to strengthen financial innovation.<sup>37</sup> Furthermore, the State Council's *Promoting the Experience of the Pilot Reform of China (Shanghai) Pilot Free Trade Zone (Circular 65)*,<sup>38</sup> issued in December 2014, enabled ELCs to conduct factoring business related to their main business nationwide. Since then, many ELCs have obtained such a factoring licence. However, the CBIRC's *Interim Measures for the Supervision and*

*Administration of Financial Leasing Companies*, issued in May 2020, do not permit ELCs to have a licence to conduct any factoring after mid-2023.<sup>39</sup> Taking away ELCs' right to use factoring solutions to finance intangible assets and supply chains will have a serious impact on their business, leading to potential losses of around CNY 2–3 billion of new business in 2023 for the European ELCs alone. This measure will also limit both innovation in financial services and Chinese customers' access to advanced financing solutions. In fact, it constitutes a step back for Chinese customers, who will not have adequate solutions for their intangible assets / supply chain financing requirements.

Factoring companies do not perform the same business as ELCs, as they purchase short-term receivables (up to 90 days in most cases), whereas ELCs use factoring to finance intangibles and/or non-remarketable assets—which are therefore considered intangible assets—with a tenure of up to five years. This requires know-how that European ELCs have developed over the years and are keen to bring to the Chinese market. It has facilitated customers from European business access to expensive information technology and industrial software, enabling companies to achieve higher efficiency, and to become more sophisticated and technologically advanced.

When it comes to supply chain financing, the underlying assets are just mere components that will be temporarily owned either by distributors or original equipment manufacturers (OEMs), system integrators (SIs) or engineering procurement construction (EPC) contractors before they are sold. The duration of temporary ownership of these components varies between a few months to a year. Distributors, OEMs, SIs and EPCs have to pay for the components they procure from their upstream suppliers with their own cash, and these components will stay in their inventory for months before being sold to their end-users when they can collect the money back. As these components are not typical leasable assets, receivable finance (factoring) by ELCs constitutes the ideal product to serve this demand from different industrial players.

The working group acknowledges that there are some pilot cases of intangible assets financing through

<sup>36</sup> According to information provided by the working group's ELC members.

<sup>37</sup> *Guiding Opinions of the General Office of the State Council on Accelerating the Development of the Financial Leasing Industry*, State Council, 31<sup>st</sup> August 2015, viewed 19<sup>th</sup> April 2022, <<http://lawinfochina.com/display.aspx?id=26921&lib=law>>

<sup>38</sup> *Promoting the Experience of the Pilot Reform of China (Shanghai) Pilot Free Trade Zone (Circular 65)*, State Council, 21<sup>st</sup> December 2014, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/zhengce/content/2015-01/29/content\\_9437.htm](http://www.gov.cn/zhengce/content/2015-01/29/content_9437.htm)>

<sup>39</sup> *Interim Measures for the Supervision and Administration of Financial Leasing Companies*, CBIRC, 26<sup>th</sup> May 2020, viewed 25<sup>th</sup> March 2022, <[http://www.gov.cn/gongbao/content/2020/content\\_5537939.htm](http://www.gov.cn/gongbao/content/2020/content_5537939.htm)>





leasing in China, but would like to get the regulator's full understanding and support to create an innovative corridor, enabling ELCs to engage in intangible and supply chain financing.

#### Recommendation

- Promote innovation in financial services by creating ELCs' right to use lean version of factoring to finance intangible assets / supply chains and by enabling ELCs to develop new intangibles leasing solutions.

## 4. Ensure Consistent Tax Schemes Between ELCs and 'Golden' Financial Leasing Companies

### 4.1 Clarify the Basis for Value-added Tax (VAT) Deductions between Headquarters and the Branch Office of an ELC

#### Concern

Inconsistency among tax authorities in interpreting VAT regulations not only increases the tax burden on ELCs but also hinders the development of the industry by forcing companies to change their business model or even give up their operations.

#### Assessment

To support the rapid development of the leasing industry, the Chinese Government has provided a preferential VAT regulation allowing for the deduction of loan interest, bond interest and vehicle purchase tax from the sales amount when calculating VAT liability. However, this preferential VAT regulation does not apply to branch offices of an ELC. Many European investors operate several different entities throughout China, and inconsistency in interpreting tax regulation is frequently encountered in different locations, especially for emerging industries such as leasing. For instance, the *Notice on the Conversion of Business Tax into Value-added Tax on a Pilot Basis (Caishui [2016] No. 36)* indicates that an ELC that has obtained approval from the MOFCOM and is engaged in financial leasing operations can avail of the preferential VAT, provided its paid capital reaches CNY 170 million.<sup>40</sup> However, in practice, the interpretation by most tax authorities is that there is no paid capital for a branch office.

Furthermore, considering the conditions of SALB business, vehicles returned by a lessee to an ELC should be recognised as goods with a partial-use value (i.e., used goods). Therefore, the remarketing income should be subject to the simplified VAT calculation method at the three per cent rate and then subsequently lowered to two per cent as soon as possible.

#### Recommendations

- Clarify that the branch office of an ELC whose main operation is financial leasing is qualified to deduct loan interest, bond interest and vehicle purchase tax from its sales amount.
- Recognise returned vehicles as goods with partial-use value, allowing for simplified VAT calculation at two per cent for remarketing income.

### 4.2 Align Taxation of ELCs with Financial Institutions

#### Concern

Financial leasing businesses are treated and taxed as financial companies under the 'Business to VAT' tax reform, yet financial institutions and ELCs often receive different tax treatment.

#### Assessment

There are two main ways in which ELCs often receive different tax treatment under China's current regime.

The first is related to VAT. Based on the *Notice on Clarification of VAT Policies for Finance, Real Estate Development and Education Support Services (Caishui [2016] No. 140)*,<sup>41</sup> a financial institution is exempt from VAT on interest incurred if a client has defaulted after 90 days, in which cases VAT shall be paid when interest is collected. An ELC, on the other hand, is required to pay VAT throughout the entire contract period regardless of any client default. This can lead to significant losses for the ELC in cases of non-payment.

The second situation is related to the thin-cap ratio. Under the *Notice on Tax Collection Policy Issues Relating to Standards for Pre-tax Deduction of Interest Payment Expenses of Related Parties of Enterprises*

<sup>40</sup> *Notice on the Conversion of Business Tax into Value-Added Tax on a Pilot Basis (Caishui [2016] No. 36)*, State Council, 23<sup>rd</sup> March 2016, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/gongbao/content/2016/content\\_5088782.htm](http://www.gov.cn/gongbao/content/2016/content_5088782.htm)>

<sup>41</sup> *Notice on Clarification of VAT Policies for Finance, Real Estate Development and Education Support Services, (Caishui [2016] No. 140)*, State Taxation Administration, 21<sup>st</sup> December 2016, viewed 19<sup>th</sup> April 2022, <<https://www.shui5.cn/article/9c/109420.html>>





(*Caishui [2008] No. 121*),<sup>42</sup> a financial institution is subject to a 5:1 thin-cap ratio when calculating non-deductible interest actually paid, while an ELC, which is categorised as a non-financial institution, is subject to a 2:1 thin-cap ratio.

The MOFCOM's *Measures for Supervision and Administration of Financial Leasing Enterprises*, issued in September 2013,<sup>43</sup> state that, "Financial leasing directly serves the real economy and plays an important role in promoting the development of equipment manufacturing industry, SME financing, enterprise technology upgrading and transformation, equipment import and export, and commodity circulation. It is an important means to promote the integration of industry and finance and develop the real economy." The fact that the regulatory responsibility for leasing companies changed from the MOFCOM to the CBIRC in 2018 further exemplifies that government authorities fully recognise that leasing companies are financial institutions and therefore should be subject to CBIRC regulations.

In Europe, most countries have interest-to-pre-tax-earning limits in place, and ELCs do not face limitations such as the 2:1 thin-cap ratio. Most commonly, the limit is set at 30 per cent of earnings before interest, taxes, depreciation and amortisation.<sup>44</sup> In China, applying a 2:1 ratio for ELCs leads to intense funding pressure and increased costs. However, if ELCs were to be regulated as financial institutions, it would greatly increase their compliance costs. The working group therefore encourages the regulator to issue specific guidance and procedures on taxation of ELCs and to apply a 5:1 related-party debt-to-equity ratio.

#### Recommendations

- Issue specific guidance and procedures for financial control of the leasing industry.
- Apply a 5:1 related-party debt-to-equity ratio for ELCs.

