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European Chamber
中国欧盟商会

European Business in China

POSITION PAPER 2018/2019

The *European Business in China Position Paper 2018/2019* represents the views of the European Union Chamber of Commerce in China. Our working groups, fora and more than 1,600 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.

European Union Chamber of Commerce in China

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The information contained herein is based on input and analysis from January 2018 to July 2018.

The information is provided for informational purposes only, and should not be construed as business or legal advice on any specific facts or circumstances. No users of this position paper should act or refrain from acting on the basis of any content included, without seeking appropriate professional advice.

The European Union Chamber of Commerce in China does not assume any legal liability or responsibility for the accuracy and completeness of the information provided in the position paper.

Message from the President

As president of the European Union Chamber of Commerce in China (European Chamber), I am very proud to present this year's *European Business in China Position Paper* (*Position Paper*), which is a bottom-up product involving the collective efforts of hundreds of people over the course of six months.

The *Position Paper* continues to be our core publication and is the cornerstone of our advocacy efforts. Knowing that the *Position Paper* is carefully read not only in Beijing and Brussels, but also throughout Chinese provinces and European Union (EU) Member States, and even as far as Washington, we always ensure that we present our recommendations in a fact-based and constructive way. I am always pleased to see copies of this publication when we meet with our counterparts in both the Chinese and EU governments.

This year, we cover China's 40th year of reform and opening and the fifth anniversary of the Third Plenum *Decision*. It is amazing how far China has come since I first set foot in Beijing back in 1982, and there have been so many areas of improvement, but in order for China to become a modern economic powerhouse much work remains.

The executive *Position Paper* examines 14 common concerns faced by European companies. These issues continue to hold back China's development and prevent businesses from serving their core function: to provide goods and services demanded by consumers, downstream companies and society as a whole. Each of these issues should be viewed by Chinese officials as a challenge to overcome in the years ahead.

Removing these hurdles is especially important this year, during which China celebrates 40 years of its Open-door Policy. Internal pressure is quickly building, with Chinese consumers demanding access to more, better and safer goods and services. External pressure is growing as well. China has already become a major global trading and investment force and the worldwide effects of a China that does not always follow globally-established norms is creating tension. While the escalation of tariffs by the United States represents a sharp and disconcerting response to the shortcomings of China's reform agenda, it is based on concerns that are common with other economic powers, including the EU. Remedying this situation by solving the challenges raised in this report should be pursued, because it is good for China and good for the world.

Both Chinese and global leaders must not lose sight of the bigger picture-China's economy, despite being the world's second largest, still has huge potential to grow by increasing the scope of its economic activity. By doing so, European investment into China will finally be able to reach its full potential, which would be much more than the meagre trickle seen in recent years.

We do not question the willingness of China's top leadership to continue to open up and reform, but a new approach is needed to implement change. It is not sufficient that the top leadership is committed to reform and opening-all levels of government need to embrace this direction. After all, many of the problems faced by international companies are not necessarily an expression of state policy, but instead result from poor regulations designed by lower-level officials that are inconsistently enforced. While the European Chamber recognises such difficulties, our member companies cannot wait indefinitely for these much-needed reforms.

Each industry solves specific problems for customers and for society. Regulations should be formulated to allow all industries to perform their core functions in the most efficient way possible. By shifting to this mentality, Chinese regulators can help maximise business opportunities while benefiting society as a whole.

To help tackle these challenges, our working groups, sub-working groups and fora have prepared 33 papers with a accumulative total of 828 recommendations. These are based on concerns raised by the European Chamber's more than 1,600 member companies. They represent countless years of experience and an immense depth of knowledge. All of this expertise is made available to Chinese officials that are ready to see through the measures necessary for China to enter its next stage of development, which will propel China over the middle-income trap and into a prosperous future.

On behalf of our member companies, I would like to extend my thanks and appreciation to the Chinese officials throughout all levels of government that we frequently work with.

I also extend my appreciation on behalf of our member companies to our partners at the Delegation of the EU to China, the European Commission and the European Parliament for their astute advice and staunch cooperation.

Finally, I would like to thank everyone who contributed to this *Position Paper*, particularly our active member companies, working group chairs and vice chairs, members of the Advisory Council, Executive Committee, Supervisory Board, the boards of our local chapters and the Secretariat of the European Chamber throughout our different chapters. Without your hard work and diligent efforts, this project could not have been accomplished.

Mats Harborn
President
European Union Chamber of Commerce in China

ABOUT THE EUROPEAN UNION CHAMBER OF COMMERCE IN CHINA

FOUNDED IN
2000
BY 51 MEMBER COMPANIES

31
WORKING GROUPS AND FORA

MORE THAN
1,600
MEMBER COMPANIES

OPERATING IN
9
CITIES

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 31 working groups and fora representing European business in China.

The European Chamber has more than 1,600 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.

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 (EBO), which connects European business associations and chambers of commerce from 37 non-EU countries around the world.

Mission statement

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

1. To ensure greater market access and a level playing field for European companies operating in China.
2. To improve market conditions for all businesses in China.
3. To facilitate networking among members and stakeholders.
4. To provide specific, relevant information to its members on how to do business in China.
5. To update its members on economic trends and legislation in China.

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 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

China has made great strides in implementing an agenda that began 40 years ago at the Third Plenum of the 11th Party Congress when Deng Xiaoping embarked upon the Reform and Opening Up period. While that anniversary is being widely celebrated in 2018, the commemoration of another Third Plenum has gone largely unobserved. Five years ago, the Third Plenum of the 18th Party Congress issued the *Decision* that, among other things, emphasised the decisive role of the market in allocating resources and the need for development to be people-centred.[1] Since it was the first plenum after Xi Jinping's assumption of the presidency, it became a critical moment that carved into stone the vision for China's economic development over the following years.

In the last half decade, improvements have been made in a variety of areas: tariffs on many consumer goods were slashed in late 2017 and early 2018, to provide greater access to goods demanded by Chinese consumers; environmental protection, a long-standing concern of the Chinese middle class, was ramped up in 2014, resulting in a 32 per cent drop in fine air particulates across much of the country;[2] and international pharmaceuticals and medical devices have seen market access expanded through smoother approval systems and fewer barriers over the last two years, as demand sharply rose for better quality healthcare.

Several encouraging results also came out of the annual EU-China Summit in 2018. Chief among them were an exchange of market access offers as part of the Comprehensive Agreement on Investment, a commitment to conclude negotiations on an agreement that protects geographical indications by the end of October and a decision to establish a working group to explore potential reforms to the World Trade Organization (WTO).[3]

However, despite these areas of welcome progress there are unignorable shortcomings that represent missing pieces of China's reform jigsaw. These were covered at length in the European Chamber's most recent report, *18 Months Since Davos: How China's Vision Became a Reform Imperative*, but the European business community is by no means the lone voice of concern.[4] The strong reaction from the United States with its escalation of tariffs is, albeit undesirable, a direct response to these deficiencies, many of them longstanding. Even the chairperson's concluding remarks on the WTO's *2018 Trade Policy Review* and the more than 1,900 questions raised by other members reflect the international community's mixed feelings towards the situation and indicate that concerns about China's role in the global economy are widespread.[5] These concerns derive from issues such as unfair technology transfers, which a reported 19 per cent of European Chamber members felt compelled to do to maintain market access in 2017, a lack of investment reciprocity and concerns over how the China Manufacturing 2025 initiative will be pursued.[6] China may think this criticism unfair, but its sheer size means that its unfair trade and investment practices will have global repercussions.

The extent to which the core principles of the *Decision* have been implemented can be evaluated with

1 *Decision of the Central Committee of the CCP on some major issues concerning comprehensively deepening reform*, China.org, 16th January 2014, viewed 2nd August 2018, <http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm>

2 Greenstone, Michael, *Four Years After Declaring War on Pollution, China Is Winning, The New York Times*, 12th March 2018, viewed 2nd August 2018, <https://www.nytimes.com/2018/03/12/upshot/china-pollution-environment-longer-lives.html>

3 *Joint statement of the 20th China-EU Summit*, Ministry of Foreign Affairs, 16th July 2018, viewed 3rd August 2018, <http://www.fmprc.gov.cn/mfa_eng/zxxx_662805/t1577516.shtml>

4 *18 Months Since Davos How China's Vision Became a Reform Imperative*, European Union Chamber of Commerce in China, 10th July 2018, viewed 3rd August 2018, <http://www.europeanchamber.com.cn/en/publications-18-months-since-davos>

5 *Trade policy review: China, Concluding remarks by the Chairperson*, WTO, 11th and 13th July 2018, viewed 3rd August 2018, <https://www.wto.org/english/tratop_e/tpr_e/tp475_crc_e.htm>

6 *European Business in China Business Confidence Survey 2018*, European Union Chamber of Commerce in China, 20th June 2018, viewed 9th August 2018, <http://www.europeanchamber.com.cn/en/publications-business-confidence-survey>p.p. 40

a simple question that cuts to the main purpose of open markets and the most fundamental needs of Chinese consumers:

Can all international companies operate on a level playing field in China to provide the goods and services that are being demanded?

As it stands, the answer is a clear 'no'. Some of the reasons for this are obvious and immediate: market access barriers, unequal access to subsidies, a dearth of licences for international firms, differentiated treatment and sectors crowded out by monopolistic state-owned enterprises (SOEs) regularly dominate headlines. However, less obvious factors also contribute to a business environment that remains out of sync with the promises made at the Third Plenum. Concerns like lengthy administrative procedures, non-transparent procurement systems, unpredictable enforcement of regulations and issues arising from poor inter-governmental coordination all inhibit smooth business operations, reduce opportunities for European investors and chip away at confidence in the Chinese market. Some of these challenges are due to state policy, others appear to be a result of lower levels of government either not fully comprehending, or failing embrace, the principles of the *Decision*. Recognising these difficulties, European firms nevertheless expect results.

The negative consequences of these issues run deep. For example, while barring market access in any given sector deprives Chinese customers from the specific goods or services that international enterprises could provide, much greater damage is caused to China's economy by the resulting lack of competition that market economies need to thrive. Other impacts exist at a seemingly smaller, but no less important scale. Highly specific standards out of line with international norms, for example, may limit the availability of certain goods that cater to the increasingly complex tastes of China's rising middle class, the growing needs of its rapidly ageing population or the developmental necessities of its more sophisticated economy. The persistence of these issues not only calls into question the decisive role of the market and the people-centred nature of development, collectively they also compose a 'reform deficit'.

