CHINA
INVESTMENT CLIMATE STATEMENT
2015

Table of Contents

Executive Summary

China maintains a more restrictive foreign investment regime than its major trading partners, including the United States. While China became the world's top destination for foreign direct investment (FDI) in 2014, according to the United Nations Conference of Trade and Development (UNCTAD), broad sectors of the economy remain closed to foreign investors. China relies on an investment catalogue to encourage foreign investment in some sectors of the economy, while restricting or prohibiting it in many other industries. China's investment approval regime appears designed to foster economic growth but may also shield inefficient or monopolistic Chinese enterprises from competition, particularly those China is trying to cultivate as market leaders. Foreign investors cite rising costs, difficulty in finding qualified human resources, market access limitations, and unclear and inconsistent enforcement of laws and regulations as significant challenges to establishing and operating businesses in China. More than half of the U.S. companies surveyed by AmCham China in 2014 believe foreign businesses are less welcome in China than before.

Over the past year, the Chinese central government announced a series of reforms and pledges that could lead to limited improvements in the overall investment climate, both from a market access and a regulatory standpoint if they were implemented. Major developments in 2014 include:

• China and the United States worked to narrow differences and reach agreement on the text of a high standard Bilateral Investment Treaty (BIT) that would encourage fairness, openness, and transparency. Both sides committed in November 2014 to continue to pursue the BIT as a top priority in their economic relations and to initiate negotiations over the "negative list" of exceptions to the agreement in early 2015.

• The Ministry of Commerce (MOFCOM) released a new draft Foreign Investment Law that would supersede the laws currently governing China's FDI regime. The draft law appears to incorporate some key principles from the U.S. model BIT, including the use of a negative list to enumerate instances where FDI is treated less favorably than domestic investment. The draft would also streamline the approval process for foreign investment in some sectors; however, the proposed law also contains a number of troubling new provisions that could facilitate discriminatory treatment of foreign investors and their investments. The draft law was released for public comment in January 2015.

• In December, Premier Li Keqiang announced the establishment of three new Free Trade Zones (FTZs) in Tianjin, Guangdong and Fujian. The FTZs are expected to expand an investment registration regime established in the Shanghai FTZ, which is simpler than the approval process required throughout most of China, and open some previously closed sectors to foreign investment.

Although the Chinese Communist Party says it expects to "fulfill" its Third Plenum market-oriented economic reform agenda by 2020, a detailed reform roadmap and timetable is lacking for many sectors. Foreign investors remain concerned about discriminatory industrial policies, opaque and selectively enforced investment approval procedures, licensing barriers that favor domestic firms, and a lack of effective administrative and legal recourse if investments are

restricted. Meanwhile, China's revised Foreign Investment Catalogue, released in March 2015, fell short of meaningful progress toward broader market access for foreign investors. Poor enforcement of intellectual property rights (IPR), the forced transfer of technology, and systemic lack of rule of law are additional concerns. Over the past year, China released new policies to exclude foreign technology from various sectors, including: proposed banking sector guidelines that could disrupt supply chains and increase firms' operating costs, a draft counter-terrorism law which imposes onerous requirements on foreign technology firms, and an intrusive national security mechanism that could be used to hinder or even block foreign investment.

The United States government has raised concerns about China's investment restrictions and discriminatory policies at high levels, in bilateral fora such as the U.S.-China Joint Commission on Commerce and Trade (JCCT), and the U.S.-China Strategic and Economic Dialogue (S&ED). The United States Government emphasizes the need for China to open new sectors to foreign investment, increase transparency, and improve the enforcement of existing laws to protect investors' rights.

1. Openness To, and Restrictions Upon, Foreign Investment

Attitude toward Foreign Direct Investment

The Chinese government has stated that it welcomes foreign investment. China attracted USD 120 billion in FDI in 2014, surpassing the United States as the world's top destination for annual FDI flows for the first time since 2003. China's sustained high economic growth rate and the expansion of its domestic market help explain its attractiveness as an FDI destination. However, foreign investors often temper their optimism regarding potential investment returns with uncertainty about China's willingness to offer a level playing field vis-à-vis domestic competitors. In addition, foreign investors report a range of challenges related to China's current investment climate. These include industrial policies that protect and promote state-owned and other domestic firms, equity caps and other restrictions on foreign ownership in many industries, weak IPR rights protection, a lack of transparency, corruption, and an unreliable legal system.