<sup>42</sup> *Notice on Tax Collection Policy Issues Relating to Standards for Pre-tax Deduction of Interest Payment Expenses of Related Parties of Enterprises (CaiShui [2008] No. 121)*, State Taxation Administration, 19<sup>th</sup> September 2008, viewed 19<sup>th</sup> April 2022, <<http://www.chinatax.gov.cn/chinatax/n810341/n810765/n812171/200809/c1191330/content.html>>

<sup>43</sup> *Measures for Supervision and Administration of Financial Leasing Enterprises*, MOFCOM, 24<sup>th</sup> September 2013, viewed 25<sup>th</sup> March 2022, <<http://lfzs.mofcom.gov.cn/article/ae/201309/20130900320558.shtml>>

<sup>44</sup> A. Kristina Zvinys, *Thin-Cap Rules in Europe*, Tax Foundation, 27<sup>th</sup> August 2020, viewed 13<sup>th</sup> June 2022, <<https://taxfoundation.org/thin-capitalization-rules-thin-cap-rules-europe-2020/>>

## 5. Allow ELCs to Obtain Cross-border Corporate Guarantees and Cross-border Bank Guarantees

### Concern

European leasing companies can use their international connections to finance the Chinese subsidiaries of multinational companies they have strong business ties with in their home country, but certain restrictions remain in this respect.

### Assessment

The *Regulations on the Administration of Foreign Exchange for Cross-border Guarantees*, issued by the State Administration of Foreign Exchange (SAFE) on 15<sup>th</sup> May 2015, only allow banks and financial institutions registered in Mainland China to obtain cross-border guarantees.<sup>45</sup> This limits the ability of European ELCs in terms of risk appetite to support foreign investment in China. As a result, Chinese SME subsidiaries of foreign companies have difficulties accessing local structured financing.

Foreign-invested ELCs receive cross-border guarantees in some lease contracts for securing the lessee in China (to fulfil the rental payment obligation under the lease agreement). Currently, it is difficult to receive real payment from the parent company outside of China if the lessee is in default. This is because leasing companies are not regarded in China as financial institutions, and therefore are not eligible for the *Onshore Borrowing with Offshore Guarantee (waibao neidai)*, which allows China-based subsidiaries to receive money from their parent company outside of China.<sup>46</sup> The working group estimates that around 20 to 30 per cent of additional business is not realised due to this constraint on foreign ELCs.

### Recommendation

- Allow ELCs to obtain cross-border corporate guarantees and cross-border bank guarantees.

<sup>45</sup> *Notice of the State Administration of Foreign Exchange on the Issuance of Regulations on the Administration of Foreign Exchange for Cross-Border Guarantees [2014] No. 29*, SAFE, 15<sup>th</sup> May 2015, viewed 19<sup>th</sup> April 2022, <<http://www.safe.gov.cn/shenzhen/2015/0515/133.html>>

<sup>46</sup> *Notice on the Measures for the Administration of the Registration of External Debt*, SAFE, 3<sup>rd</sup> May 2013, viewed 19<sup>th</sup> April 2022, <[http://www.gov.cn/zwqk/2013-05/03/content\\_2395170.htm](http://www.gov.cn/zwqk/2013-05/03/content_2395170.htm)>





## 6. Include CFCs and AFCs in the Pilot Programme to Sell Non-Performing Loans (NPLs) in Batches to Asset Management Companies (AMCs)

### Concern

According to the current regulations, it is not feasible for CFCs to sell NPLs, as individual loans cannot be transferred in batches and other NPLs sold in batches can only be assigned to financial AMCs or a local recognised AMC.

### Assessment

With the development of the CFC industry and the AFC industry in China, a large amount of NPLs have accumulated in the market. It is difficult for CFCs and AFCs to dispose of NPLs, as individual loans (including all kinds of loans with individuals as the main borrowers, such as housing, automobile or student loans, and credit card debts) cannot be transferred in batches (equal to 10 or more NPLs). Other NPLs sold in batches can only be assigned to AMCs or a local recognised AMC.<sup>47</sup> CFCs' business particularity is to grant small ticket loans to multiple individual borrowers. Considering this, it is not practical for CFCs to dispose of NPLs in batches of less than 10 loans. As NPLs accumulate, CFCs and AFCs must often resort to writing them off.

Unfortunately, China still has no regulatory mechanism that allows and guides the sale of NPLs by CFCs and AFCs; however, the working group has noticed some, albeit small, positive developments on this front. In January 2021, the CBIRC issued the *Notice Concerning the Undertaking of Non-Performing Loan Transfer Trial Work*, including in its scope sales of consumer loans, credit card overdrafts and personal business loans. Under this pilot programme, six Chinese state-owned banks and 12 commercial banks are eligible to sell NPLs in batches to AMCs.<sup>48</sup> In 2021, 45 business

transactions were handled, disposing of 27,438 NPLs from 7,825 households. The total outstanding principal reached approximately CNY 1.77 billion, the total transfer price CNY 223 million and the average principal recovery rate 12.57 per cent. Personal business credit loans represented the highest proportion. Under the programme, the six state-owned banks sold 29 batches of personal business, and 17 AMCs acquired a total of 42 batches.<sup>49</sup>

The working group views this development as a breakthrough in the sale of NPLs in batches, which is now expected to accelerate. This will help to improve the asset quality of banks and financial institutions in China. However, as the pilot runs until 31<sup>st</sup> December 2022, it remains to be seen what the market impact and revenue of such NPLs sale would be. Therefore, if the pilot is successful and opening is consolidated, the working group advocates for the inclusion of CFCs and AFCs, and for relevant rules and policies to be formulated that support and facilitate NPL sales, including an end-to-end process for realising NPL sale.

### Recommendations

- Lift restrictions on batch transfers of NPLs in the consumer finance industry and the automotive finance industry and issue clear supportive guidance on this process.
- Include CFCs and AFCs in the NPL pilot project and set up relevant rules and policies to support/facilitate the sale of NPLs by CFCs and AFCs, including an end-to-end process for realising NPL transfer to sale.

<sup>47</sup> Local AMCs are financial institutions with special permissions to engage in the wholesale purchase of financial non-performing assets, but they do not have financial institution licences. In August 2021, local regulators solicited the opinions of members of the local AMC sector on the draft version of the *Local Asset Management Company Supervisory and Regulatory Provisional Measures* to "seek to remedy gaps in local AMC regulation in China, amidst a broader push to step up oversight of the Chinese financial sector." *Local Asset Management Companies Set for New Rules to Address Regulatory Gaps*, *China Banking News*, 4<sup>th</sup> August 2021, viewed 20<sup>th</sup> June 2022, <<https://www.chinabankingnews.com/2021/08/04/local-asset-management-companies-set-for-new-rules-to-address-regulatory-lacunae/>>

<sup>48</sup> *China Commences Trial for Bulk Transfer of Personal Non-performing Loans to Asset Management Companies*, *China Banking News*, 12<sup>th</sup> January 2021, viewed 19<sup>th</sup> April 2022, <<https://www.chinabankingnews.com/2021/01/12/china-commences-trials-for-transfer-of-personal-non-performing-loans-to-asset-management-companies/>>

<sup>49</sup> *Launch of the 2021 Annual Report on Non-Performing Loan Transfer Pilot Operations*, Yindeng Centre, 26<sup>th</sup> May 2022, viewed 20<sup>th</sup> June 2022, <<http://www.yindeng.com.cn/Home/cn/zczrxx/jlyd/20220526/1424186.shtml>>





## Abbreviations

14FYP	14 <sup>th</sup> Five-year Plan
AFC	Auto Finance Company
AMC	Asset Management Company
CBRC	China Banking Regulatory Commission
CBIRC	China Banking and Insurance Regulatory Commission
CFC	Consumer Finance Company
CNY	Chinese Yuan
DMV	Department of Motor Vehicles
ELC	Equipment Leasing Company
EPC	Engineering Procurement Construction
ICT	Information and Communications Technology
MOFCOM	Ministry of Commerce
MSME	Micro Small, and Medium-sized Enterprise
NBFI	Non-banking Financial Institution
NPC	National People's Congress
NPL	Non-performing Loan
OEM	Original Equipment Manufacturer
PBOC	People's Bank of China
PPSR	Personal Properties Security Register
SAFE	State Administration of Foreign Exchange
SALB	Sale and Leaseback
SI	System Integrator
SME	Small and Medium-sized Enterprise
VAO	Vehicle Administrative Office
VAT	Value-added Tax





# Insurance Working Group

## Key Recommendations

### 1. Allow Foreign-invested Insurers to Shape their Distribution Networks as They See Fit

- Allow foreign-invested insurance companies to apply at any time for approval licences to open new branches in as many provinces as they believe necessary and to apply for branch licences in batches.
- Ensure that provincial licences cover the whole province without any further requirements at the sub-provincial level.
- Train, support and empower local China Banking and Insurance Regulatory Commission offices to handle licence applications from foreign-invested insurers.