China's ambitions to become a champion of globalisation have been repeatedly espoused since President Xi spoke at Davos in January 2017, and are welcomed by European businesses. However, the continuation of limited reciprocity has for some time been building mistrust as an increasing number of political leaders and voters around the world see China as taking advantage of the situation. It is therefore incumbent on the Chinese Government to accelerate the pace of reform and to begin to bridge the increasing gap between potential and reality. The recommendations contained in this report are provided to Chinese leaders with the sincere intention of providing concrete suggestions on how to address the shortcomings of the reform agenda set out at the Third Plenum and to begin significantly reducing the reform deficit.

At the heart of these recommendations is the need for Chinese leaders to consider the fundamental purpose of the different sectors of its economy. Just as the underlying social value of business is to provide in a responsible way goods and services demanded by customers, each industry has an important social contribution to make as well. By using this as the starting point, Chinese officials can begin the process of reappraising how the regulatory environment can be improved to allow each respective industry to fulfil its core task to its maximum potential. To this end, each of the European Chamber's working groups have described in their respective position papers the essential role that they play in the economy.

By approaching reform from this more holistic perspective, China can begin to dismantle the barriers currently preventing European enterprises from fully contributing to its economy, and those that exist between customers, and the goods and services that they are demanding.

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The Reform Deficit

	Common Concerns / Working Groups	Agriculture, Food and Beverage	Auto Components	Automotive	Aviation and Aerospace	Banking and Securities	Carbon Market	Construction	Consumer Finance
1	Access to licences	X				X			X
2	Complex and lengthy administrative procedures	X	X	X	X	X		X	X
3	Consultation and communication	X	X	X	X	X	X	X	
4	Cybersecurity			X		X			X
5	IPR and R&D		X	X					
6	Overlapping regulations and interdepartmental coordination	X	X	X					X
7	Market access barriers	X		X	X	X	X	X	
8	SOE-related issues		X			X		X	
9	Standards setting	X	X		X	X	X	X	
10	Transparency issues	X	X	X		X	X		
11	Unclear regulations and unpredictable enforcement	X	X	X	X	X	X	X	X
12	Unequal and unfair treatment	X		X		X	X	X	X
13	Unfair procurement systems							X	
14	SMEs	X	X	X	X	X	X	X	X

This chart indicates the common concerns held by European businesses in China across multiple sectors. Each X marks a significant shortcoming in the reform agenda that needs to be resolved.

Cosmetics	Energy	Environment	Finance and Taxation	Healthcare Equipment	Human Resources	Information and Communication Technology	International Liner Shipping	Insurance	Investment	Legal and Competition	Logistics	Petrochemicals, Chemicals and Refining	Pharmaceutical	
				X		X		X	X					1
X			X	X	X	X		X	X		X	X	X	2
X	X	X	X	X	X	X		X	X	X	X	X	X	3
				X		X		X	X					4
	X		X			X						X	X	5
		X		X	X	X			X		X	X	X	6
	X	X				X	X	X	X	X			X	7
	X	X						X	X			X		8
X	X		X	X		X	X			X		X	X	9
X	X	X	X		X	X	X	X	X	X	X	X	X	10
X		X	X		X	X	X	X	X	X		X	X	11
	X	X	X	X	X	X	X	X	X	X		X	X	12
	X	X		X		X							X	13
X	X	X	X	X	X	X	X	X	X	X	X		X	14

Executive Position Paper

Major speeches delivered by the Chinese leadership at Davos,[1] the 19th Party Congress,[2] the Two Sessions[3] and Boao,[4] clearly and repeatedly assured the rest of the world that China is in the midst of a period of accelerated reform and opening up. This rhetoric was an expansion of themes first seen in the 2013 Third Plenum *Decision*,[5] which emphasised the need for the market to play a decisive role in resource allocation and for development to be people-centred. It was then cemented in government policy through a series of documents promulgated by the State Council in 2017 and 2018.[6,7&8]

China has indeed delivered meaningful progress, most notably in environmental protection, consumer goods and healthcare, as well as through some improvements to local business environments. Additionally, international enterprises investing in financial services, automotive, shipbuilding and aerospace had one of their longstanding recommendations accepted, with announcements that foreign investment caps in those industries would be removed in the coming years. This was followed by the promulgation of the revised *Special Administrative Measures on Access to Foreign Investment 2018* (*Negative List*).[9]

However, while welcomed by European businesses, these steps make up only a small part of a larger set of reforms that are needed to realise ambitions that have been stated by Chinese leaders and put into high-level policies.

To address this 'reform deficit', the Chinese Government would benefit from taking a more holistic approach. The very purpose of industries and individual businesses is to provide goods and services that satisfy consumer demands in the safest and most efficient way possible. Officials should use this as a starting point for determining regulatory measures that will give full play to market forces in order to create a truly open and competitive environment in which businesses, and therefore the economy, can thrive.

This year's *European Business in China Position Paper* (*Position Paper*) examines the core functions of different industries and horizontal issues, addresses the main concerns currently being faced by European businesses operating in China and provides their recommendations to improve the business environment through improved economic and regulatory reform.

1 *President Xi's speech to Davos in full*, World Economic Forum, 17th January 2017, viewed 2nd August 2018, <https://www.weforum.org/agenda/2017/01/full-text-of-xi-jinping-keynote-at-the-world-economic-forum>

2 *Full text of Xi Jinping's report at 19th CPC National Congress, Xinhua*, 3rd November 2017, viewed 2nd August 2018, <http://www.xinhuanet.com/english/special/2017-11/03/c_136725942.htm>

3 *Li Keqiang delivers work report to National People's Congress, Youth Net*, 5th March 2018, viewed 3rd June 2018, <http://news.youth.cn/sz/201803/t20180305_11470698.htm>

4 *Transcript: President Xi addresses the 2018 Boao Forum for Asia in Hainan*, US-China Perception Monitor, 11th April 2018, viewed 3rd June 2018, <https://www.uscnpm.org/blog/2018/04/11/transcript-president-xi-addresses-2018-boao-forum-asia-hainan/>

5 *Decision of the Central Committee of the CCP on some major issues concerning comprehensively deepening reform*, China.org, 16th January 2014, viewed 2nd August 2018, <http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm>

6 *State Council on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment,* State Council, 17th January 2017, viewed 29th March 2018, <http://www.gov.cn/zhengce/content/2017-01/17/content_5160624.htm>

7 *Notice of the State Council on Several Measures for Promoting Foreign Investment*, State Council, 16th August 2017, viewed 29th March 2018, <http://www.gov.cn/zhengce/content/2017-08/16/content_5218057.htm>

8 *Circular of the State Council on Several Measures for Actively and Effectively Utilising Foreign Investment to Promote the High Quality Development*, State Council, 15th June 2018, viewed 2nd August 2018, <http://www.gov.cn/zhengce/content/2018-06/15/content_5298972.htm>

9 *Special Administrative Measures on Access to Foreign Investment 2018 (Negative List)*, Ministry of Commerce, 29th June 2018, viewed 31st July 2018, <http://english.mofcom.gov.cn/article/policyrelease/announcement/201807/20180702765903.shtml>

This *Executive Position Paper* begins by examining 14 common concerns that are frequently faced by a variety of industries. Each concern draws on issues provided by European Chamber working groups to illustrate clear examples of how businesses are affected and what the government can do to resolve the situation.

Access to licences

When applied appropriately, licensing requirements serve the important function of requiring businesses to meet a certain set of standards in order to operate. This is especially relevant in sectors where significant externalities could result from inadequate standards or resources. However, licensing also has the potential to function as a barrier to market access and international investment if licences are not made equally available to international firms, or the conditions that they have to satisfy to qualify for them are unreasonable.

Cross-border financial services

As China continues to open up its stocks and bonds markets and draw in capital flows to invest in them, it will require greater capacity to facilitate cross-border transfers. A crucial part of making such flows possible is a custodian service to safeguard a customer's assets while a deal is being processed. Providing custodian services requires either a cross-border licence or an on-shore licence, which have capital requirements of Chinese yuan (CNY) 8 and 40 billion respectively. These requirements, especially the latter, are high by international norms, making them prohibitively expensive to many financial institutions. Furthermore, the process for obtaining a licence is complicated by the fact that they are managed by both the China Securities Regulatory Commission (CSRC) and the China Banking and Insurance Regulatory Commission (CBIRC). European Chamber members have noted that this additional layer of complexity is challenging, as is the preferential treatment often afforded to Chinese applicants. As a result, no foreign bank has ever been awarded an on-shore licence, and only a token few have secured a cross-border licence.

These issues have several negative impacts on China's development. First, they limit the value of recent financial sector openings through the lifting of equity caps on international financial institutions.[10] Second, they potentially restrict the inflow of capital to participate in the development of China's stock and bond markets. Third, they inhibit European players from bringing in more competitive practices to help raise industry standards overall. Resolving this barrier to doing business in China is not challenging. Aligning the capital requirements with international norms, and both simplifying the licensing process and applying uniform standards regardless of the applicant's national origin would be a major step in the right direction.

Ensure access to insurance licences and approvals

Insurance companies also struggle to access licences. Starting in 2015, the government became much more conservative in the insurance sector, with the number of insurance licences that were issued dropping to just 13 from over 100 the previous year.[11] With the exception of a few licences for reinsurance services, no international players have obtained a licence since 2012. Even in the reinsurance sector, criteria for establishing operations are high: the company must have at least 30 years of experience,

10 John, Alun, *Foreign banks praise new rules that remove China ownership handicap*, *South China Morning Post*, 10th November 2017, viewed 30th July 2018, <https://www.scmp.com/business/banking-finance/article/2119397/foreign-banks-praise-new-rules-remove-china-ownership>

11 Chatterjee, Sumeet, and Price, Michelle, *Exclusive: China Insurance Regulator Tightening New License Issuance – Sources*, *Reuters*, 22nd December 2016, viewed 30th March 2018, <https://www.reuters.com/article/us-china-insurance-regulator-exclusive/exclusive-china-insurance-regulator-tightening-new-license-issuance-sources-idUSKBN14B062>

assets totalling at least United States dollar (USD) 5 billion, and must meet any other conditions the regulator deems necessary.[12] Similarly, challenging procedures for licensing in the special health insurance sector are also raising concerns for international providers.