The American Chamber of Commerce in China's 2014 American Business in China White Paper can be found here: http://www.amchamchina.org/whitepaper

Other Investment Policy Reviews

Organization for Economic Cooperation and Development (OECD)

China is not a member of the OECD. The OECD Council decided to establish a country program of dialogue and co-operation with China in October 1995. The most recent OECD Investment Policy Review for China was completed in 2008. The OECD Investment Policy Review noted that the policy changes in China between 2006-2008 tightened restrictions on inward direct investment, including cross-border mergers and acquisitions.

The report can be found at:
http://www.oecd.org/investment/investmentfordevelopment/oecdinvestmentpolicyreviews-china2008encouragingresponsiblebusinessconduct.htm

World Trade Organization (WTO)

China became a member of the World Trade Organization (WTO) in 2001. WTO membership boosted China's economic growth and advanced its legal and governmental reforms. The most recent WTO Investment Policy Review for China was completed in 2012. The report states that there were few changes to China's policies on inward foreign investment in the period under review (2010-2011).

The report can be found at:
http://www.wto.org/english/tratop_e/tpr_e/tp364_e.htm

IMF information can be found at:
http://www.imf.org/external/country/Chn/

FDI Statistics from MOFCOM can be found at:
http://www.fdi.gov.cn/1800000121_10000177_8.html

Laws/Regulations of Foreign Direct Investment

Overview

China has a legal and regulatory framework that provides the government with discretion to promote investment in specific regions or industries it wishes to develop, and to restrict foreign investment deemed not to be in its national interest or that would compete with state-sanctioned monopolies or other favored domestic firms. Foreign investors report that many regulations contain undefined key terms and standards, and that regulations are often applied in an inconsistent manner by different regulatory entities and localities. Potential investment restrictions in China are thus much broader than those of many developed countries, including the United States.

The Constitution of the People's Republic of China was adopted by the 5th National People's Congress on December 4, 1982, with several revisions through 2004. China's accession to the WTO spurred significant transformations in various areas of Chinese domestic law. The current Chinese leadership has emphasized the need to strengthen the rule of law in China. Nonetheless, foreign investors have expressed concern that the legal system allows regulators significant discretion to adapt decisions to changing circumstances, which results in an unpredictable business climate and rulings that can appear arbitrary or discriminatory. Generally, unlike the United States, the legal system is designed to serve state and Communist Party interests, and as such, does not consistently protect individual rights or effectively resolve disputes. The current system is still being developed as a venue to address investment and commercial disputes.

FDI Laws

Article 18 of the Constitution states that China permits foreign enterprises and other economic organizations or individuals to invest in China. The issuance of the China-Foreign Equity Joint Venture Enterprise Law in 1979 marked the beginning of the establishment of China's foreign investment legal regime. Since then, China has established a foreign investment legal regime based on three central laws. These are: the China-Foreign Equity Joint Venture Enterprise Law, the China-Foreign Cooperative Joint Venture Enterprise Law, and the Foreign-Invested Enterprise Law.

Administrative regulations and regulatory documents governing FDI issued by the State Council include, but are not limited to:

- the Implementation Regulations of the China-Foreign Equity Joint Venture Enterprises Law
- the Implementation Regulations of the China-Foreign Cooperative Joint Venture Enterprise Law
- the Implementation Regulations of the Foreign-Invested Enterprise Law
- the State Council Provisions on Encouraging Foreign Investment
- the Provisions on Guiding the Direction of Foreign Investment
- the Administrative Provisions on Foreign Investment to Telecom Enterprises

There are over 1,000 rules and regulatory documents related to foreign investment in China issued by government ministries. They include, but are not limited to:

- the Guiding Catalogue of Foreign Investment Industries
- the Provisions on Mergers & Acquisition of Domestic Enterprises by Foreign Investors
- the Administrative Provisions on Foreign Investment in Road Transportation Industry
- the Interim Provisions on Foreign Investment in Cinemas
- the Administrative Measures on Foreign Investment in Commercial Areas
- the Administrative Measures on Ratification of Foreign Invested Projects
- the Administrative Measures on Foreign Investment in Distribution Enterprises of Books, Newspapers and Periodicals
- the Provision on the Establishment of Investment Companies by Foreign Investors
- the Administrative Measures on Strategic Investment in Listed Companies by Foreign Investors

In addition, local legislatures and governments also enact their own regulations and rules to regulate foreign investments in their areas, in accordance with national laws and policies; for example, Wuhan's Administration Regulation on Foreign-Invested Enterprises and Shanghai's Municipal Administration Measures on the Land Usage of Foreign-Invested Enterprises.