### 2. Clarify that Foreign Shareholders Can Exercise their Equity Right Proportional to their Equity Shares

- Clarify how the *Guidelines for Corporate Governance of Banking and Insurance Institutions* apply to foreign-invested insurance companies in joint ventures, and more specifically how historical arrangements such as 50/50 governance models can be preserved in the future.

### 3. Build a Fair and Comprehensive Regulatory Environment that Encompasses Different Insurance Business Models

- Implement a level playing field for insurers of any size, as well as between insurers and online intermediaries, to ensure undistorted competition and fair treatment of consumers, and to support ongoing product innovation.

### 4. Create More Opportunities for Foreign Insurers to Contribute to China's Pension Reform

- Include foreign insurers in third-pillar pilot programmes and invite them to share their expertise.

## Introduction to the Working Group

The Insurance Working Group is the voice of Europe's insurance industry in China, and was the first of the European Chamber's working groups to be set up. It represents leading European insurers, brokers and other service providers engaged in life, non-life, reinsurance and speciality insurance. Insurance is a form of safety in an unpredictable world – it shields families, individuals and businesses alike from all kinds of risks that may arise from our modern and complex society. Insurance is therefore a key element for economic freedom, as it enables companies and

households to deploy their resources without having to worry about unforeseen events. Insurance is also a formidable engine of local and regional economic growth because it enables trade, innovation and risk protection. The insurance industry plays a vital role in improving the livelihoods, quality of life and wellbeing of all people, which is a key focus of China's common prosperity policy.<sup>1</sup>

<sup>1</sup> Chipman Koty, Alexander, *How to Understand China's Common Prosperity Policy*, China Briefing, 21<sup>st</sup> March 2022, viewed 21<sup>st</sup> June 2022, <<https://www.china-briefing.com/news/china-common-prosperity-what-does-it-mean-for-foreign-investors/#healthcareandwellnessHeader>>





While members of the Insurance Working Group have varying operational structures, all of them consider China a long-term priority market. They are fully committed to contributing to the sustainable growth of the Chinese insurance market and they are aware of the crucial role commercial insurance plays in China's economy and society. To this end, they want to provide added value to the industry by introducing best practices and technical know-how.

## Recent Developments

In over 40 years of reform and opening-up, China has grown into the world's second-largest insurance market after the United States. However, China's insurance market growth is largely based on the activities of domestic players, with no single foreign or Sino-foreign joint venture (JVs) insurers capturing over two per cent of the market. Most foreign-invested insurance companies that have entered the Chinese market are relatively small JVs, as regulatory restrictions still limit the rate of branch expansion and the percentage of foreign ownership.<sup>2</sup>

China has taken steps to foster the openness of its financial sector in recent years, encouraging the development of new insurance products and removing significant barriers for foreign insurers, such as the requirement to have operated for at least 30 years before entering China; the 50 per cent foreign ownership cap for life insurance JVs with a Chinese partner; and rules on the establishment and management of branches that specifically applied to foreign insurers.<sup>3</sup> As a result, a few foreign players have established wholly or majority foreign-owned companies, or increased their shareholding in JVs since 2019.<sup>4</sup>

Ensuring economic stability has also been among the Chinese Government's recent priorities and has guided its policymaking over the past years, with regulators issuing an increasing number of measures to contain hidden risks within the insurance sector. In 2021, the China Banking and Insurance Regulatory Commission (CBIRC) adopted over 30 new measures to improve

compliance management, safeguard the legal rights and interests of policyholders, and guarantee the competence of individuals occupying key functions in insurance companies.<sup>5</sup> Cybersecurity, data localisation, and data transfer and protection have also become increasingly pressing issues for European financial institutions in China.<sup>6</sup> Strict compliance with these regulatory requirements increases operational risks and associated costs.

In 2021, China's insurance sector struggled to generate profit as consumer demand faltered and the economy was shaken by a series of shocks, including sporadic COVID-19 outbreaks, a property market slump and regulatory crackdowns on various sectors.<sup>7</sup> For the second straight year, insurance companies in China reported a premium growth slowdown as well as lower investment returns. Insurance companies are shifting away from their traditional sales-focussed approach to a more productive model with products that better respond to consumer demand. The COVID-19 pandemic has also accelerated the transformation by pushing insurers to partner with technology companies to drive efficiency and expand capabilities. While demand for insurance is still huge, the sector needs to transform its services and products to meet customers' needs and take its business online to offer digital channels and remote sales solutions.<sup>8</sup>

## Key Recommendations

### 1. Allow Foreign-invested Insurers to Shape their Distribution Networks as They See Fit 20

#### Concern

It is challenging for foreign insurers to obtain approval from the CBIRC and its local offices to open or close provincial branches.

<sup>2</sup> *China market opportunities for foreign insurance companies under the new opening-up policies*, Deloitte, June 2020, viewed 22<sup>nd</sup> April 2022, <<https://www2.deloitte.com/cn/en/pages/financial-services/articles/china-market-opportunities-for-foreign-insurance-companies-under-the-new-opening-up-policies.html>>

<sup>3</sup> *Ibid.*

<sup>4</sup> *Ibid.*

<sup>5</sup> Zhan Hao et al., *Insurance and Reinsurance in China: Overview*, Thomson Reuters Practical Law, 1<sup>st</sup> December 2021, viewed 12<sup>th</sup> May 2022, <[https://uk.practicallaw.thomsonreuters.com/5-501-2000?transitionType=Default&contextData=\(sc.Default\)&firstPage=true#co\\_anchor\\_a850984](https://uk.practicallaw.thomsonreuters.com/5-501-2000?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a850984)>

<sup>6</sup> For more information on the impacts of cybersecurity and data protection in China, please refer to the *Cybersecurity Sub-working Group Position Paper 2022/2023*, p. 347.

<sup>7</sup> Kelsey Cheng and Wu Yujian, *China's Insurers Suffer Rocky First Quarter Amid Covid Fallout, Volatile Markets*, *Caixin Global*, 6<sup>th</sup> May 2022, viewed 10<sup>th</sup> May 2022, <<https://www.caixinglobal.com/2022-05-06/chinas-insurers-suffer-rocky-first-quarter-amid-covid-fallout-volatile-markets-101881410.html>>

<sup>8</sup> *Ibid.*





### Assessment

The current regulatory treatment of domestic and foreign insurance players is equal on paper, but because the Chinese market is perceived to be a very expensive investment, the number of new market entrants is low. In addition, the insurance market is still dominated by large domestic players that have the advantage of established branch networks. This is a significant disincentive for new foreign-invested entrants, which—as restrictions mean they can only open an average of one branch per year—face a seven-to-ten-year waiting period just to be able to cover less than one third of all Chinese provinces. Most companies that have already entered the China market found it more profitable to build their network with a Chinese partner; however, this may lead to other challenges, as the appetite for risk and profit between the two partners in such a JV is often different.

These dynamics impact the opening-up and reform of China's insurance sector because if foreign insurers do not perceive the Chinese market to be profitable, the overall growth rate of the market will slow down. If foreign-invested insurers could apply for branch licences in batches, instead of one province at a time, more players would be encouraged to enter the market, which in turn would help to foster a more competitive landscape. Once an insurance company has obtained a provincial licence, it would also be positive for China's insurance industry if this licence could cover the whole province without any further requirements at the sub-provincial level, such as the opening of sub-branches.

For insurance companies already based in China, part of the problem in expanding branches is that local CBIRC offices lack experience in dealing with foreign-invested insurers. This has an impact on licence applications and business development. Additional requirements at the sub-provincial level further impede market access or make it economically difficult for small insurers, including all foreign ones. As of July 2021, the CBIRC has delegated powers and authorities regarding the supervision of property and casualty (P&C) and life insurance companies to its provincial offices. In December 2020, the CBIRC issued the *Circular on Deepening the Reform of Streamlining Administration and Delegating Power, Improving Regulation and Upgrading Services and Optimising the Business*

*Environment in the Banking and Insurance Industries*.<sup>9</sup>

However, based on the working group's observations, local CBIRC offices are not familiar with the procedures and have to consult with headquarters before making decisions, which prolongs the approval process and adds more uncertainties for applicants. The working group therefore recommends, training, supporting and empowering local CBIRC offices to handle licence applications from foreign-invested insurers. In addition, The working group also recommends the CBIRC and its local offices should also clarify their powers and authority, based on which of the local offices publish guidelines concerning administrative licensing/approval management, and endeavour to accelerate the approval process.

### Recommendations

- Allow foreign-invested insurance companies to apply at any time for approval licences to open new branches in as many provinces as they believe necessary, and to apply for branch licences in batches.
- Ensure that provincial licences cover the whole province without any further requirements at the sub-provincial level.
- Train, support and empower local CBIRC offices to handle licence applications from foreign-invested insurers.