Much like the rest of the financial sector, insurance providers will see equity caps raised in the near future. Before the end of 2018, equity caps will start being raised to 51 per cent over the following three years and then removed entirely after five years.[13] However, licences act as a second barrier to market access – what value is full ownership if you cannot actually operate? As long as licensing issues remain, the Chinese market will miss out on additional investment that can bring capital, best practices, unique expertise and much needed competition to the insurance sector. Lowering the onerous requirements insurance companies must follow would be a good place to start, but providing equal opportunities for international insurance providers to enter the Chinese market is crucially needed as well.

Complex and lengthy administrative procedures

Administrative processes are necessary for a variety of purposes. For instance, they provide an important check to ensure that businesses have done their due diligence in preparing for business ventures as varied as building a new factory to importing goods in a safe manner. However, as the bureaucratic saying goes, 'it is always easier to add something than to change it', which frequently results in increasingly complex procedures that take longer and longer to complete. When it gets to this point, the value of these procedures for identifying potential issues can be reduced due to their inefficient and sometimes deterring complexity.

The bureaucratic circus of human resources

Notwithstanding the arbitrary limitations on foreign talent, due to things like being over 60 years old (with some regions making exceptions),[14] the process for obtaining a work permit is challenging and lengthy. This process was changed in March 2017,[15] and now involves sorting talent into either A, B or C categories.[16] Once categorised as A-level talent, most administrative processes become considerably easier. However, for the B-level talent commonly needed by European companies, the process has become substantially more complicated. Perhaps the biggest challenge is the extensive notarisation of background checks and university degrees, the standards for which are not clear due to the often-unique nature of either the documents themselves or the notarisation processes across different countries. Furthermore, after completing the lengthy, and often expensive, documentation requirements and obtaining everything necessary to enter China for employment, foreign talent must frustratingly register with the local police within 24 hours of entering China, every time they cross the border. This may be a minor inconvenience to those who rarely travel outside of China, but for the many international businesspeople who frequently travel for work, this becomes a significant hassle.

While the arbitrary limits on who can obtain a residency permit deprive China of talented individuals who can contribute to its economic and social development, the needless complexity of the application process

12 *Regulations of the People's Republic of China on the Administration of Foreign Funded Insurance Companies*, CIRC, 25th November 2015, viewed 1st August 2018, http://bxjg.circ.gov.cn/web/site0/tab7758/info3980764.htm

13 Xin, Zhiming, and Li, Xiang, *Financial Sector Opened Up Further*, State Council, 11th November 2017, viewed 30th March 2018, <http://english.gov.cn/state_council/ministries/2017/11/11/content_281475938683388.htm>

14 *Shanghai to allow expats over 60 to work, China Daily*, 21st August 2016, viewed 30th July 2018, <http://www.chinadaily.com.cn/china/2016-08/21/content_26547297.htm>

15 *Notice on the Implementation of the Foreigners' Work Permit System*, State Administration of Foreign Experts Affairs, 6th April 2017, viewed 13th February 2018,<http://www.safea.gov.cn/content.shtml?id=12749533>

16 *China Work Permits: Are You an A, B, or C Tier Talent?*, Dezan Shira & Associates, 19th July 2017, viewed 13th February 2018, <http://www.china-briefing.com/news/2017/07/19/china-work-permits-are-you-a-b-c-tier-talent.html>

and the requirement to continuously register with the local authorities complicates the lives of those who have already decided to work in China. This lengthy process also frequently leaves businesses, that critically need certain skills, without someone to carry out certain tasks for weeks or even months after they were initially offered a position. When renewing or transferring a permit, foreign talent is often 'grounded' while the authorities process their passport for up to several weeks. This is all especially frustrating for the many foreigners who have been in China for years, if not decades. Simplifying these procedures, particularly for those who have already obtained work permits in the past, and mitigating the burden of registering with the local police for those with a history of living and working in China would be highly welcomed by the international business community.

Government restructuring slows administrative reform

The extensive government restructuring announced in March 2018 is expected to improve the efficiency of public administration considerably.[17] However, many of the reforms that started in 2017 have been slowed or even halted for the foreseeable future. In May 2017, the former China Food and Drug Administration (CFDA) started a series of public consultations on specific regulations aimed at streamlining regulatory processes by expediting clinical studies, and drug evaluation and approval through three main regulations: the *Announcement of Adjusting the Evaluation, Examination and Approval of Pharmaceutical Clinical Trials (Draft for Public Consultation)*,[18] a document aimed at streamlining clinical studies in China; the *Provisions on the Administration of Pharmaceutical Standards (Draft for Public Consultation)*, which addressed the incompatibility of Chinese drug standards with international standards; and the *Technical Guideline for the Conditional Approval of Urgently Needed Drugs (Draft for Public Consultation)*,[19] which opened a pathway for accelerated drug approval. These all represent promising reforms that can help provide quality pharmaceuticals to Chinese consumers in a more efficient way.

Unfortunately, these regulations have seen little to no progress since their announcement, even though the CNDA publicly announced that its daily operations would not be affected by the restructuring. Understanding that the situation is complex, European pharmaceutical companies nevertheless urge that these more-than-year-old regulations be implemented as soon as possible. Delays are expected in the process of government structuring, but not being able to access cutting-edge drugs for a year, due to as of yet unreformed approval and registration procedures, could be detrimental to the health and well being of Chinese consumers.

The working group appreciates the former CFDA's and the current CNDA's efforts to streamline and accelerate clinical trials and drug evaluation and approval, and the industry is looking forward to these new regulations entering into force in a manageable time frame. Beyond that, as the restructuring is finalised, further optimisation of these processes, to maintain quality and provide new drugs to patients quickly, can ensure a healthy Chinese population.

Consultation and communication

The entire purpose of a regulation is to provide the best possible outcomes for as many stakeholders as possible. In order to achieve this, consultation with all stakeholders is crucial. Engaging those who have interests in any given issue helps to balance needs and allow for novel solutions that could maximise outcomes in ways previously unconsidered.

17 *Restructuring Across the Board, China Daily*, 14th March 2018, viewed 9th May 2018, <http://www.chinadaily.com.cn/a/201803/14/WS5aa882b0a3106e7dcc1418b4.html>

18 *Announcement of Adjusting the Evaluation, Examination and Approval of Pharmaceutical Clinical Trials (Draft for Public Consultation)*, CFDA, 14th December 2017, viewed 9th May 2018, <http://samr.cfda.gov.cn/WS01/CL0050/219216.html>

19 *Technical Guideline for the Conditional Approval of Urgently Needed Drugs (Draft for Public Consultation)*, CFDA, 20th December 2017, viewed 9th May 2018, <http://samr.cfda.gov.cn/WS01/CL0050/219890.html>

Cooperation can help China's aviation sector take flight

The sheer scale of growth in China's aviation sector has left civil aviation authorities under immense pressure. Under the current system, many airports are approaching capacity and the current allocation of airspace for civilian use is highly congested.[20] Much of this is due to the limitations of China's air traffic management (ATM) system, particularly when paired with the de-prioritisation of civil carriers in slot allocation.[21] There are many different techniques that could be applied to remedy these issues: new technologies that boost the efficiency of ATM through things like performance-based navigation implementation in mega-hub airports or re-categorisation implementation to shorten air traffic sequencing. Beyond that, top level implementation of a uniform national ATM system, increased airspace allocation for civil aviation and optimal use of the space that is available by using big data and air traffic flow management (ATFM).

Passengers in China pay a considerable price under the current system, with frequent and often long flight delays. However, resolving these issues in the current aviation environment is about more than just improving efficiency, it is quickly becoming a necessity due to the rapid growth of flight demand and airports' limited capacity. Before growth reaches the limit that airports and airspace can accommodate, the new approaches that European firms can help to realise need to be considered. To facilitate these approaches, China should expand opportunities for consultation with international providers that can bring best practices and cutting-edge methods to improve efficiency and make the most of technological development. In the long term, establishing new communication platforms such as a regular EU-China aviation summit or forum can increase the opportunities for improving China's aviation system.

Similarly, current mechanisms should be utilised even more to improve China's aviation sector. The EU-China Aviation Partnership Project can deepen the opportunities for improving China's aviation systems in the eight areas it focusses on: regulatory dialogue on safety, general aviation, ATM/air navigation services and airports, airworthiness, environmental protection, economic policy and regulation, aviation safety and security, and legislation and law enforcement.[22] Additionally, finalising the Bilateral Civil Aviation Safety Agreement and using its conclusion as a springboard for further engagement will benefit the aviation sector's further development.[23]

Consultation can bring results to China's fledgling carbon market

By 2020, China plans to fully implement an emissions trading system (ETS) after years of piloting.[24] As an important tool in China's efforts to take a leading role in combatting climate change, an ambition unambiguously stated by President Xi Jinping during his work report at the 19th Party Congress, the process of planning, realising, then fine-tuning China's ETS will be extremely important. To create the best possible system, officials should make the most of stakeholders' invaluable experience. Fortunately for China there is no need to repeat the mistakes made in some of the first ETSs as it can learn from other countries that have already been through the process. Better yet, China has a significant number of international experts who participated in those early systems that are ready to engage the government and consult on the development of China's carbon market. Between compliance entities, traders, domestic

20 Jennings, Ralph, *China's Airports Can't Solve the Serious Problem of Flight Delays – Here's Why, Forbes*, 6th June 2017, viewed 30th July 2018, <https://www.forbes.com/sites/ralphjennings/2017/06/06/hogging-of-space-explains-why-so-many-flights-still-take-off-late-in-china/#57a433f72610>

21 *Why China leads the world in flight delays*, *The Economist*, 30th October 2017, viewed 30th July 2018, <https://www.economist.com/graphic-detail/2017/10/30/why-china-leads-the-world-in-flight-delays>

22 *About the EU-China APP*, EU-China Aviation Partnership Project, viewed 1st August 2018, <https://www.eu-china-app.org/about-eu-china-app>

23 *Aviation Strategy for Europe: Commission strengthens aviation ties with China*, European Commission Mobility and Transport, 8th December 2017, viewed 1st August 2018, <https://ec.europa.eu/transport/modes/air/news/2017-12-08-aviation-strategy-europe-commission-strengthens-aviation-ties-china_en>

24 *A first phase of the national ETS is now set to start in 2017 ahead of the original schedule,* the Climate Group, 22nd February 2017, viewed 4th May 2018, <https://www.theclimategroup.org/news/spotlight-china-new-emissions-trading-system-set-revamp-global-market>

and international companies, and European governments, China has no shortage of opportunities for stakeholder engagement.

