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Foreign Investors: Navigating China's New Procurement Standards

On December 5, 2024, the Ministry of Finance (MOF) has drafted **the Circular on Matters Concerning Standards for Domestic Products in Government Procurement and Implementation Policies (Draft for Comment)** (hereinafter referred to as the "Draft"), and seeks public comment till January 4, 2025. The Draft is in accordance with the Government Procurement Law of the People's Republic of China, the Foreign Investment Law of the People's Republic of China, and other relevant laws and regulations. The Draft aims to modernizing China's government procurement market system and build a market-oriented, law-based, and international business environment.

Key Content

The Draft seeks to clarify "Domestic Product Standards" and propose price advantage for products made in China in the field of government procurement.

- Specify the standards of Domestic Product

The current standard for domestic products is based on whether the final product requires import customs clearance procedures. Though easy to implement, it's relatively rough and unclear. The Draft designed a more precise criteria for domestic products and a clearer deduction of the evaluated price. A domestic product has to meet all of the following criteria:

- (1) Origin requirement: The products need to be manufactured domestically, that is, the change of attributes from raw materials and components to products is realized within China's territory, excluding OEM, simple packaging, etc.
- (2) Cost proportion requirement: The cost of components produced in China for the product meets the required proportion which is determined for different products and adjusted dynamically.
- (3) Requirements for key components and processes: Based on meeting the above-mentioned conditions, for specific products, it is also required that their key components are produced in China and critical processes are carried out in China.

Requiring the localization of key components and critical processes help to retain high-value-added industries. These criteria highlight the "Made in China" of core technologies. By encouraging enterprises to develop key technologies and core production capabilities, it's significant for driving the upgrading of domestic enterprises, discouraging technology outflow, and improving the competitiveness of Made in China products.

- Products deemed as produced within China

For assembled products or components, the relevant suppliers shall provide procurement contracts, purchase records, records of manufacturing, processing, and assembly, as well as other supporting materials. If it can be proven that the products or components are produced within China, the relevant products or components can be regarded as produced within China.

For products or components directly manufactured or processed from raw materials, such as steel, ceramic products, glass, etc., the relevant suppliers shall provide documentation such as the factory address legally marked on the product or component packaging. If the factory address is within the customs territory of China, the product or component can be deemed as produced within China.

- Application scope of the standard

The standard is currently exclusively to goods, including procurement of goods involved in government procurement of goods projects and service projects, mainly industrial manufactured goods, excluding agricultural,

forestry, animal husbandry, fishery products, and mineral products.

- Supportive policies for domestic products

The Draft introduces a 20% price deduction for domestic products when domestically made and non-domestically made products compete for bid of government procurement. In procurement projects or packages consisting of multiple products, when the cost of domestic products constitutes no less than 80 percent of supplier's total cost, all items in the bid will be eligible for a 20 percent price deduction. This signals China's intention to support domestic manufacturing and bolster local supply chains.

- Step-by-step establish the standard system

The MOF and relevant departments will fully seek consultation from all parties including domestic and foreign-invested enterprises (FIEs), associations, and chambers of commerce, to formulate requirements for the cost proportion of components produced in China for relevant products and requirements for key components and key processes of specific products within 3 to 5 years.

Before that, as long as a product is produced in China, it is regarded as a domestic product in government procurement activities. A transition period gives goods that currently do not meet the domestic product standard an opportunity to compete on the same stage. FIEs can seize this challenge to accelerate their industrial layout and integrate deeper in China market.

- Align with international rules

The standards for domestic products in government procurement and supportive policies comply with relevant international economic and trade rules such as the "Agreement of the World Trade Organization". After China joins international agreements such as the WTO "Agreement on Government Procurement" (GPA) and the "Comprehensive and Progressive Agreement for Trans-Pacific Partnership" (CPTPP), products of other participating parties will be exempted according to the agreements.

Impact on Foreign Investors

By offering a transparent criterion of domestic products and price deduction rules, this policy poses both opportunities and challenges for FIEs.

- Equal treatment of both domestic and foreign investors

The Draft ensures the equal participation of all types of business entities in government procurement activities and offers transparent and predictable criteria. After the promulgation of the standards and supportive policies, products that are standards compliant, whether they are from domestic or foreign invested enterprises, will be eligible for the benefits from government procurement support policies.

- Encourage foreign investment

The clear and unified standards offer a greater competition environment. The equal treatment on products of foreign invested contributes to accelerating the establishment of factories and production by foreign investment in China and cultivating and strengthening the domestic supply chain. The policy encourages foreign investors to increase their production layout and investment in China, transfer more production links, key-component production, and key processes to China to meet the domestic product standards and expand the Chinese government procurement market.

- Face greater competitive pressure

The price preferential policy for domestic products enhances their competitive advantage and pose challenges for FIEs. If FIEs seek to qualify as domestic products, they need to adjust their production processes, supply-chain layout, etc., increase procurement or investment in China, localize their technologies, and may face pressure of cost increase in the short term.

Suggestions for FIEs

The Draft places importance on advantages FIEs might be granted with if FIEs' products are in compliance with relevant standards. Currently, enterprises shall:

- Review and evaluate if the products are in compliance with standards of Domestic Product and be aware of discrepancies from the standards and conduct corresponding rectifications.
- Establish a comprehensive compliance management system, strengthen the management and monitoring of all aspects of product production, assembling, procurement, sales, etc., to ensure that the entire process from production to delivery of the product meets the standards of Domestic Product and the requirements of government procurement policies.

In the meantime, requirements for the proportion of cost of components produced in China for the products as well as requirements for key components and key processes for specific products, will be formulated within three to five years. Enterprises shall also keep an eye on the latest developments of relevant regulatory.

Conclusion

This policy highlights building a more fair and transparent government procurement market environment, providing equal competitive opportunities for domestic and foreign invested enterprises, and meanwhile promoting industrial upgrading and high-quality economic development. The official implementation of this policy will introduce more high-quality foreign-invested products into the Chinese market and increase more FIEs' involvement in the government procurement. At the same time, it provides FIEs with a larger development space and opportunities, attracting foreign investment to expand the local production layout in China.

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