## 2. Clarify that Foreign Shareholders Can Exercise their Equity Right Proportional to their Equity Shares 2

### Concern

Under the *Guidelines for Corporate Governance of Banking and Insurance Institutions (Guidelines)* published by the CBIRC in June 2021, it is unclear whether foreign shareholders are able to exercise their full right to nominate directors for the board, or independent directors and supervisors, based on their proportion of equity shares.

### Assessment

The *Guidelines* stipulate that one shareholder, including its affiliates, shall not nominate directors for more than one third of all board seats, and impose similar

<sup>9</sup> *Circular on Deepening the Reform of Streamlining Administration and Delegating Power, Improving Regulation and Upgrading Services and Optimising the Business Environment in the Banking and Insurance Industries*, CBIRC, 30<sup>th</sup> December 2020, viewed 22<sup>nd</sup> April 2022, <<http://www.cbirc.gov.cn/view/pages/ItemDetail.html?docId=956594&itemId=928&generalType=0>>





limitations on nominations for independent directors and supervisors.<sup>10</sup> This means that for foreign life JV insurance companies with foreign shareholders' holdings equal to or higher than 50 per cent, the foreign shareholders will not be able to exercise their equity right based on the proportion of equity shares they hold.

This limitation imposed on director nomination rights is consistent with the requirement that one shareholder shall not hold more than one third of equity shares for local insurance companies as stipulated in the CBIRC's *Administrative Measures for the Equity of Insurance Companies*.<sup>11</sup> However, following reforms to China's financial sector, foreign shareholders can now hold up to 100 per cent of shares of a foreign-invested life or P&C insurance company. Therefore, the newly proposed limitation in the *Guidelines* is not consistent with rules stipulated in the CBIRC's *Circular on Clarifying the Time Point for Removing the Foreign Shareholding Percentage Limit on Joint Venture Life Insurance Companies*.<sup>12</sup> The working group, therefore, suggests that the regulator further clarifies whether foreign-invested insurance companies in JVs are excluded from the limitations imposed on director (as well as independent director and supervisor) nominations for shareholders.

The *Guidelines* also put a strong emphasis on the Chinese Communist Party's (CCP) role in corporate governance, requiring state-owned banks and insurance companies to ensure that: 1) CCP leaders are integrated into all aspects of corporate governance and their articles of association; 2) CCP members sit on the board of directors and senior management team; and 3) the CCP committee participates in the decision-making of major issues within the enterprise. Privately owned banks and insurance companies are only required to establish a CCP organisation to ensure "the core role of the Party and the implementation of the Party's lines and policies".<sup>13</sup> The *Guidelines* do not

define "state-owned" banks and insurance companies, which creates ambiguity, as the extent to which these requirements will apply to foreign-invested insurance JVs will depend on the CBIRC's interpretation. The working group, therefore, suggests that the regulator further clarify whether foreign-invested insurance companies in JVs are subject to the requirements to integrate the corporate CCP leadership into all aspects of corporate governance.

#### Recommendation

- Clarify how the *Guidelines* apply to foreign-invested insurance companies in JVs, and more specifically how historical arrangements such as 50/50 governance models can be preserved in the future.

### 3. Build a Fair and Comprehensive Regulatory Environment that Encompasses Different Insurance Business Models

#### Concern

The current regulatory framework, coupled with increasing compliance costs, results in an unlevel playing field and discourages innovation in the insurance industry.

#### Assessment

Insurance companies are having to change their business models due to increased digitalisation. This is reflected in the CBIRC's *Measures for Internet Insurance Business*, in which insurance companies using online platforms are included. Members of the Insurance Working Group increasingly see different types of insurance models being established, with a particular trend in insurers partnering up with technology companies. This has reshaped the value chain, with disruptive innovations and big data now enabling smarter solutions for processes and automation. This poses a challenge for both the regulator, which must draft and promulgate many dedicated regulations, and for insurance companies, which must comply with a growing number of regulations that are sometimes contradictory.

The access to online distribution for all insurance product categories should be identical for insurers of all sizes, i.e., qualitative prerequisites and any financial ratio thresholds should be the same. There should be no nominal thresholds, such as a minimum

<sup>10</sup> *Guidelines for Corporate Governance for Banking and Insurance Institutions*, CBIRC, 8<sup>th</sup> June 2021, viewed 22<sup>nd</sup> April 2022, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=989067&itemId=915&generalType=0>>

<sup>11</sup> *Administrative Measures for the Equity of Insurance Companies*, State Council, 2<sup>nd</sup> March 2018, viewed 22<sup>nd</sup> April 2022, <[http://www.gov.cn/gongbao/content/2018/content\\_5294432.htm](http://www.gov.cn/gongbao/content/2018/content_5294432.htm)>

<sup>12</sup> *Circular on Clarifying the Time Point for Removing the Foreign Shareholding Percentage Limit on Joint Venture Life Insurance Companies*, CBIRC, 6<sup>th</sup> December 2019, viewed 22<sup>nd</sup> April 2022, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=858344&itemId=928&generalType=0>>

<sup>13</sup> *Guidelines for Corporate Governance for Banking and Insurance Institutions*, CBIRC, 8<sup>th</sup> June 2021, viewed 22<sup>nd</sup> April 2022, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=989067&itemId=915&generalType=0>>





solvency capital, because this would exclude small and medium-sized insurers—potentially including most or all European insurers operating in China—from important segments of online distribution, especially on the life insurance side. Insurers which are small in terms of premium income, profit, nominal solvency capital or other key performance indicators should not be excluded from the online distribution of certain types of products. The product scope should reflect the recent low interest rate environment and differentiated consumer needs. Furthermore, life insurers should be allowed to sell online not only traditional life, annuity and pension products, but also products with profit participation and unit-linked products, while providing full transparency to consumers on what is guaranteed and what is not.

Most European life insurers have developed relevant expertise and a track record in their home markets to help mitigate the impact of lower interest rates on clients. Based on this experience, they can contribute to the further development of the Chinese life insurance market.

#### Recommendation

- Implement a level playing field for insurers of any size, as well as between insurers and online intermediaries, to ensure undistorted competition and fair treatment of consumers, and to support ongoing product innovation.

## 4. Create More Opportunities for Foreign Insurers to Contribute to China's Pension Reform

### Concern

China's three-pillar pension system—conceptually similar to many European countries but far more imbalanced, with low coverage and insufficient benefit adequacy—is not equipped to cater to China's rapidly ageing society.

### Assessment

Since 2014, when the Chinese Government announced plans to unify its urban and rural pension schemes by 2020, the authorities have paid greater attention to China's three-pillar pension system and, more particularly, to the reform and development of the second and third pillars consisting respectively of

employer-sponsored occupational annuities and personal savings-funded insurance.<sup>14</sup> A growing number of officials and economists are concerned about the sustainability of the current state-dominated system, warning that it might soon run short of funds.<sup>15</sup> As employer-sponsored pensions only cover a limited portion of the population, developing the private pension system—the third pillar—has become a priority for policymakers.<sup>16</sup>

In June 2021, the CBRIC initiated a one-year pilot scheme for commercial pension products in Zhejiang Province (including Ningbo) and Chongqing, allowing workers to open individual pension accounts at one of the six participating insurance companies, i.e., China Life Insurance, People's Life Insurance, Taiping Life Insurance, China Pacific Life Insurance, Taikang Life Insurance and Xinhua Life Insurance.<sup>17</sup> According to the CBIRC, the six insurers had underwritten nearly 50,000 policies worth a total of Chinese yuan (CNY) 400 million (United States dollars (USD) 63.2 million) as of January 2022, including almost 10,000 policyholders from the new economy sector, such as couriers and drivers of ride-hailing platforms.<sup>18</sup> On 15<sup>th</sup> February 2022, the CBIRC issued the *Notice on Expansion of the Pilot Scope of Exclusive Commercial Pension Insurance*, expanding its commercial pension pilot scheme nationwide from 1<sup>st</sup> March 2022, and allowing other pension providers, including state-owned national pension insurance, to participate.<sup>19</sup> The regulator has called on pension providers to keep exploring new products to cater to the needs of China's ageing population.