There are obvious costs to limited stakeholder engagement, but the greatest cost is a needless delay in solving the same challenges that have been experienced by other ETSs around the world. In order to meet China's commitments to the Paris Agreement, resolving such issues is of pressing importance.[25] Consultation can start a national ETS off on the right foot if given the proper platforms during the planning and execution stages of developing China's carbon market. One model to consider would be the European Commission's public consultation practices for climate action, which extensively engages stakeholders and brings their expertise to bear on relevant policies.[26]

China's tax incentives prove elusive to many

Changing a country's tax regime can be a painstaking affair, but the limited communication between the government and international business community makes it even more complicated in China. For example, released on 28th December 2017, *Notice [2017] No. 88* grants non-local companies the option to obtain a deferral for the withholding tax (WHT) on any dividends that are reinvested in certain sectors in China. On 2nd January 2018, the State Administration of Taxation (SAT) released its *Guidance on the Re-Investment Dividend Withholding Tax Deferral Scheme* (*Announcement [2018] No. 3*),[27] which provided guidelines for implementing *Notice [2017] No. 88*. However, there are still several areas where European businesses perceive it to be unclear. For example, if the list of sectors currently covered by the WHT is reduced, how will the deferral be dealt with in the sectors removed from the list? Such technical matters need to be clarified and communicated to the international business community, with them ideally being consulted in advance of such policies being released so they can adequately prepare.

Another example is the value-added tax (VAT) policy. While some clarification has been provided with the release of circulars, such as the *Notice on Fully Expanding the VAT Pilot Programme* (*Notice [2016] No. 36*), questions still remain.[28] For example, services that are "fully consumed outside of China" qualify for a VAT exemption,[29] but the definition of such services is not clear. European businesses note that the recipient of the service must be located outside China and that services cannot be related to goods or real estate inside the country. However, it is unclear whether this covers only direct relationships between the exported service and either goods or real estate, or indirect ones as well. The lack of guidance creates uncertainty for businesses and may put them in a position where they cannot make the most of an exemption that they should be able to qualify for. To resolve this, clear definitions and comprehensive guidance should be provided and clearly articulated to the business community.

Cybersecurity

A well-regulated modern economy necessitates cybersecurity measures that aim for a balance between security and development. Consumers, businesses and the government all have common and competing interests in this area that need to be considered. Completely unregulated data flows and unsecured

25 *Adoption of the Paris Agreement*, United Nations Framework Convention on Climate Change, 12th December 2015, viewed 30th July 2018, <https://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf>

26 *Public consultations*, European Commission – energy, climate change and environment, viewed 30th July 2018, <https://ec.europa.eu/clima/consultations_en>

27 *Guidance on the Re-Investment Dividend Withholding Tax Deferral Scheme, Announcement [2018] No. 3*, SAT, 2nd January 2018, viewed 4th June 2018, <http://www.chinatax.gov.cn/n810341/n810755/c3033019/content.html>

28 *Notice on Fully Expanding the VAT Pilot Programme, Notice [2016] No. 36*, Ministry of Finance and the SAT, 23rd March 2016, viewed 2nd May 2018, <http://www.chinatax.gov.cn/n810341/n810755/c2043931/content.html>

29 Ibid.

infrastructure are as much a risk as highly restrictive data channels and security so excessive that compliance becomes a significant burden. To strike this balance, engagement with businesses and consumers alike is necessary.

Overbearing data transfer rules just one of several policies out of sync with globalisation

On 7th November 2016, China's Cybersecurity Law was promulgated.[30] Since that time, the sheer scope of the policy has become an increasingly significant concern for European companies in China. There are few sectors left unaffected by the law and its many follow-up regulations. Personal information and important data collected and generated by critical information infrastructure (CII) operators in China must be extensively localised, and cross-border data transfers are as tedious as they are difficult to comply with.

One example is the draft *Measures on the Security Assessment of Cross-border Transfer of Personal Information and Important Data* (*Data Transfer Measures*),[31] which only pays lip service to the balance of security needs and the free flow of data, and instead focuses almost exclusively on the security obligations of businesses, with little done to facilitate cross-border data transfers for those in compliance. This is akin to a border security policy being so focused on preventing illegal entry and exit that it fails to lay the groundwork for legal methods of crossing the country's border.

Furthermore, the broad definitions under the Cybersecurity Law's framework are currently difficult to understand, let alone comply with, due to more detailed regulations that have yet to be released. One key definition is "critical information infrastructure" (CII), which is currently defined in such broad terms that a great deal is left open for interpretation. These broad definitions result in nearly all impacted enterprises having to assume that parts of their business would fall under this definition. This brings major costs as they are forced to duplicate information technology infrastructure within China in order to comply. The European Chamber therefore urges clarification on these definitions through the timely issuance of supplemental materials in order to allow European companies to easily understand what steps they need to take in order to comply.

On top of these concerns is the limited clarity found in parts of the regulatory system. If given greater opportunity to voice their concerns, European companies would be able to guide policies so they can protect their data while still facilitating its flow. They could also provide insight into correctly identifying crucial data and information infrastructure, or pursue new measures using the 'least-interference principle' to minimise collateral effects.

The current and potential costs of the Cybersecurity Law and its implementation go beyond the economic costs of compliance or the missed opportunities from restrictions. The greatest casualty of the current system is China's reputation as an advocate for greater global integration. Despite efforts made by state media to promote China's openness and global leadership in all things cyber at the Wuzhen World Internet Conference in December 2017, the reality is quite different.[32] A 2018 study by the European Centre for International Political Economy ranked China as the most restrictive country in their digital trade restrictiveness index.[33] It is difficult for the rest of the world to reconcile the messaging from China's

30 Cybersecurity Law, National People's Congress, 7th November 2016, viewed 24th April 2018, <http://www.npc.gov.cn/npc/xinwen/2016-11/07/content_2001605.htm>

31 *Measures on the Security Assessment of Cross-border Transfer of Personal Information and Important Data (Draft for Comments)*, Cyberspace Administration of China, 11th April 2017, viewed 24th April 2018, <http://www.cac.gov.cn/2017-04/11/c_1120785691.htm>

32 Media Center, World Internet Conference – Wuzhen Summit Website, last updated 10th July 2018, viewed 30th July 2018, <http://www.wuzhenwic.org/news.html>

33 *Digital Trade Restrictiveness Index*, European Centre for International Political Economy, April 2018, viewed 8th June 2018, <http://ecipe.org/app/uploads/2018/04/DTRI-final1.pdf>

leadership with measures that run contrary to the underlying principles of globalisation. To resolve this contradiction, Chinese leaders should open up the development of the Cybersecurity Law and its various measures to allow for greater consultation with affected stakeholders. This can better align China's rules with those that not only provide much-needed security in cyberspace but facilitate the free flow of information as well.

Intellectual Property Rights (IPR)/Research and Development (R&D)

IPR is the foundation of innovation and new ideas. Without properly protecting new creations, the all-important incentive of taking risks and trying new things is lost, and both the economy and society lose out. R&D is built on the foundation of strong IPR to help facilitate new creations and novel ideas. Good R&D policies will encourage results in areas that help address critical issues in society and contribute to people's wellbeing and overall quality of life.

Specialist intellectual property courts (IP) courts could boost IP protection beyond their own courtrooms

Since their establishment in 2014, the three IP courts in Beijing, Shanghai and Guangzhou have made a significant contribution to the overall quality of China's IPR system.[34] In the *European Business in China Business Confidence Survey 2018*, surveyed companies rated different authorities in their responses to IP infringement.[35] Specialist IP courts were rated the highest with nearly twice as many 'excellent' responses than non-specialist courts and three times as many as administrative enforcement authorities. The number of specialist IP courts, as well as their capacity, is set to increase according to several announcements in 2017, a step welcomed by European firms.[36,37&38] However, more can be done to maximise the value of specialist courts. For example, best practices developed in those courts should be shared more broadly to create greater capacity in non-specialist courts and even among administrative authorities.

Relying exclusively on expanding the specialist courts presents a serious lost opportunity that imposes costs on China's IPR environment. As China becomes increasingly innovative, and local firms raise their demand for IPR services, the supply of quality judicial services needs to rise accordingly. To achieve this, IP courts should develop clear, uniform guidelines by publishing decisions. Publishing and disseminating all cases can help improve the capabilities of all judges, lawyers and other legal professionals.

R&D support is available but difficult to acquire

At the national level, the R&D regulatory framework has been steadily improving in recent years. At both the national and local level, measures are being pursued to continue this trend. In October 2017, 11 National Key Projects were announced that aimed to deepen R&D of up-and-coming technologies.[39] Local governments are stepping up their efforts to improve the R&D environment as well, with Shanghai[40] and

34 Yin, Cao, *To ease load, more IP courts planned*, *China Daily*, 30th August 2017, viewed 30th July 2018, <http://www.chinadaily.com.cn/china/2017-08/30/content_31308314.htm>

35 *European Business in China Business Confidence Survey 2018*, European Union Chamber of Commerce in China, 20th June 2018, p. 21, viewed 30th July 2018, <http://www.europeanchamber.com.cn/en/publications-business-confidence-survey>

36 *SPC Puts National Appellate IP Court on Its Agenda, China IPR*, 11th May 2017, viewed 1st August 2018, <https://chinaipr.com/2017/05/11/spc-puts-national-appellate-ip-court-on-its-agenda/>

37 Tsai, Lee, *New Intellectual Property Courts to be Established in Nanjing, Suzhou, Chengdu and Wuhan, Lexology*, 9th May 2017, viewed 11th September 2017, <https://www.lexology.com/library/detail.aspx?g=ba2cb3c8-b64f-4195-a63b-2ec0d6feb482>

38 *The Supreme Court's Work Conditions Report on IPR Courts*, National People's Congress, 29th August 2017, viewed 22nd November 2017, <http://www.npc.gov.cn/npc/xinwen/2017-08/29/content_2027585.htm>

39 *Notice of the Ministry of Science and Technology on Issuing the Guidelines for the Application of the 2018 Annual Key Projects of Key Special Programmes, New Energy Vehicles*, Ministry of Science and Technology, 10th October 2017, viewed 30th March 2018, <http://service.most.gov.cn/2015tztg_all/20171010/2340.html>

40 Zhou, Wenting, *Shanghai Unveils Steps to Attract Foreign R&D Centres*, State Council, 17th October 2017, viewed 9th February 2018, <http://english.gov.cn/news/top_news/2017/10/17/content_281475910713210.htm>

Guangzhou[41&42] showing real leadership in this area. Based on a number of R&D-related policies, alongside State Council guarantees through the *Notice of the State Council on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment* (State Council Document, Guofa [2017] No. 5),[43] international companies should have equal access to support provided for R&D purposes.