Under this foreign investment legal regime, China approves foreign investments on a case-by-case basis following review by multiple government agencies. China claims to provide national treatment after an investment has been established, but not before. Foreign investors may only invest where allowed by laws, regulations, and rules, in specified areas or industries, and are required to obtain ratification for planned investment projects and to establish companies. In some industries, such as the telecommunication industry, foreign investors are also required to obtain approval from relevant industry regulators. Separate approval processes govern land use and other administrative areas. Reviews may overlap, resulting in potentially redundant examinations. Low transparency limits the predictability of outcomes.

A list of Chinese laws and regulations, central and local can be found here: http://www.gov.cn/zhengce/

FDI Reform Announcements

In November 2013, following the Third Plenum of the 18th Party Congress, the Chinese Communist Party issued a report which is described by the Chinese leadership as one of the largest and most ambitious economic reform programs since Deng Xiaoping's pioneering market-oriented reforms in 1978. Among other things, the report directs China to broaden foreign investment access in China, to explore the possibility of a model for allowing foreign investment that would provide national treatment at all phases of investment, including market access (i.e., the "pre-establishment" phase of investment), and employ a "negative list" approach in identifying exceptions (meaning that all investments are permitted except for those explicitly excluded), and to set up more free trade zones like the newly established and still evolving Shanghai Pilot Free Trade Zone. The report also stated China intends to unify laws and regulations governing foreign and domestic investment. The United States is encouraged by these broad policy pronouncements and will closely monitor China's implementation measures to determine how and to what extent China follows through on them.

The English version of the Third Plenum decision can be found here:
http://www.china.org.cn/china/third_plenary_session/2013-11/16/content_30620736.htm

In January 2015, China's Ministry of Commerce (MOFCOM) issued a new draft Foreign Investment Law for public comment. When enacted, the law will unify and supersede the three laws governing foreign-invested enterprises (FIEs): the China-Foreign Equity Joint Venture Enterprise Law, the Foreign-Invested Enterprise Law and the China-Foreign Cooperative Joint Venture Enterprise Law. The draft Foreign Investment Law would abolish the case-by-case approach to regulating foreign investment and adopt a system that would treat FDI the same as domestic investment, apart from exceptions to this "national treatment" that would be detailed on a "negative list." Nevertheless, the draft law retains a distinction between foreign and domestic investment, which could invite opportunities for discriminatory treatment of foreign investors and their investments.

Industrial Promotion

Five-Year Plan

China defines its broad economic goals through five-year macro-economic plans. The most significant of these for foreign investors is China's Five-Year Plan (FYP) on Foreign Capital Utilization. The 12th FYP for Utilization of Overseas Capital and Investment Abroad, issued by the National Development and Reform Commission (NDRC) in 2012, promises to guide more foreign direct investment (FDI) to an identified set of strategic and newly emerging industries (SEIs), namely energy efficiency and environmental technologies, next generation information technology, biotechnology, advanced equipment manufacturing, new energy sector, new materials, and new-energy vehicles, while "strictly" limiting FDI in energy and resource-intensive and environmentally damaging industries; encourage foreign multinationals to set up regional headquarters and research and development (R&D) centers in China; encourage foreign investment in production services such as modern logistics, software development, engineering design, vocational skill training, information consulting, technology, and intellectual property services; "steadily open up" banking, securities, insurance, telecom, fuel, and logistics industries;

"gradually open up" education and sports; guide foreign capital to enter healthcare, culture, tourism, and home services; and encourage foreign capital to enter creative design. The 13th FYP is expected in 2017.

Innovation

A major goal of China's investment policies, stated in the 12th FYP, is to encourage the domestic development of technological innovation and know-how. Investment projects that involve the transfer of technology or the potential for "indigenous innovation" tend to be favorably received by China's investment authorities. China seeks to promote investment in higher value-added sectors, including high technology research and development, advanced manufacturing, clean energy technology, and select modern services sectors. Foreign investors often must weigh the potential value of accessing China's market against China's inability or unwillingness to protect their intellectual property.

Regional growth

China also seeks to spread the benefits of foreign investment beyond its relatively wealthy coastal areas by encouraging foreign companies to establish regional headquarters and operations in Central, Western, and Northeastern China. China publishes and regularly revises a Catalogue of Priority Industries for Foreign Investment in the Central-Western Regions, which outlines incentives to attract investment in targeted sectors to those parts of China.