14 Jiang, Xueqing, *Final pillar of pension system investment in focus*, State Council, 16<sup>th</sup> November 2021, viewed 22<sup>nd</sup> April 2022, <[http://english.www.gov.cn/news/topnews/202111/16/content\\_WS619308c8c6d0df57f98e507b.html](http://english.www.gov.cn/news/topnews/202111/16/content_WS619308c8c6d0df57f98e507b.html)>

15 In 2018, the first pillar funds accounted for 74.7 per cent of total pension funds in China, while the funds in enterprise annuities and occupational annuities—the 'second pillar'—made up 25.3 per cent. See: *Insurance Operations - Building a Pension System in the Post-Epidemic and Post-Demographic Dividend Era*, National Institution for Finance and Development, 1<sup>st</sup> August 2020, viewed 22<sup>nd</sup> April 2022, <<https://mp.weixin.qq.com/s/0lap-m-wPXl880PmK0iuaA>>

16 Wu Yujian et al, *In Depth: China's Pension Insurers Told to Stop Pursuing Quick and Risky Profits*, *Caixin Global*, 10<sup>th</sup> March 2022, viewed 22<sup>nd</sup> April 2022, <<https://www.caixinglobal.com/2022-03-10/in-depth-chinas-pension-insurers-told-to-stop-pursuing-quick-and-risky-profits-101853868.html>>

17 *Notice on Launching the Pilot Programme for Exclusive Commercial Pension Insurance*, CBIRC, 15<sup>th</sup> May 2021, viewed 22<sup>nd</sup> April 2022, <<http://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=983945&itemId=925&generalType=0>>

18 *Notice on the Expansion of the Pilot Scope of Exclusive Commercial Pension Insurance*, CBIRC, 21<sup>st</sup> February 2021, viewed 22<sup>nd</sup> April 2022, <<https://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=1039066&itemId=915>>

19 *Notice on the Expansion of the Pilot Scope of Exclusive Commercial Pension Insurance*, CBIRC, 21<sup>st</sup> February 2021, viewed 22<sup>nd</sup> April 2022, <<http://www.cbirc.gov.cn/cn/view/pages/governmentDetail.html?docId=1039036&itemId=861&generalType=1>>



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On 21<sup>st</sup> April 2022, the State Council solicited public opinions on a framework for a private pension programme. The scheme outlined in the *Notice on Soliciting Public Opinions for the Development of Personal Pensions* will be government-backed and voluntary. People can decide whether to participate and which financial products to invest in, with preferential tax policies to be rolled out to encourage participation in the programme. Selected cities will carry out a trial run for a year before nationwide implementation.<sup>20</sup> The working group believes it would be valuable for China to allow foreign insurers to participate in this type of third-pillar pilot programme, to offer their expertise and help develop product innovation.

#### Recommendation

- Include foreign insurers in third-pillar pilot programmes and invite them to share their expertise.

## Abbreviations

CBIRC	China Banking and Insurance Regulatory Commission
CCP	Chinese Communist Party
CNY	Chinese Yuan
JV	Joint Venture
P&C	Property and Casualty
USD	United States Dollar

<sup>20</sup> *Notice on Soliciting Public Opinions for the Development of Personal Pensions*, State Council, 21<sup>st</sup> April 2022, viewed 22<sup>nd</sup> April 2022, <[http://www.gov.cn/zhengce/content/2022-04/21/content\\_5686402.htm](http://www.gov.cn/zhengce/content/2022-04/21/content_5686402.htm)>



# Section Six

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Forums

# 6





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## Corporate Social Responsibility Forum

The Corporate Social Responsibility (CSR) Forum is an event-driven platform that regularly organises meetings, training courses and events of interest to all European Chamber members. Established in 2005, it is now comprised of more than 250 member companies that cover a wide range of corporate functions, such as sustainability/CSR, marketing and communications, public relations, government relations, corporate governance and compliance, human resources, the environment, and health and safety.

The CSR Forum promotes best practices established by European companies and emphasises the importance of a strategic and innovative approach to CSR. Furthermore, the forum fosters CSR collaboration and co-innovation between the European Chamber, Chinese government agencies, professional organisations and local non-governmental organisations.

As the shared goal and common interest of both the European Union (EU) and China, carbon neutrality is and will continue to be the focus of the CSR community. In 2019, as part of efforts to transition its economy to a sustainable and resource-efficient economic model, the EU launched its Green Deal strategy, and stated its aim to be climate neutral—an economy with net-zero greenhouse gas emissions—by 2050. The Chinese Government has also repeatedly emphasised the importance of establishing a sustainable economy as part of its national strategy to reach 'carbon peak' by 2030 and 'carbon neutrality' by 2060.<sup>1</sup> Many European Chamber member companies have also made carbon commitments and set themselves decarbonisation goals. Moreover, proactive engagement in transitioning to low-carbon operations will bring members' significant opportunities for corporate development.

To offer members a platform to share best practices, the CSR Forum held 22 activities—including meetings, seminars and conferences on topics such as China's 30/60 carbon neutrality goals—in Beijing and Shanghai in 2021. In addition, regular forum meetings also covered a wide range of topics, including corporate sustainability strategy planning, dealing with pandemic-related disruptions, diversity and inclusion, circular supply chain management, and common prosperity.

The European Chamber held its 5<sup>th</sup> Sustainable Business Awards and its 7<sup>th</sup> CSR Awards in 2021, and continues to host dialogues on topics related to CSR through its *Corporate Social Profitability Chief Executive Officer/VIP Talk* series. This series brings together corporate leaders for high-level discussions on the importance of incorporating sustainability and innovation into strategic decision-making to improve companies' bottom lines.

The European Chamber has established strong partnerships with governmental stakeholders such as the EU Delegation to China, the Norwegian Consulate General in Shanghai, the Dutch Embassy, the Swedish Embassy and the German Embassy to advocate CSR awareness and responsible business conduct in the business community.

In 2022/2023, the Corporate Social Responsibility Forum will continue to foster dialogue between European Chamber member companies and Chinese stakeholders to promote the best European CSR practices and explore new, innovative ways to act sustainably.

<sup>1</sup> *Carbon Peak and Carbon Neutrality 30/60 Targets Kicks Off a New Era of Low Carbon*, Tencent News, 5<sup>th</sup> March 2021, viewed 2<sup>nd</sup> April 2022, <<https://new.qq.com/omn/20210305/20210305A0DAWP00.html>>





## Government Affairs Forum

Established in 2011, the Government Affairs Forum consists of government affairs (GA) professionals from European Chamber member companies that represent a wide range of industries. Most of the forum's participants have a great deal of experience in GA and policy advocacy at the local and national level in both Europe and China. The overall aim of the Government Affairs Forum is to promote a fair business environment in China, by helping member companies to understand and navigate China's challenging regulatory landscape, an area that lacks transparency and predictability.

The forum frequently hosts meetings featuring speakers from academia, industry and the Chinese Government. As a result, the forum has established itself as a platform for sharing best practices, social networking and where members can learn more about recently-enacted policies and the latest GA trends. This forum is open to all members of the European Chamber.

In 2021, the forum solicited members' comments on the *Regulations of China (Beijing) Pilot Free Trade Zone* and the *Catalogue of Industries Encouraging Foreign Investment 2021*, and submitted this information to the Beijing Municipal Bureau of Commerce, the Beijing Municipal Development and Reform Commission and the National Development and Reform Commission (NDRC). The purpose of submitting members' opinions and suggestions, on these regulations and others, is to promote a level playing field, contribute towards China's economic development and to enhance European Union (EU)-China cooperation.

The Government Affairs Forum provides a platform for dialogue with all levels of the Chinese Government. It gives local policymakers the opportunity to provide policy interpretations so that forum members can better understand important industry and regional developments.

In March 2021, the forum met with officials from Beijing's Tongzhou District to learn more about the development of the Beijing sub-centre.

In May 2021, the forum invited officials from the China (Beijing) Pilot Free Trade Zone and Integrated National Demonstration Zone for Opening up the Service Sector Leading Group (the Two Zone Office) to introduce the Two Zones.

In July 2021, at the national level, the forum participated in the EU-China Green Development Partnership Dialogue hosted by the NDRC.

In October 2021, approximately 70 members attended a meeting with representatives from the Beijing Bureau of Ecology and Environment, who provided analysis of the capital's decarbonisation policies.

In December 2021, the forum held a seminar on the role that GA functions play in crisis management, with over 20 members participating. A GA expert shared her insights through case studies and gave guidance to members on how to better interact with Chinese government authorities.





## Manufacturing Forum

Since its establishment in 2012, the Manufacturing Forum has kept pace with the ever-changing challenges faced by European manufacturing companies operating in China.

The forum is comprised of 150 member companies that cover a wide range of industries, such as automotive, consumer goods, electronics, energy, healthcare, machinery, petrochemicals and telecommunications. It functions as a platform for sharing practical information between members and supporting their operations in China.

Throughout 2021 and early 2022, the forum organised many events, including meetings, factory tours, seminars and training courses. Topics covered in these events included: decarbonisation, energy-saving policies, power shortages and the impact of the travel restrictions—such as hindering experts from travelling to China to upgrade machinery and train local teams—as well as disruptive innovation; lean management; and the lack of talent in the Greater Bay Area within the manufacturing industry, among others.