Unfortunately this is not always the case. European firms routinely report that they struggle to access government support for R&D. This is true more generally but also for the industries covered by the China Manufacturing 2025 initiative, most of which are also covered by the National Key Projects that are also meant to be equally accessible to international companies.[44] One common issue that members seeking R&D support have reported is the very short application period, which is difficult to meet, especially considering the complexity of the application process. The effects of this are felt more acutely when new lines of support are made available but not widely announced. European firms also note that some of their domestic competition have managed to obtain tender information, giving them an unfair advantage at obtaining grants.

All of this results in uncertainty and frustration for highly innovative European companies that might invest more in local R&D given the right conditions. This can be addressed by extending the timeframe for applying for support, as well as announcing new support mechanisms more widely. Most importantly, it is imperative that Chinese officials implement these measures in a fair manner to ensure that support is equally accessible to both international and domestic innovators through greater transparency and simplified application procedures.

Market Access

The ability to enter a market is necessary for providing goods and services to the population. However, market access can be prevented by means other than policies that directly block investment, such as a negative list. Administrative barriers, licence restrictions, differentiated treatment for international firms, and a wide variety of other factors can act as barriers as well.

The construction sector: how not to build an open market

While much focus has been placed on China's opening up through the recently revised *Special Administrative Measures on Access to Foreign Investment 2018* (*Negative List*),[45] and the associated raising of equity caps across several industries, there are many other barriers to market access that limit the roles international businesses can play in China's development in the construction sector.

European construction service providers (CSPs), including architects, quantity surveyors, project managers and contractors, face significant legal barriers to participation in the Chinese market. For more than 15 years, international CSPs have been permitted to establish wholly foreign-owned construction enterprises (WFOCEs). Unfortunately, they are only allowed to engage in four categories of construction

41 *Policies and Measures of Guangdong Province on Further Opening-up and Actively Attracting Foreign Direct Investment*, Guangdong Provincial Government, 1st December 2017, viewed 26th February 2018, <http://www.ndrc.gov.cn/fzgggz/wzly/wstz/wstzgk/201801/t20180130_875477.html>

42 *R&D and Standards Invigorating New Kinetic Energy: Shenzhen Introduces Policies to Encourage Small and Medium-sized Enterprises to Make use of R&D Results*, General Administration of Quality Supervision, Inspection and Quarantine, 24th April 2017, viewed 30th March 2018, <http://www.aqsiq.gov.cn/zjxw/dfzjxw/dfftpxw/201704/t20170424_486751.htm>

43 *Notice of the State Council on Several Measures on Promoting Further Openness and Active Utilisation of Foreign Investment*, State Council, 30th December 2016, viewed 30th April 2018, <http://www.gov.cn/zhengce/content/2017-01/17/content_5160624.htm>

44 *European Business in China Business Confidence Survey 2018*, European Union Chamber of Commerce in China, 20th June 2018, p. 41, viewed 30th July 2018, <http://www.europeanchamber.com.cn/en/publications-business-confidence-survey>

45 *Special Administrative Measures on Access to Foreign Investment 2018 (Negative List)*, Ministry of Commerce, 29th June 2018, viewed 31st July 2018, <http://english.mofcom.gov.cn/article/policyrelease/announcement/201807/20180702765903.shtml>

projects as determined by Decree 113, the *Regulations on the Administration of Foreign-invested Construction Enterprises*.[46]

The first two categories amount to construction projects funded solely by foreign investment or funded through international financial institutions awarded through international bid invitations, neither of which account for more than a tiny portion of construction projects. The second two are, once the legal terminology is clarified, similarly limited. They essentially restrict international CSPs to contributing technological capacity, advanced project management and other sorts of contracting and subcontracting help for tasks that cannot be done by local firms. As a result, the role available to non-local CSPs is, to be generous, niche at best. This is reflected by the fact that WFOCEs account for around 0.27 per cent of the total value of output of all CSPs in China in 2016.[47]

This reality imposes considerable costs on the Chinese economy, international CSPs and the reputation of China as an open economy. Even quadrupling the current total value of output held by WFOCEs would barely break the one per cent mark, which brings into question why local firms need such extensive protection. Opening the sector will require equal access to locally-invested construction projects and will provide a level playing field for all participants, regardless of them being legally defined as either 'domestic' or 'foreign' enterprises.

Access to China's legal services market continues to tighten

Despite permission to register and control international law firms and foreign lawyers in China, the legal services sector remains highly restricted to international participation. Legal services was one of the few sectors to see a step backwards in recent years, with the release of the *2017 Foreign Investment Catalogue* it was moved from the 'restricted' to the 'prohibited' category.[48] This change was solidified with the promulgation of the *Negative List*, which left the status of legal services unchanged.[49] International firms are not even able to practice law in areas generally deemed 'non-contentious', such as foreign investment, contractual and commercial matters, employment matters, mergers and acquisitions, competition law, banking and finance law, and capital markets law. Furthermore, the Chinese legal profession is limited to Chinese nationals, as only they are permitted to sit for the Chinese bar. Meanwhile, Chinese law firms are able to establish operations in the European Union and practice law, and Chinese nationals can sit for the bar exam in most European countries.

Leaving clients without a full range of choices in legal representation is a significant shortcoming in China's reform agenda. These highly restrictive measures on international investment in the legal services sector, along with the extremely limited role that foreign legal professionals can play, also deprive international businesses of their right to select their preferred service for facilitating trade and investment. This potentially distributes the negative impacts of this situation to other parts the economy. To rectify the situation, legal services should be removed from the negative list to allow international law firms to fully practice the law of the People's Republic of China in non-contentious areas through the employment of qualified and licensed lawyers.

46 *Regulations on the Administration of Foreign-Invested Construction Enterprises*, Ministry of Construction, Ministry of Foreign Trade and Economic Cooperation and the Ministry of Commerce, 2002, viewed 7th April 2018, <http://www.mofcom.gov.cn/article/bh/200301/20030100064300.shtml>

47 *Statistical Data for the Total Revenue in 2016 of Construction Enterprises Classified According to Type of Registration*, National Bureau of Statistics, June 2017, viewed 7th April 2018, <http://data.stats.gov.cn/easyquery.htm?cn=C01>

48 *Catalogue for the Guidance of Foreign Investment Industries* (*2017 revised version*), National Development and Reform Commission, 28th June 2017, viewed 29th June 2018, <http://www.gov.cn/xinwen/2017-06/28/content_5206424.htm>

49 *Special Administrative Measures on Access to Foreign Investment 2018* (*Negative List*), Ministry of Commerce, 29th June 2018, viewed 31st July 2018, <http://english.mofcom.gov.cn/article/policyrelease/announcement/201807/20180702765903.shtml>

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International relay left embargoed by service limitations

International relay is the practice of a company that carries cargo from China to an international destination on its own vessels, and then transfers that cargo to another company vessel in a different Chinese port. For example, in Tianjin a container destined for Manila is put on a company ship bound for Bangkok, and in Nanjing a container destined for Bangkok is loaded onto a ship owned by the same company bound for Manila. The vessels both stop in Shanghai and the containers are then transferred to the opposite vessel bound for their respective destinations.

Currently, this is only permitted for Chinese-flagged vessels of wholly-owned Chinese enterprises, meaning that foreign-flagged vessels owned by international companies cannot engage in international relay. Instead, the containers and vessels from the above example may have to pass off the containers at an overseas port which, in this example, would need to be done in South Korea, Japan or a Southeast Asian country. Any of those destinations would require one or both vessels to deviate substantially from their destination, thus raising costs, lengthening their time at sea and reducing efficiency. Opening international relay to all companies and all vessels would allow for optimised routes to be taken, shorten transit times, and lower costs and pollution, all while boosting demand for Chinese port facilities.

Overlapping regulations and interdepartmental communication

Good regulation necessitates clarity and uniformity. When regulations overlap, or multiple regulators apply different policies in the same area, compliance becomes impossible for businesses. Additionally, ambiguity caused by such overlaps opens the door to exploitation as unscrupulous companies might take advantage of the confusion.

Accelerate homogenisation of online and offline cash loan regulations

Regulators have struggled to keep pace with China's rapidly developing consumer finance sector. This has resulted in a number of regulations that cover what is essentially the same service in significantly different ways. One key example is the provision of cash loans, a service that is regulated differently depending on whether it is provided online or offline. This makes the sector rife with rent-seeking behaviour through repeat borrowing, improper debt collection, abnormally high interest rates and privacy violations. This raises concerns about fairness on the part of financial institutions that might accidentally find themselves noncompliant and consumers who risk being exploited.

It was therefore welcome news on 1st December 2017 when the *Notice on the Regulation and Rectification of the 'Cash Loan' Business* was promulgated.[50] The notice aims to homogenise regulations for online and offline cash loan services. European financial institutions are eager to see this become a reality and urge regulators to implement it in a timely manner. At the same time, the regulations should be reconsidered to optimise the sector, and stakeholders should be consulted to create the best system possible. Doing so can lead to a uniform approach for regulating compliant and licensed companies that protect data privacy and consumer rights, on a level playing field with fair competition.

Who can do what now? And who is responsible for overseeing it?

As China continues to upgrade its manufacturing industries, the need for volatile and dangerous materials

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50 *Notice on the Regulation and Rectification of the 'Cash Loan' Business, Financial News*, 1st December 2017, viewed 3rd May 2018, <http://www.financialnews.com.cn/jg/zc/201712/t20171201_128858.html >

will only increase. This will necessitate a reappraisal of how these goods are classified and managed. Current regulations generally require that a supplier with an appropriate licence and the required facilities handle the storage and transportation of dangerous goods, but this is not always the case. For example, according to China's Fire Bureau, lithium-ion batteries require a dangerous goods licence for storage, but lithium-ion batteries are not even classified as dangerous goods according to the Safety Bureau. Differences also exist from province to province, or even rail terminal to rail terminal, when transporting dangerous goods throughout China.