The Catalogue of Priority Industries for Foreign Investment in the Central-Western Regions can be found here: http://www.ndrc.gov.cn/zcfb/zcfbl/201305/W020130516388520815145.pdf

Limits on Foreign Control

Catalogue for the Guidance of Foreign Investment in Industries

China outlines its specific foreign investment objectives primarily through its Catalogue for the Guidance of Foreign Investment in Industries, most recently revised in March 2015, and maintained by MOFCOM and the National Development and Reform Commission (NDRC). The catalogue delineates sectors of the economy where foreign investment is "encouraged," "restricted," and "prohibited." Investment in sectors not listed in the catalogue is considered permitted. China "encourages" investment in sectors where it believes it will benefit from foreign assistance or technology. Investment is "restricted" and "prohibited" in sectors that China deems sensitive, that touch on national security, or which do not meet the goals of China's economic development plans.

The 2015 edition of the Catalogue lifts foreign investment restrictions on foreign investment in several areas, including in the manufacturing sector, but makes limited progress in services, agriculture, and infrastructure. According to the NDRC, the Catalogue reduces the number of restricted industries from 79 to 38, with direct sales and insurance brokerage companies among the beneficiaries, and limits the number of sectors for which Chinese-controlled joint ventures are required from 44 to 35. Moreover, the new Catalogue reduces the number of industries requiring joint ventures with Chinese partners, but allowing foreign control, from 43 to 15, including in real estate development. The overall reforms to the Catalogue may improve market access in some sectors but the Catalogue also reduces access in others. In general, foreign investment restrictions remain largely unaltered in industries that traditionally face heavy restrictions, such as banking, telecommunications, and cultural industries. On the positive side, the new Catalogue exempts the e-commerce industry from the 50 percent equity cap for foreign investment in value-added telecom services.

The Chinese version of the 2015 Foreign Investment Catalogue can be found here: http://www.mofcom.gov.cn/article/b/f/201503/20150300911747.shtml

Problems with the Catalogue

The catalogue reflects China's market access restrictions. Contradictions between the catalogue and other measures have confused investors and added to the perception that investment guidelines do not provide a secure basis for business planning. Even in “encouraged” and “permitted” sectors, regulations apart from the catalogue often detail additional restrictions on the specific forms of investment that are allowed. Chinese regulators have maintained the flexibility to ignore the catalogue’s guidance in some instances, and to restrict or approve foreign investment for reasons other than those specified. The government may also adopt new regulations or establish industrial policies that supersede the most recently published edition of the catalogue. Uncertainty as to which industries are being promoted and how long such designations will be valid undermines confidence in the stability and predictability of the investment climate.

Equity Caps

In addition to dividing industries into “encouraged,” “restricted,” and “prohibited” categories, the catalogue may also require that investment take certain forms (such as a domestic-foreign equity joint venture) and/or that the foreign shareholder’s proportion of investment in the enterprise be limited to a minority share. Agency-specific regulations may also require that investment take certain forms.

For example:

- In the oil and natural gas exploration and development industry, foreign investment is required to take the form of equity joint ventures and cooperative joint ventures.
- In the accounting and auditing sectors, the Chief Partner of a firm must be a Chinese national.
- In higher education and pre-school, foreign investment is only permitted in the form of cooperative joint ventures led by a Chinese partner.
- In some sectors, the Chinese partners individually or as a group maintain control of the enterprise; for example, construction and operation of civilian airports, construction and operation of nuclear power plants, establishment and operation of cinemas, and the design and manufacture of civil-use satellites.

In some sectors, the foreign shareholder's proportion of the investment may not exceed a certain percentage. For example, foreign stakes are limited to:

- 50% in value-added telecom services (excepting e-commerce)
- 49% in basic telecom enterprises
- 50% in life insurance firms
- 49% in security investment fund management companies

Mandatory Intellectual Property (IP)/technology transfer requirements

Mandatory joint venture structures and equity caps give Chinese partner firms significant control, often allowing them to benefit from technology transfer. In addition, the relative opacity of the approval process and the broad discretion granted to the authorities foster an environment where government authorities can impose deal-specific conditions beyond written legal requirements, often with the intent to force technology transfer as a condition of market access or to support industrial policies and the interests of local competitors.

Privatization Program

Early indications following China's November 2013 Third Plenum reform pronouncements suggest China will attempt to sell shares in state-owned enterprises (SOEs) to outside investors, improve SOE management structures, emphasize the importance of SOEs meeting financial goals, and take steps to bring private capital into some sectors traditionally monopolized by SOEs, such as energy, telecoms, and finance. Practically, the government must still work out how to implement its SOE reform vision, but a 2014 move to restructure a major state-owned conglomerate, Citic Group, by listing its assets in Hong Kong, where it will be subject to greater transparency rules and heightened regulatory scrutiny, suggests a possible mechanism to improve SOE corporate governance and transparency. The government also committed at the Third Plenum to raise the portion of earnings that SOEs pay out as dividends to the public budget, although here, too, the pace and method of implementation remains uncertain.