The forum also has a WeChat group for members that allows them to share information in a timely manner, and exchange experiences and ideas conveniently and efficiently. Issues that emerged for discussion via the WeChat group include:

- local regulation updates;
- industry information;
- human resources concerns;
- requests for help from the European Chamber; and
- requests for help from other members.

In May and September 2021, manufacturers in several Chinese provinces were forced to shut down production with little or no notice from their local governments, which imposed the measures in order to curb energy consumption and as part of China's planned energy transition to renewable sources. In response, the European Chamber took coordinated actions at both national and local levels to help members communicate with the relevant authorities and solve their issues. The Manufacturing Forum also helped member companies organise a series of events, giving practical solutions through best-practices sharing, updates on energy transition trends and advice on how to upgrade their energy usage and achieve their carbon neutrality goals.

In addition, due to the wave of COVID-19 outbreaks across various regions in early 2022, local governments enacted a series of measures relating to international courier services, with strict requirements for the decontamination of all components coming from abroad. The forum organised exchange meetings with local authorities on the topic, and actively sought government updates on the relevant policies.

Going forward, the Manufacturing Forum intends to continue to engage members by organising more interactive activities and providing information on industry-related topics, such as manufacturing innovation, supply chain management and energy transition. The forum will also focus on the potential future opportunities for European enterprises operating in China in respect to new technologies (such as artificial intelligence, fifth generation mobile technology and autonomous driving) and decarbonisation (such as 'clean tech'—environmentally friendly practices and technologies—and energy efficiency).





## Marketing and Communications Forum

The Marketing and Communications Forum is comprised of marketing and communications professionals from a wide range of industries. They represent nearly 400 member companies based in the European Chamber's Beijing, Shanghai and South China chapters. Through regular activities such as meetings, seminars and training sessions, the forum provides a platform to exchange information, experiences and best practices among members on the best use of marketing and communications to achieve business objectives in China.

Looking back over 2021, it is obvious that markets continued to be influenced by the COVID-19 pandemic, causing disruptions to business operations. Despite this looming shadow, the global economy is steadily, if slowly, recovering. Against this backdrop, the Marketing and Communications Forum's events placed a spotlight on innovative marketing strategies and digitalisation processes that optimise sales revenue. They also provided a platform to discuss emerging trends with member companies, and to share suggestions and best practices.

The Marketing and Communications Forum started 2021 with events on marketing trends and strategy sharing in January and March, organised by the Beijing and South China chapters respectively. In addition, due to the intensified political sensitivities of doing business in China, the forum organised a webinar in March on crisis communication, traditionally always a popular topic. Speakers shared their professional experiences in public relations relating to dealing with crises.

The forum also organised a series of events aimed at helping member companies utilise tools and technologies to better realise growth targets. For example, an event in May introduced innovative project management theories and tools for marketing professionals, while another event in November illustrated how marketing technology can empower company branding and growth.

The e-commerce market continued to grow – according to *Xinhua*, China's annual online commodity sales broke the Chinese yuan (CNY) 10 trillion threshold for the first time in 2021.<sup>1</sup> Tapping into this trend, in April the forum organised a webinar on the Chinese e-commerce market, providing advice on entering the China market through e-commerce platforms. By presenting a clear overview of the Chinese e-commerce market, the webinar showed how brands need to adapt to the digitalisation trend and localise their branding to suit Chinese consumers' preference for online platforms.

Video is now one of the most popular means of obtaining information, making it an increasingly important and influential tool for companies to convey their key messages. Enterprises are increasingly choosing to provide video content on their media channels to engage followers. Therefore, the Marketing and Communications Forum organised experience-sharing sessions on video marketing in Beijing in September 2021 and in the South China Chapter a month later.

The Marketing and Communications Forum will continue to hold events relevant to members' interests in the coming year. In parallel, training courses on content marketing, social media, crisis management, video marketing and live-streaming will also be provided across all chapters, helping members to constantly improve their professional marketing and communications skillsets.

<sup>1</sup> China's Annual Online Commodity Sale Broke the 1000 Billion RMB Threshold For The First Time in 2021, *Xinhua*, 28<sup>th</sup> January 2022, viewed 2<sup>nd</sup> March, <[http://www.gov.cn/xinwen/2022-01/28/content\\_5670892.htm](http://www.gov.cn/xinwen/2022-01/28/content_5670892.htm)>





## Small and Medium-sized Enterprise Forum

Comprised of more than 200 European small and medium-sized enterprises (SMEs), the European Chamber's Small and Medium-sized Enterprise Forum was established in 2005 to provide a platform for SME members to share experiences and gain practical information on how to successfully operate in China. Relevant stakeholders also include European and Chinese government officials and SME support service organisations, such as the European Union (EU) SME Centre and China Intellectual Property (IP) SME Helpdesk.

SMEs face numerous challenges in China's increasingly competitive markets. As national issues in 2021 evened out, additional focus was put on local issues like securing funding through Greater Bay Area subsidies. However, certain difficulties remain unaddressed. Attracting, hiring and retaining talent, for instance, is an issue critical to every SME's operations that is greatly exacerbated by the restrictive COVID-19-related travel and quarantine policies imposed by China on international travellers.

In 2021, China continued to encourage development of the SME sector, specifically with commitments in the 14<sup>th</sup> Five-year Plan to improve the business and innovation environment for small businesses, as well as plans to strengthen China's middle-income group. Moreover, in the same spirit, the National Development and Reform Commission indicated in its 2022 Plan for National Economic and Social Development that emphasis would be placed on improving the business environment for SMEs in order for them to thrive in China, as well as providing opportunities for them to work in conjunction with larger companies to meet national goals.<sup>1</sup>

Nevertheless, European SMEs regularly report encountering market access barriers or discretionary implementation of regulations while conducting business in China.<sup>2</sup> To help European SMEs overcome these challenges, the Small and Medium-sized Enterprise Forum maintains a strong network for companies to share resources and insights on the regulatory environment. The forum also works closely with relevant European Chamber working groups to ensure that specific SME requirements and concerns are voiced in any advocacy activities.

In 2021, the Small and Medium-sized Enterprise Forum organised many events in the European Chamber's Beijing, Shanghai and South China chapters. These events focussed on areas such as policy environment, regional business opportunities and intellectual property, among others. In addition, a new branch of the forum was established in 2021 by the Tianjin Chapter.

In 2022/2023, the forum will remain a source of regular policy updates, as well as insights on topics such as talent management, best-practice sharing, and new regulations and guidelines that may impact SME operations. The forum will also continue to provide a platform and opportunities for European SMEs to share solutions to common problems and to foster success.

<sup>1</sup> Plan downloadable from: *China releases reports on budgets, national economic and social development plans*, State Council Information Office, 14<sup>th</sup> March 2022, viewed 20<sup>th</sup> April 2022, <[http://english.scio.gov.cn/topnews/2022-03/14/content\\_78106885.htm](http://english.scio.gov.cn/topnews/2022-03/14/content_78106885.htm)>

<sup>2</sup> *European Business in China Business Confidence Survey 2021*, European Union Chamber of Commerce in China, 10<sup>th</sup> June 2021, viewed 20<sup>th</sup> April 2022, <<https://www.europeanchamber.com.cn/en/publications-business-confidence-survey>>





## Sports Forum

The Sports Forum is a platform intended to connect European Chamber member companies in the sports industry for the purposes of insight and business intelligence-sharing. It also aims to bring together European sports companies, government stakeholders and local communities through the integration of sports, education and business, and to contribute to the development of the sports environment in China in a cooperative and non-politicised manner. The Sports Forum was established in late November 2020 by six European Chamber members that rank among Europe's top sports companies. Within the next 18 months, the forum grew to comprise 34 member companies.

The Sports Forum follows the positive spirits of the Olympic Games: faster; higher; stronger; together. Ahead of the Beijing Winter Olympics 2022, the European Chamber held a meeting with Gou Zhongwen, minister of the General Administration of Sports (GAS) and chair of the Beijing Olympic Committee, to discuss how the European Chamber can promote the development of sports and the Olympic spirit in China. The European Chamber has established strong partnerships with the GAS and the Shanghai Administration of Sports (SAS). The Chamber signed five-year cooperation agreement with the GAS on 1<sup>st</sup> November 2021, committing both sides to cooperating on the development of sporting activities, and the promotion of sports-related industries and events.

Sport can improve living standards, help individuals in their pursuit of a better life, promote economic and social development, and achieve the goals of Healthy China 2030. Youth sport, in particular, is a priority for the Chinese Government. This, alongside the integration of sport and education, and the coordination of cultural learning and physical exercise, are focal points of the China Sports Law,<sup>1</sup> in drafting at the time of writing, and the *14<sup>th</sup> Five-year Plan for the Development of Sports*.<sup>2</sup> The Sports Forum supports China's national Integration of Sports and Education strategy,<sup>3</sup> and hopes to establish further cooperation to better facilitate the sports industry and this programme.