At the very least these issues can incur significant costs related to non-compliance, and at the very worst they put people's lives at risk. The limited coordination between departments or different locales can be improved by creating uniform lists for dangerous goods at the national level. Similarly, creating national standards for how dangerous goods need to be stored and transported, as well as what qualifies a business to obtain a licence to do so, would be helpful. As important as producing homogenised policies is the corresponding support needed to ensure that local officials have the sufficient capacity to enforce these rules. This will require training to develop expertise, as well as the appropriate tools and materials to carry out the work.

Procurement

All governments and public entities engage in a variety of tasks that require the procurement of goods and services from the private sector. Everything from the construction and management of infrastructure to the healthcare system relies on a fair and transparent procurement system. In certain sectors, China has struggled to create a fair and transparent system based on global best practices. This not only raises a fundamental concern about the cost and quality of goods and services that are being procured, but also how these procurement systems, and the wide scope of China's Bidding Law, are being used as a form of state aid. With President Xi having announced China's ambition to fully accede to the World Trade Organization (WTO) Agreement on Government Procurement, it is of special importance that this is addressed.[51]

Fair procurement can energise the Belt and Road Initiative (BRI)

While many sectors are worried about procurement practices for the BRI, the energy sector is especially concerned. Whether a natural gas pipeline from Russia, an oil pipeline from Pakistan, or the development of green energy across Central Asia, BRI projects are often energy-centric. European companies have much to offer in order to bring these projects up to world-class standards and create new opportunities in the involved regions, an ambition often trumpeted by Chinese state media.[52] However, the procurement and tendering processes are often opaque, and the share of projects and contracts going to Chinese firms is simply too high to indicate a fair system. The Center for Strategic and International Studies reported in January 2018 that 89 per cent of BRI-related projects were awarded to Chinese companies.[53]

The problems this creates are considerable. In addition to concerns about costs and quality, unfair procurement under BRI projects raises serious consternation across the world. There is a contradiction between China's stated ambition to become a champion of globalisation and the rules-based economic

51 *Transcript: President Xi Addresses the 2018 Bo'ao Forum for Asia in Hainan, US-China Perception Monitor*, 11th April 2018, viewed 25th July 2018, <https://www.uscnpm.org/blog/2018/04/11/transcript-president-xi-addresses-2018-boao-forum-asia-hainan/>

52 *China's Promotion of BRI Brings New Opportunities to Foreign-Invested Enterprises, Xinhua*, 28th April 2015, viewed 28th April 2018, <http://www.xinhuanet.com/fortune/2015-04/28/c_1115121344.htm>

53 Hillman, Johnathan, *China's Belt and Road Initiative: Five Years Later*, Center for Strategic and International Studies, 25th January 2018, viewed 25th July 2018, <https://www.csis.org/analysis/chinas-belt-and-road-initiative-five-years-later-0>

order, and the use of its signature BRI as a source of support for national champions. This can be remedied by addressing the lack of transparency and ensuring fair opportunities for all companies, regardless of national origin. Transparency can be improved by mandating that all projects and contracts under the BRI publish their engineering, procurement and construction tendering information online and release the appropriate information about the winning bidders and suppliers for any given contract in line with international best practices.[54] Equal opportunities can be realised by legally removing any distinction between Chinese and non-Chinese firms and by providing an appropriate means of recourse in the event that bids are selected unfairly. This should first be done with procurement for BRI projects in China where it can directly control how such procedures work. Additionally, Chinese leaders should encourage the relevant governments in other countries to align their procurement policies with international norms to ensure that the BRI is an exemplar of fair and open development.

Healthcare equipment – short-term thinking risks long-term outcomes

At the national level, the Chinese Government has taken steps to encourage competition and fight monopolistic power through policies like the National Development and Reform Commission's (NDRC's) *Working Plan 2017/2018 to Abolish Anti-competition Policies*.[55] This affects procurement systems by working against the all too common preference for awarding contracts to local companies. Despite this policy, the medical device industry periodically struggles with local and provincial level policies that weigh procurement opportunities in favour of local producers. The Sichuan Health and Family Planning Commission, for example, released a policy in November 2017 aimed at capping rising healthcare costs that, on top of cutting back procurement more broadly, stated that the "use of imported high-value medical devices must be seriously restricted."[56] Another procurement issue is found in Fujian Province's *Notice on the Progress of Transparent Procurement of Medical Devices (Disposable Devices),* which mandates that manufacturers choose distributors that have their business registered within the province, which further complicates the process of securing a bid.[57] This is problematic, as distributors are in charge of providing service and maintenance, training, commissioning of devices and other specialised work. There is no guarantee that a local distributor can provide the necessary level of service, thus limiting the value of medical devices in the province.

This hurts Chinese patients in both the short and long term. Lower priced goods often mean lower quality, meaning that health outcomes are sacrificed for patients. In the long run, buying cheaper medical devices also often results in them being more frequently replaced as such products tend to have much shorter lifespans than higher quality ones. The net result is the risk of worse health outcomes as well as higher costs over the lifetime of a patient. To collect the health and cost-saving dividends of using better quality medical devices, all levels of government should replace policies that engender a preference for locally produced or distributed products and aim for a level playing field instead. Additionally, a cost evaluation system needs to be developed to appropriately weigh the value of a medical device based on cost, lifespan and projected outcomes.

54 *Transparency*, OECD Public Procurement Toolbox, viewed 25th July 2018, <http://www.oecd.org/governance/procurement/toolbox/principlestools/transparency/>

55 *Working Plan 2017/2018 to abolish anti-competition policies*, NDRC, 12th December 2017, viewed 5th May 2018, <http://www.gov.cn/xinwen/2017-12/12/content_5246226.htm>

56 *Urgent notice on strengthening accountability and strictly controlling unreasonable growth of medical expenses*, Sichuan Health and Family Planning Commission, 10th November 2017, viewed 5th May 2018, <https://tieba.baidu.com/p/5449562416?red_tag=1912952024>

57 *Notice on the Progress of Transparent Procurement of Medical Devices (Disposable Devices)*, Medical Health Insurance Committee of Fujian Province, 23rd July 2018, viewed 1st August 2018, <http://www.fjyxcg.gov.cn/HttpChannel?action=WEBSITE_GOTO_INFORMATION&INFOID=I1807231810028100001>

State-owned Enterprises (SOEs)

Chinese SOEs played important roles in China's early years of reform and opening up. Historically, they were integral for economic production while also holding key social responsibilities, like employment of large sections of the population. However, as China's economy matures and relies more and more on efficiency, SOEs have become an economic liability. Still reliant on SOEs to fulfil social functions, the government has propped up these struggling giants that absorb an increasing amount of resources that would otherwise go to the more efficient private sector. Addressing these concerns will require more than just SOE reform, but will necessitate simultaneous efforts to replace their social responsibilities with an effective social safety net.

SOEs dominate and crowd out multiple sectors

A variety of sectors are heavily dominated by SOEs to the point where competitive forces are suppressed. While few sectors are left unaffected by the state-owned economy, the most pronounced areas in which SOEs often crowd out healthy competition are the agricultural, aviation, banking, chemicals, construction, energy, environment, insurance, shipbuilding, shipping, and quality and safety services sectors. The degree of SOE dominance has a significant effect on the meaning of recent opening in sectors like shipbuilding or banking, for example. After all, entering a market with unnaturally beefed-up 'national champions' as your competition is no easy task.

Funding channels increasingly flow towards SOEs

A pressing horizontal issue that impacts the private sector for European and Chinese firms alike is the decreasing access to funding due to SOEs. While finding local financing is a perennial issue for international companies in China, particularly for small and medium-sized enterprises (SMEs), it is only becoming more problematic as funding is soaked up by the increasingly large state-owned economy. While SOE reform has been, at least nominally, at the top of the current government's agenda for a while now, the mechanisms of reform have chiefly been a reassertion of the party and the consolidation of the largest SOEs. However, increasing the size of an organisation does not necessarily lead to increased efficiency, and the general haemorrhaging of funds to cover for losses, a common issue with Chinese SOEs, that would normally result in insolvency has hardly been an efficient use of resources. As a result of this emerging trend, funding for the private sector is sparse. As pointed out in the July 2018 Australian National University China Update, "…the share of bank loans to nonfinancial corporations that went to private firms fell from 57 per cent in 2013 to only 19 per cent by 2015, while the share that went to SOEs almost doubled over the same period—from 35 per cent to 69 per cent."[58]

Such a massive misallocation of funds to inefficient SOEs is especially problematic – it is a hugely inefficient use of capital and incurs an opportunity cost when those funds could have otherwise financed the more efficient private sector and provided real economic growth. Furthermore, the current direction of SOE 'reform' is resulting in an increasingly large amount of resources being allocated to investments that would never be made based on market forces, thus calling into question the Third Plenum commitment to allow the market to play "the decisive role in resource allocation."[59] To realise this commitment and see capital flow naturally to deserving firms, the approach to SOE reform must change.

58 Lardy, Nicholas, *Private Sector Development,* Australian National University Press, Acton, July 2018, p. 339, viewed 27th July 2018, <https://press.anu.edu.au/node/4267/download>

59 *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform*, Communist Party of China, 16th January 2014, viewed 30th July 2018, <http://www.china.org.cn/china/third_plenary_session/2014-01/16/content_31212602.htm>

As reported by the International Monetary Fund (IMF) in 2017, four major steps need to be taken:[60]

1. "Restructure fundamentally sound enterprises and liquidate nonviable ones... Noncore objectives, such as social functions, should be transferred to the government budget…
2. Harden budget constraints. Implicit guarantees, such as preferential access to credit, should be gradually ended through greater tolerance of defaults…
3. Reduce entry barriers and phase out restrictions that give state-owned enterprises a privileged role. Competition could be fostered by allowing entry of private or foreign firms…
4. Advance complementary reforms, including reform to grant access to public services… and a framework for insolvency and resolution of state-owned enterprises"

Standards

Standard setting, either formally through government policy or through voluntary adoption, aims to address concerns such as quality, safety, environmental protection and consistency. When standards fall out of line with global best practices, they end up limiting the outcomes they were created to facilitate. As China strives to become a standard setter that contributes to global best practices, it should also look to where it can benefit from aligning its own standards with those of international norms.

Remanufactured auto parts and the circular economy

Chinese standards that define waste and non-waste products for importation currently restrict used auto components from entering China for remanufacturing purposes.[61] International standards differentiate between the 'core' of a used auto part, which can be remanufactured and used again, and the 'waste' and scrap that cannot be reused. As China is the fourth largest exporter of auto components in the world, there is a strong industrial foundation to import used cores for remanufacturing.[62] However, current Chinese standards classify many of these cores as waste and/or scrap, making it difficult to import them. This brings significant costs to the Chinese economy. First, it denies the market additional economic opportunities by depriving remanufacturing, an important part of the circular economy, of the inputs it needs. Second, it impacts consumers by withholding refurbished auto components from the market, decreasing their choices and leaving prices higher due to the low supply of auto parts.

The solution to this issue is quite simple, as several sets of standards exist outside of China that could be used as a model to align with China's relevant regulations. Under the United Nation's Basel Agreement, clear distinctions are made between waste and used equipment intended for repair and refurbishment.[63] Auto components are specifically covered by agreed-upon definitions from four international industrial associations, including the Remanufacturing Committee of the China Association of Automobile Manufacturers, which explicitly defines what a core is.[64] Adopting these international standards would be a simple way to resolve these issues and bring new opportunities and choices to Chinese consumers.

60 Lam, Raphael, and Schipke, Alfred, *Getting China's 'Trusted Sons' Back in Shape*, IMF Asia and Pacific Department, 27th April 2017, viewed 27th July 2018, <https://www.imf.org/en/News/Articles/2017/04/26/NA042717-Getting-Chinas-Trusted-Sons-Back-into-shape>

61 *Old mechanical and electrical products prohibited import directory" (second batch)*, Ministry of Commerce, General Administration of Customs and the General Administration of Quality Supervision, Inspection and Quarantine, 27th December 2001, viewed on 1st August 2018, <http://www.mofcom.gov.cn/aarticle/b/e/200207/20020700031667.html>

62 Workman, Daniel, *Automotive Parts Exports by Country*, World's Top Exports, 27th June 2018, viewed 25th July 2018, <http://www.worldstopexports.com/automotive-parts-exports-country/>

63 The technical guidelines on transboundary movements of electrical and electronic waste and used electrical and electronic equipment, in particular regarding the distinction between waste and non-waste under the Basel Convention, Basel Convention, 30th September 2015, viewed 24th July 2018, <http://www.basel.int/Implementation/Publications/LatestTechnicalGuidelines/tabid/5875/Default.aspx#>

64 *Remanufacturing Associations Agree on International Industry Definition,* CLEPA, 13th September 2016, viewed 24th July 2018, <https://clepa.eu/wp-content/uploads/2016/09/Reman-press-release-final-060913-1.pdf>

Diverging paths – international standards and domestic regulations in the chemicals sector

Self-established standards in the chemicals industry have strengthened considerably in the last two decades with the Responsible Care (RC) approach to environmental and safety standards being adopted by over 60 countries, including China as of 2014.[65] This has led to many European chemical companies in China self-regulating and applying standards that go beyond those mandated in regulations. Unfortunately, policies from the Chinese Government have focused on a 'one-size-fits-all' approach to regulating the entire industry, which is problematic considering how diverse it is. Policies have also taken a blanket approach to dealing with things like air quality. The extensive closing of chemical plants throughout the winter of 2017–2018, as part of the fight for blue skies in northern China, is the most pronounced example of this.[66] Even firms that went above and beyond regulations found themselves shut down in order to hit local air quality index targets.

Such an approach brings significant costs. Closing down compliant chemical producers has a direct impact on the company and its workers, but the impact on downstream producers that rely on their products magnifies the effects.[67] Without the right supplies, factories are forced to shut down or adjust their supply lines at great costs, ultimately leaving the consumer with a higher price tag. Solving these issues will require a rethinking of the current approach taken by regulators. Rather than applying the 'one-size-fits-all' method, environmental standards should be based on emissions by each individual company. Furthermore, government support of international best practices, including through the framework of RC and the encouragement of voluntarily imposing even higher standards, would contribute to a safer and greener future for the industry.

Transparency

Transparency is a crucial component of an efficient and fair government. If the mechanisms that determine policies and enforce regulations cannot be clearly seen and understood by those that they affect, both the ability to comply with those rules and the sense of trust in government are diminished.

Information and Communication Technology (ICT) standards development would benefit from full engagement with European firms

Standards developing organisations (SDOs) play a critical role in the ICT sector's development in China. As standard setting becomes an ever more important task, it is increasingly necessary to promote transparency of the processes by which they are determined. This is necessary for creating the best possible standards, promoting better understanding of the standards themselves, which improves compliance, and for fostering trust in the systems that they underpin. Calls from the highest levels of China's leadership and from the State Council have unambiguously called for international players to participate in China's standards setting process. Both the revised Standardisation Law and the *Guidelines on Foreign Invested Enterprises' (FIEs') Participation in China's Standardisation Work* aim to level the playing field for international companies in China by allowing them to play an equal role in the formulation

65 *Responsible Care*, International Council of Chemical Associations, viewed 25th July 2018, <https://www.icca-chem.org/responsible-care/>

66 *China Anti-Pollution Drive Takes Heavy Toll*, *Chemicals Industry News and Analysis*, 11th December 2017, viewed 24th July 2018, <https://chemical-materials.elsevier.com/chemicals-industry-news-and-analysis/china-anti-pollution-drive-takes-heavy-toll/>

67 *China to pause before tightening again on pollution*, ICIS, 1st March 2018, viewed 24th July 2018, <https://www.icis.com/resources/news/2018/03/01/10198376/china-to-pause-before-tightening-again-on-pollution/>

of standards and making the process open and transparent.[68&69] In the ICT sector, there has been significant improvement in allowing international companies to join SDOs, but certain limitations remain.

One example is the National Information Security Standardisation Technical Committee (TC260),[70] which recently opened up membership to non-Chinese participants. Allowing membership is a step in the right direction, but European participants report that they are not extended equal membership status and are blocked from participating in some activities and working groups in these organisations. For example, a number of TC260's working groups, including the important Working Group 3 on Cryptographic Solutions, are only open to domestic participants. Similar problems exist for the International Mobile Technology-2020 Promotion Group for 5G, which plays a central role in the development and definition of 5G in China, as international companies are barred from having full membership in certain working groups. Recent expansions in the organisational roles these international companies can play is indicative of a trend towards greater involvement. That is welcomed, but European firms are eager to be fully involved in the standards-setting process.

To facilitate better industry outcomes and to deepen trust between European companies and regulators, full participation and greater transparency are needed. Opening SDOs to allow international players full membership and unfettered participation, and requiring SDOs and regulators to develop more open and transparent processes that are clearly communicated would be a positive start.

Dearth of approvals lays bare the costs of opaque criteria

When it comes to approval criteria for new goods in China, transparency issues exist across a broad range of sectors. One notable example of this is in the agriculture, food and beverage sector with regard to genetically modified (GM) products and/or materials. Prior to 2010, the former Ministry of Health (MOH) approved a variety of new food ingredients and additives that were based on both traditional techniques as well as GM technology. Unfortunately, starting in 2010, the former MOH stopped approving GM-based products and required biosafety certificates issued by the former Ministry of Agriculture, and a consensus on issuing such certificates was delayed until the State Council's Food Safety Committee advanced a solution in June 2017. A year later, the National Health Commission (NHC) began to accept petitions for GM-based product approval, but with the additional requirement for approval from the new Ministry of Agriculture and Rural Affairs (MARA). These procedures have yet to be fully defined, thus leaving petition requirements incomplete and functionally impossible to use.

In 2017, experts from China Agricultural University were given the task of drafting the *Guidance on Safety Evaluation of GMMs (and Products) for Food Use* (*Guidance*). To date, neither the MARA nor the NHC have disclosed any content from the *Guidance*. Without greater transparency on how to access this content, such as recommended approval processes, requirements and timeframes, private sector players are unable to properly prepare for approval.

As no new food materials or additives derived from GM technologies have been approved in the last eight years, many products are still waiting for access to the Chinese market. This means that Chinese consumers are deprived of nutritious and useful food products. In fact, this deprivation will continue for an extended period even after approval procedures are finalised, as only then will companies be able to

68 *Standardisation Law of the People's Republic of China*, National People's Congress, 4th November 2017, viewed 31st July 2018, <http://www.npc.gov.cn/npc/xinwen/2017-11/04/content_2031446.htm>

69 *Guidelines on FIEs' Participation in China's Standardisation Work*, Standardisation Administration of China, NDRC and the Ministry of Commerce, 29th November 2017, viewed 31st July 2018, <http://www.sac.gov.cn/szhywb/sytz/201711/t20171129_324590.htm>

70 *National Information Security Standardisation Technical Committee Website*, viewed 31st July 2018, <https://www.tc260.org.cn/>

begin preparation for bringing their products to the Chinese market.

To help resolve this situation, the *Guidance* should be published as soon as possible. Following that, greater transparency is required to clearly define approval procedures, which should then be communicated to the relevant industries so they can adequately prepare.

Unclear regulations and unpredictable enforcement

The purpose of well-formulated regulations is to steer businesses into compliance and, as a result, produce positive outcomes and/or avoid negative ones. Regulation cannot achieve these ends if the measures it employs are unclear or ambiguous. European businesses in China want to be in full compliance with local policies, but rules are often opaque and leave too much room for interpretation. This makes compliance difficult, if not impossible, and puts companies that are eager to follow the rules in a position where punitive action could be taken against them.

Evaluation metrics – a blemish on China's cosmetics sector

The regulatory framework surrounding the cosmetics industry is complicated, especially with regard to new ingredients. Registration of new products and ingredients is necessary, and the requirements are high, the procedures rigorous and the duration lengthy. This is not inherently problematic, but it becomes arduous due to the ambiguous standards and opaque evaluation metrics, especially for new ingredients. Since the implementation of a new ingredient registration management system in 2009, only four new ingredients have been approved. Furthermore, low-risk, non-functional ingredients used across the globe also require registration and evaluation prior to entering the Chinese market.

As a consequence of these unclear regulations and criteria, many cosmetic products are out of reach for Chinese consumers. This is inconsistent with other recent developments, such as the recent cut to tariffs on many consumer goods, including a number of cosmetics products. Duties on these products were roughly halved,[71] which was welcome news to Chinese consumers who consumed euro (EUR) 33.34 billion in imported cosmetics in 2017.[72] Clearly, the government wants to improve access to global products, but at the same time it raises de facto barriers through ambiguous evaluative criteria. The government could benefit from aligning with the demands of Chinese consumers and increasing the value of recently lowered tariffs on cosmetics through regulatory reform. The aim of the reform should be to provide clear standards that align with international norms to make it easier for global brands to comply.