Since its formation, the forum has held 11 activities, including meetings and roundtable discussions, in both Beijing and Shanghai. In the coming year, the Sports Forum will continue to organise events and foster dialogue between European Chamber member companies and Chinese stakeholders to promote the benefits of sports, and work with relevant government agencies and other stakeholders to exchange best practices in sports in both the European Union and China.

1 [Call for comments] *China Sports Law draft and its explanation*, Tencent News, 5<sup>th</sup> November 2021, viewed 1<sup>st</sup> April 2022, <<https://new.qq.com/omn/20211105/20211105A02QHW00.html>>

2 *Notice of the General Administration of Sport on the issuance of the 14<sup>th</sup> Five-year Plan for the Development of Sports*, GAS, 8<sup>th</sup> October 2021, viewed 1<sup>st</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2021-10/26/content\\_5644891.htm](http://www.gov.cn/zhengce/zhengceku/2021-10/26/content_5644891.htm)>

3 *Notice of the General Administration of Sports and the Ministry of Education on the Issuance of Opinions on Deepening the Integration of Sports and Education and Promoting Healthy Youth Development*, GAS and Ministry of Education, 31<sup>st</sup> August 2020, viewed 1<sup>st</sup> April 2022, <[http://www.gov.cn/zhengce/zhengceku/2020-09/21/content\\_5545112.htm](http://www.gov.cn/zhengce/zhengceku/2020-09/21/content_5545112.htm)>





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# 7 Section Seven

## Appendix



## Abbreviations

14FYP	14 <sup>th</sup> Five-year Plan
30/60 Goals	China's plan to peak carbon emissions before 2030 and achieve carbon neutrality by 2060
5G	Fifth Generation Mobile Network
ABS	Asset-backed Securitisation
AFB	Agriculture, Food and Beverage
AFC	Auto Finance Company
ADAS	Advanced Driver Assistance System
ADR	Alternative Dispute Resolution
AEO	Authorised Economic Operator
AFC	Auto Finance Company
AI	Artificial Intelligence
AICM	Association of International Chemical Manufacturers
AMC	Asset Management Company
AML	Anti-money Laundering
AML	Anti-monopoly Law
AMP	Alternative Marine Power
AQSIQ	General Administration of Quality Supervision, Inspection and Quarantine
ATEX	Equipment for Potentially Explosive Atmospheres
ATM	Air Traffic Management
AUCL	Anti-unfair Competition Law
BASA	Bilateral Aviation Safety Agreement
bcm	Billion Cubic Metres
BCS	Business Confidence Survey
BEV	Battery Electric Vehicle
BMI	Basic Medical Insurance
BRI	Belt and Road Initiative
CAAC	Civil Aviation Administration of China
CAC	Cyberspace Administration of China
CAI	Comprehensive Agreement on Investment
CAICT	China Academy of Information and Communication Technology
CANSI	China Association for National Shipbuilding Industry
CAS	Chinese Accounting Standards
CBAM	Carbon Border Adjustment Mechanism
CBIRC	China Banking and Insurance Regulatory Commission
CBRC	China Banking Regulatory Commission
cc	Cubic Centimetre
CCC	China Compulsory Certification
CCE	Continued Compliance Education
CCER	Chinese Certified Emission Reduction
CCP	Chinese Communist Party
CCPIT	China Council for the Promotion of International Trade
CCPS	Classified Cybersecurity Protection Scheme
CCS	China Classification Society
CD	Certificate of Deposit
CDE	Center for Drug Evaluation



CDMD	Consumable and Disposable Medical Devices
CDS	Customs Declaration Sheet
CEA	China Emission Allowance
CEPL	Circular Economy Promotion Law
CFC	Corporate Finance Company
CFDA	China Food and Drug Administration
CFE	Centre for Food Evaluation
CFETS	China Foreign Exchange Trade System
CGHC	China Gas Heating Specialty Committee
CGT	Cell and Gene Therapy
CGT	Common Ground Taxonomy
CGT	Compensated Gross Tonnage
CHC	Chinese Holding Company
CHI	Commercial Health Insurance
ChP	Chinese Pharmacopeia
CIBM	China Interbank Bond Market
CIFER	China Import Food Enterprises Registration
CII	Critical Infrastructure Information
CIT	Corporate Income Tax
CLE	Continued Legal Education
CMC	Chemistry Manufacturing Control
CMDE	Centre for Medical Device Evaluation
CNCA	Certification and Accreditation Administration of China
CNIPA	China National Intellectual Property Administration
CNY	Chinese Yuan
CO <sub>2</sub>	Carbon Dioxide
COCIR	European Coordination Committee of the Radiological, Electromedical and Healthcare Information Technology Industry
COD	Commercial Operation Date
COMAC	Commercial Aircraft Corporation of China
CORSIA	Carbon Offsetting and Reduction Scheme for International Aviation
COP	Conference of Parties
CPCIF	China Petroleum and Chemical Industry Federation
CRR	Capital Requirements Regulation
CSA	Coordination and Support Action
CSAR	Cosmetics Supervision and Administration Regulation
CSDC	China Securities Depository and Clearing Corporation Limited
CSL	Cybersecurity Law
CSP	Construction Service Provider
CSRC	China Securities Regulatory Commission
CSRD	Corporate Sustainability Reporting Directive
CSRM	Cybersecurity Review Measures
CT	Cycle Threshold
CTG	Coal-to-gas
CV	Commercial Vehicle
CVD	Coordinated Vulnerability Disclosure
DAL	Drug Administration Law
DCM	Drug Committee Meetings
DDR	Deposit Deviation Ratio
DES	District Energy Systems

DG	Dangerous Goods
DGR	Dangerous Goods Regulations
DIP	Diagnosis-intervention Package
DMV	Department of Motor Vehicles
DOJ	Department of Justice
DPL	Data Protection Law
DRG	Diagnosis-related Group
DRS	Deposit and Return System
DRR	Drug Registration Regulation
DSL	Data Security Law
DVFA	Danish Veterinary and Food Administration
DWT	Dead Weight Tonnage
EAL	Evaluation Assessment Level
EASA	European Aviation Safety Agency
ECHI	Europe China Heating Initiative
ECL	Export Control Law
ECN	European Competition Network
EDS	Express Delivery Services
EE	Energy Efficiency
EHS	Environment, Health and Safety
ELC	Equipment Leasing Company
EMA	European Medicines Agency
EPC	Engineering Procurement Construction
EPR	Extended Producer Responsibility
ESCO	Energy Service Company
ESG	Environmental, Social and Governance
ETS	Emissions Trading System
ETS	Energy Trading System
EU	European Union
EUR	Euro
EV	Electric Vehicle
FAO	Foreign Affairs Office
FAQ	Frequently-asked-Questions
FCEV	Fuel Cell Electric Vehicles
FCM	Food Contact Materials
FCPA	Foreign Corrupt Practices Act
FDI	Foreign Direct Investment
FI	Financial Institution
FICLS	Foreign-invested Company Limited by Shares
FIE	Foreign-invested Enterprise
FIL	Foreign Investment Law
FOP	Front of Package
FSMP	Food for Special Medical Purpose
FTP	Free Trade Port
FTZ	Free Trade Zone
FYP	Five-year Plan
G	Mobile Technology Generation
GA	General Aviation
GACC	General Administration of Customs of People's Republic of China
GB	Guobiao



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GCW	Gross Combination Weight
GDP	Gross Domestic Product
GEC	Green Electricity Certificate
GFE	Guangzhou Futures Exchange
GFMA	Global Financial Market Associations
GHG	Greenhouse Gas
GHz	Gigahertz
GI	Geographical Indication
GM	Genetically Modified
GMM	Genetically Modified Microorganism
GPA	Government Procurement Agreement
GPL	Government Procurement Law
GW	Gigawatt
HC	Hazardous Chemicals
HED	European Union-China High Economic and Trade Dialogue
HGR	Human Genetic Resources
HNTE	High and New-Technology Enterprise
HQ	Headquarters
HQLAAR	High-quality Liquid Asset Adequacy Ratio
HR	Human Resources
HSA	Health Security Administration
HSE	Health, Safety and Environment
HVAC	Heating, Ventilation and Air Conditioning
IaaS	Infrastructure as a Service
IATA	International Air Transport Association
ICAO	International Civil Aviation Organization
ICH	International Council for Harmonisation of Technical Requirements for Pharmaceuticals for Human Use
ICMRA	International Coalition of Medicines Regulatory Authorities
ICT	Information and Communications Technology
ICV	Intelligent and Connected Vehicles
IDC	Internet Data Centre
IDF	International Dairy Federation
IEC	International Electrotechnical Commission
IMF	International Monetary Fund
IMO	International Maritime Organization
IMT	International Mobile Telecommunications
IoT	Internet of Things
IP	Intellectual Property
IPI	International Procurement Instrument
IPR	Intellectual Property Rights
IP-VPN	Internet Protocol Virtual Private Network
IRC	Internet Resource Collaboration
ISO	International Organization for Standardization
IT	Information Technology
ITU	International Telecommunication Union
IVD	In-vitro Diagnostics
JV	Joint Venture
kg	Kilogram
km	Kilometre