Clear regulations but unpredictable implementation

China's 'battle for blue skies' has been a major focus for officials over the last year and has resulted in major shifts in the economy.[73] Implementation of environmental protection measures has swung heavily in the right direction, and the clearer skies over northern China indicates progress.[74] Unfortunately, this came at the expense of many businesses being forcibly shut down without clear explanation. Beginning just after the 19th Party Congress in October 2017, implementation of environmental regulations became

71 *Most favoured nation tariff adjustment table for imported consumer goods*, Ministry of Finance, 31st May 2018, viewed 26th July 2018, <http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201805/P020180531717000728789.pdf?mc_cid=4b79f7dc70&mc_eid=9caa937cd4>

72 CNY 251.4 billion, currency rate based on the June 2018 average of 0.132634 EUR/CNY, *China's Cosmetics Market*, HKTDC Research, 23rd July 2018, viewed 26th July 2018, <http://china-trade-research.hktdc.com/business-news/article/China-Consumer-Market/China-s-Cosmetics-Market/ccm/en/1/1X000000/1X002L09.htm>

73 *Xi Vows Tough Battle Against Pollution to Boost Ecological Advancement, Xinhua*, 19th May 2018, viewed 12th July 2018, <http://www.xinhuanet.com/english/2018-05/19/c_137191441.htm>

74 *PM2.5 in Beijing down 54%, but nationwide air quality improvements slow as coal use increases*, Green Peace East Asia, 11th January 2018, viewed 11th April 2018, <http://m.greenpeace.org/eastasia/high/press/releases/climate-energy/2018/PM25- in-Beijing-down-54-nationwide-air-quality-improvements-slow-as-coal-use-increases/>

erratic and difficult to track. The ensuing actions by local officials resulted in production in many plants being unexpectedly restricted and then suddenly permitted, and companies that had long been compliant with environmental policies were frequently treated no differently from violators.

The lack of clear and consistent implementation and enforcement of regulations and limited oversight resulted in substantial economic losses and serious harm to the sector's trust in government. With the issuance of the *Three-year Action Plan on Fighting for Blue Sky* by the State Council and the *Plan on Strengthening the Inspection on Key Areas for the Fight for Blue Sky in 2018–2019* by the Ministry of Ecology and Environment (MEE),[75&76] government enforcement and inspections are set to become even stricter in the future, which is welcome news provided they are fairly and consistently enforced. Fortunately, on 28th May 2018, the MEE formulated the *Opinions on Prohibiting the 'One Size Fits All' Approach to Enforcement on Environmental Protection*.[77] This should lead to regulations being appropriately applied to individual companies, but it will require significant efforts on the part of the central government to ensure that such measures are implemented properly at the working level. It will also necessitate that the government provide clear guidance to companies on how to avoid production disruptions.

Unequal/unfair treatment

Fairness and equal treatment are the cornerstones of a market economy. Differentiated treatment not only harms economic outcomes, but also is out of line with the principle of reciprocity. Furthermore, national treatment, as outlined both through the WTO and in Chinese policy, is a crucial component of the global economy that underpins all trade and investment between countries. As China becomes increasingly mature and competitive, it is imperative that it ends formal and informal protections extended to its domestic companies.

What's with the FIE definition anyway?

Under the current legal framework, all companies registered in China fall under the measures found in the Company Law.[78] However, international firms are further required to register as FIEs due to a variety of policies. This creates a legal distinction for non-native companies compared to indigenous ones. This continued legal differentiation stands contrary to the commitment made by President Xi at the 19th Party Congress in October 2017 that, "all businesses registered in China will be treated equally."[79] Furthermore, it lays the legal foundation for differentiated treatment and provides a potential barrier to legal recourse after unfair treatment is experienced in the business environment. Unfortunately, this distinction looks unlikely to disappear, as it remains in the current draft Foreign Investment Law.[80]

In the past, differentiated treatment may have been tolerated due to the economic conditions of the time. However, as Chinese firms are now major competitors the world over, continuing to lay the foundation for an unlevel playing field in China through the FIE legal distinction has become problematic. As China's

75 *Announcement on the Issuance of the Three-year Action Plan on Fighting for Blue Sky*, State Council, 3rd July 2018, viewed 12th July 2018, <http://www.gov.cn/zhengce/content/2018-07/03/content_5303158.htm>

76 *Announcement on the Issuance of the Plan on Strengthening the Inspection on Key Areas for the Fight for Blue Sky in 2018–2019*, MEE, 7th June 2018, viewed 12th July 2018, <http://www.mep.gov.cn/gkml/sthjbgw/sthjbwj/201806/t20180612_442954.htm>

77 *Prohibition on the 'One size fits all' Approach to Enforcement of Environmental Protection*, MEE, 5th June 2018, viewed 8th June 2018, <http://www.mee.gov.cn/gkml/sthjbgw/qt/201805/t20180528_441554.htm>

78 *Company Law*, CSRC, 28th December 2013, viewed 25th July 2018, <http://www.csrc.gov.cn/pub/shenzhen/ztzl/ssgsjgxx/jgfg/zh/201506/t20150612_278979.htm>

79 *Full Text of President Xi Jinping's Report at the 19th CPC National Congress, Xinhua*, 3rd November 2017, viewed 25th July 2018, <http://www.xinhuanet.com/english/special/2017-11/03/c_136725942.htm>

80 Foreign Investment Law (Draft), MOFCOM, 19th January 2015, viewed 11th August 2018, <http://tfs.mofcom.gov.cn/article/as/201501/20150100871010.shtml?>

economic growth slows and margins become tighter, unfair practices that were once overlooked due to the sheer scale and potential of the market will become all the more acute and may seriously impact investment decisions. Laying an unambiguous legal foundation for a level playing field is more crucial than ever. Doing so is simple: remove the distinction of 'FIE' and have a single Company Law under which all businesses are defined uniformly.

New energy vehicles (NEVs), same old preferential treatment

China's burgeoning NEV market is a crucial field of competition for automakers around the world. A variety of policy mechanisms have been put in place to encourage consumers to purchase NEVs. These policies range from free licence plates (a big deal in cities that heavily restrict plates to limit congestion) to production and consumption subsidies. While on paper these are all equally available to all makes and models that reach certain technical requirements, in practice they heavily favour local NEV producers.[81] A token few European models can be found on lists, but European producers report that they are the exception rather than the rule. This is all the more problematic due to the NEV credit system, which will require automakers to begin producing a certain ratio of NEVs relative to their overall vehicle production totals in order to remain compliant.[82] Essentially, they are being forced to compete on a very uneven playing field.

This is, ironically, a concern shared by Chinese companies trying to compete overseas. In October 2017, China submitted a series of questions to the WTO to raise concerns over "doubts about the specificity of certain policies, the conditions for granting subsidies and the amounts of subsidies" made available for NEVs in the United States (US).[83] This submission also raised concerns about the availability of those subsidies to non-US producers. If this is enough of an issue for China to raise in the WTO, then it should be worth resolving domestically. Solving these issues would require putting an end to unambiguous measures and differentiated treatment, as well as clear means of recourse and appeal for when unequal treatment occurs.

SMEs in China deserve a fair chance to make it big

SMEs in China not only face all of the problems covered thus far, but doubly so. They often struggle to participate in activities like standards setting and consultation on new regulations, leaving them without a voice in the decision-making process and without a better understanding of how to comply when regulations and standards are eventually released. Complex administrative procedures, unclear regulations and overlapping rules and policies are especially challenging for many SMEs, as they lack the resources to employ an in-house government affairs team and/or legal team to help them navigate these issues. IPR protection is another issue that is more pronounced for smaller firms, as they lack the resources to deal with legal challenges. The dominance of SOEs is also highly problematic in some sectors, as many SMEs rely on supplying larger firms for business, and international SMEs are often overlooked entirely by Chinese state-owned firms.

As China's economic growth continues to slow, it cannot be so selective about the investment it receives. Furthermore, most of the multinational corporations (MNCs) that are interested in entering the Chinese

81 Schwartz, Jan, Jourdan, Adam, *Global automakers call on China to ease "impossible" electric car rules*, *Reuters*, 13th July 2017, viewed 26th July 2018, <https://www.reuters.com/article/us-china-autos-electric/global-automakers-call-on-china-to-ease-impossible-electric-car-rules-idUSKBN19Y1RC>

82 *The management of the average fuel consumption of passenger vehicles and the new energy vehicle management method*, Ministry of Industry and Information Technology, 27th September 2017, viewed 25th May 2018, <http://www.miit.gov.cn/n1146290/n4388791/c5826378/content.html>

83 Miles, Tom, *New energy vehicles top China's list of subsidy questions for U.S.*, *Reuters*, 14th October 2017, viewed 26th July 2018, <https://www.reuters.com/article/us-usa-china-subsidies/new-energy-vehicles-top-chinas-list-of-subsidy-questions-for-u-s-idUSKBN1CI2DX>

market are already here, so attracting new foreign direct investment will require looking at smaller companies. It is also worth bearing in mind that some of the SMEs of today may become the MNCs of tomorrow. In the meantime, they contribute to growth, innovation, employment and taxes. SMEs are the barometer of a business environment: the fairer the system, the better chance SMEs have at succeeding. If China truly wants to create a fair economic system, it should look more seriously at solving the biggest challenges facing SMEs.

Conclusion

The European business community in China appreciates the Chinese leadership's rhetoric and calls for greater opening and reform, and acknowledges the areas of progress that have been seen throughout the last year. However, relative to the expectations set by multiple high-level speeches, as well as policies promulgated by the top levels of government, progress has fallen short.

Understanding that reform does not happen overnight, the European Chamber nevertheless believes that the pace of change needs to accelerate in order to satisfy not only the needs of international companies, but also the needs of China's economy. Moving towards a fair and open business environment calls for more than just expanding market access, it also requires national treatment and a truly level playing field for international companies.

It is for this reason that the European Chamber encourages China to adopt the recommendations found throughout this year's *European Business in China Position Paper*. Drawing on the experiences of the European Chamber's more than 1,600 member companies, the 828 recommendations provided in this report address everything from high-level concerns to extremely specific details. By engaging with European companies to resolve these challenges, the Chinese Government can begin the process of addressing current shortcomings in its reform agenda.

The European Chamber stands ready to cooperate and engage with the authorities at all levels to ensure that China's economy reaches its full potential and becomes an example of openness, fairness and reciprocity.

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