KPI	Key Performance Indicators
KR	Key Recommendation
kW	Kilowatt
LDR	Loan to Deposit Ratio
LMR	Liquidity Matching Ratio
LNG	Liquefied Natural Gas
m <sup>2</sup>	Square Metre
M&A	Mergers and Acquisitions
MAA	Marketing Authorisation Application
MAD	Mutual Acceptance of Data
MAH	Marketing Authorisation Holder
MARA	Ministry of Agriculture and Rural Affairs
MED	Marine Equipment Directive
MEE	Ministry of Ecology and Environment
MEM	Ministry of Emergency Management
MEP	Minimum Energy Performance Standards
MFA	Human Resources
MHz	Megahertz
MIIT	Ministry of Industry and Information Technology
MNC	Multinational Corporations
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
MOH	Ministry of Health
MOHRSS	Ministry of Human Resources and Social Security
MOHURD	Ministry of Housing and Urban-Rural Development
MOJ	Ministry of Justice
MOST	Ministry of Science and Technology
MOT	Ministry of Transport
MOU	Memorandum of Understanding
MPA	Macro-prudential Assessment
MPS	Ministry of Public Security
mRNA	Messenger Ribonucleic Acid
MRV	Monitoring, Reporting and Verification
MSA	Maritime Safety Administration
MSME	Micro Small, and Medium-sized Enterprise
NAB	National Anti-monopoly Bureau
NAB	Non-alcoholic Beer
NAFMII	National Association of Financial Markets Institutional Investors
NBFI	Non-banking Financial Institution
NBS	National Bureau of Statistics
NDM	National Declaration Model
NDRC	National Development and Reform Commission
NEA	National Energy Administration
NEV	New Energy Vehicle
NG	Natural Gas
NGO	Non-governmental Organisation
NHC	National Health Commission
NHFPC	National Health and Family Planning Commission
NHSA	National Healthcare Security Administration
NIA	National Immigration Administration



NIP	National Immunisation Programme
NMPA	National Medical Products Administration
NOx	Nitrogen Oxide
NPC	National People's Congress
NPCSC	Standing Committee of National People's Congress
NPL	Non-performing Loan
NRA	National Railway Administration
NRDL	National Reimbursement Drug List
NVOCC	Non-vessel Operating Common Carriers
OE	Original Equipment
OECD	Organisation for Economic Cooperation and Development
OEM	Original Equipment Manufacturer
P&C	Property and Casualty
PaaS	Platform as a Service
PAC	Priority Assessment Chemicals
PBOC	People's Bank of China
PC	Personal Computer
PCC	Priority Control Chemicals
PCR	Petrochemicals, Chemicals and Refining
PCR	Polymerase Chain Reaction
PDG	Pharmacopeial Discussion Group
PDP	Pollutant Discharge Permit
PET	Polyethylene Terephthalate
PHEV	Plug-in Hybrid Electric Vehicle
PIC/S	Pharmaceutical Inspection Cooperation Scheme
PIPL	Personal Information Protection Law
PM	Particulate Matter
PMI	Purchasing Managers Index
PPA	Power Purchase Agreement
PPP	Purchasing Power Parity
PSB	Public Security Bureau
PRC	People's Republic of China
PRDL	Provincial Reimbursement Drug List
PTA	Patent Term Adjustment
PTE	Patent Term Extension
PTE	Purchase Tax Exemption
PTL	Patent Linkage
Q&A	Question-and-Answer
QC	Quality Control
QSS	Quality and Safety Services
R&D	Research and Development
RDP	Regulatory Data Protection
RE	Real Estate
RE	Renewable Energy
REACH	Registration, Evaluation, Authorisation and Restriction of Chemicals
RMB	Renminbi
RMOA	Risk Management Option Analysis
ROP	Refined Oil Products
rPET	Recycled Polyethylene Terephthalate
RPS	Reimbursement Payment Standards

RPS	Renewables Portfolio Standard
S&T	Science and Technology
SaaS	Software as a Service
SAC	Standardisation Administration of China
SAF	Sustainable Aviation Fuel
SAFE	Standards to Secure and Facilitate Global Trade
SAFE	State Administration of Foreign Exchange
SALB	Sale and Leaseback
SAMR	State Administration for Market Regulation
SARS	Severe Acute Respiratory Syndrome
SC	State Council
SCA	Standards and Conformity Assessment
SCA	State Cryptography Administration
SCH	Shanghai Clearing House
SCS	Social Credit System
SDG	Sustainable Development Goal
SEC	Securities and Exchange Commission
SF6	Sulphur Hexafluoride
SHEEX	Shanghai Environment and Energy Exchange
SI	System Integrator
SME	Small and Medium-sized Enterprise
SOE	State-owned Enterprise
SPB	State Post Bureau
SPC	Supreme People's Court
SSE	Shanghai Shipping Exchange
STA	State Taxation Administration
TAC	Type Approval Certificate
TBL	Tender and Bidding Law
TBT	Technical Barriers to Trade
TC	Technical Committee
TC209	Technical Committee of Textile Standardisation
TC260	National Information Security Standardisation Technical Committee
THC	Terminal Handling Charges
TIC	Testing, Inspection and Certification
TIP	Technical Implementation Procedure
TML	Trademark Law
TPA	Third-party Access
TTC	Threshold of Toxicological Concern
UAS	Unmanned Aircraft System
UAV	Unmanned Aerial Vehicle
UK	United Kingdom
UN	United Nations
UNEA	United Nations Environment Assembly
US	United States
USD	United States Dollars
UTM	UAS Traffic Management
VAO	Vehicle Administrative Office
VAT	Value-added Tax
VATS	Value-added Telecoms Services
VBP	Volume-based Procurement



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VOC	Volatile Organic Compounds
VUCA	Volatility, Uncertainty, Confusion and Ambiguity
WCO	World Customs Organization
WFOE	Wholly Foreign-owned Enterprise
WHO	World Health Organisation
WiGig	Wireless Gigabit
WIPO	World Intellectual Property Organization
WRC	World Radiocommunication Conference
WSC	World Semiconductor Council
WTO	World Trade Organization





**European Chamber**  
中国欧盟商会

**Beijing**

Tel: +86 (10) 6462 2066  
Fax: +86 (10) 6462 2067  
Email: [euccc@european-chamber.com.cn](mailto:euccc@european-chamber.com.cn)

**Nanjing**

Tel: +86 (25) 8362 7330  
Fax: +86 (25) 8362 7332  
Email: [nanjing@european-chamber.com.cn](mailto:nanjing@european-chamber.com.cn)

**Shanghai**

Tel: +86 (21) 6385 2023  
Fax: +86 (21) 6385 2381  
Email: [shanghai@european-chamber.com.cn](mailto:shanghai@european-chamber.com.cn)

**Shenyang**

Tel: +86 (24) 3198 4229  
Fax: +86 (24) 3198 4229  
Email: [shenyang@european-chamber.com.cn](mailto:shenyang@european-chamber.com.cn)

**South China - Guangzhou**

Tel: +86 (20) 3801 0269  
Fax: +86 (20) 3801 0275  
Email: [southchina@european-chamber.com.cn](mailto:southchina@european-chamber.com.cn)

**South China - Shenzhen**

Tel: +86 (755) 8632 9114  
Fax: +86 (755) 8632 9785  
Email: [southchina@european-chamber.com.cn](mailto:southchina@european-chamber.com.cn)

**Southwest - Chengdu**

Tel: +86 (28) 8527 6517  
Fax: +86 (28) 8527 6517  
Email: [chengdu@european-chamber.com.cn](mailto:chengdu@european-chamber.com.cn)

**Southwest - Chongqing**

Tel: +86 (23) 6308 5669  
Fax: +86 (23) 6308 5669  
Email: [chongqing@european-chamber.com.cn](mailto:chongqing@european-chamber.com.cn)

**Tianjin**

Tel: +86 (22) 5830 7608  
Fax: +86 (22) 5830 7608  
Email: [tianjin@european-chamber.com.cn](mailto:tianjin@european-chamber.com.cn)