Screening of FDI

Overview

As mentioned, foreign investors are required to obtain approvals for their investment projects and to establish an enterprise. In some industries, such as telecommunications, foreign investors are also required to get approval from industry regulators.

Catalogue of Investment Projects Subject to Government Ratification

In July 2004, the State Council issued its Decision on Investment Regime Reform and the Catalogue of Investment Projects subject to Government Ratification (Ratification Catalogue). According to the Ratification Catalogue, all proposed foreign investment projects in China must be submitted for "review and ratification" by the National Development and Reform Commission (NDRC) or provincial or local Development and Reform Commissions, depending on the sector and value of the investment. In 2013, however, the government issued a new catalogue narrowing the scope of foreign investment projects subject to NDRC ratification. Foreign investment which does not require Chinese control according to the Foreign Investment Catalogue and which is not listed in the Ratification Catalogue requires only “filing for record” with the local NDRC office. The policy shift marked a positive step toward easing bureaucratic barriers to foreign investment.

In November 2014, China released a new edition of the Ratification Catalogue, which eliminates the requirement for NDRC ratification in 15 sectors (out of approximately 50) and delegates ratification authority to local governments in another 23 sectors. The new Ratification Catalogue also raises the threshold of foreign ownership that would trigger the requirement for NDRC approval, as opposed to registration, in several sectors. When announcing the reforms, the NDRC stated the goal of the latest revision to the Ratification Catalogue is to limit ratification to projects relating to “national and ecological security, geographic and resource development,” and the “public interest.” The NDRC estimated the number of projects requiring ratification from central government authorities would fall by 76 percent following revisions made over the past several years.

The NDRC's approval process for foreign investment projects includes assessing the project's compliance with China's laws and regulations; its compliance with the Foreign Investment Catalogue and industrial policy; its national security, environmental safety, and public interest implications; its use of resources and energy; and its economic development ramifications. In some cases, NDRC also solicits the opinions of relevant Chinese industrial regulators and "consulting agencies," which may include industry associations that represent domestic firms. This can create conflicts of interest that disadvantage foreign investors. The State Council may also weigh in for high-value projects in "restricted" sectors.

The Catalogue of Investment Projects subject to Government Ratification can be found here: http://www.gov.cn/zhengce/content/2014-11/18/content_9219.htm

Approvals

Based on the three foreign investment laws, once NDRC approves the foreign investment project, foreign investors must apply to the Ministry of Commerce (MOFCOM) for approval to legally establish a company. Next, foreign investors apply for a business license from the State Administration of Industry and Commerce (SAIC), which allows the firm to operate. Once a license is obtained, the investor registers with China's tax and foreign exchange agencies. Greenfield investment projects must also seek approval from China's Environmental Protection Ministry and its Ministry of Land Resources. The actual implementation of China’s foreign investment approvals process may vary in specific cases, depending on the details of a particular investment proposal and local rules and practices.

The U.S. Chamber of Commerce’s report on China’s Approval Process for Inbound Foreign Direct Investment can be found here:
http://www.uschamber.com/sites/default/files/reports/020021_China_InvestmentPaper_hires.pdf

Draft Foreign Investment Law

As mentioned, the Ministry of Commerce (MOFCOM) in January 2015 proposed a new Foreign Investment Law, which reflects key principles from the U.S. model BIT, including the use of a negative list to enumerate instances where FDI is treated differently than domestic investment. The draft would also streamline the approval process for foreign investment in some sectors but contains a number of troubling provisions that could facilitate discriminatory treatment of foreign investment. The draft law was released for public comment in January 2015.

Anti-monopoly Review and National Security Review

MOFCOM conducts anti-monopoly and/or national security reviews of proposed mergers or acquisitions of domestic enterprises by foreign investors. The anti-monopoly review is detailed in the section below, on competition policy. Article 31 of China's Anti-monopoly Law also notes that if a merger or acquisition of a domestic enterprise by a foreign investor poses national security concerns, a separate national security review is also required. MOFCOM's Rules on Mergers and Acquisitions of Domestic Enterprises by Foreign Investment Article 12 stipulates that parties are required to report transaction to MOFCOM if:

- foreign investors obtain actual control, via merger or acquisition, of a domestic enterprise in a key industry;
- the merger or acquisition affects or may affect national economic security;
- the merger or acquisition would cause the transfer of actual control of a domestic enterprise with a famous trademark or a Chinese time-honored brand.

If MOFCOM determines that the parties did not report a merger or acquisition that affects or could affect national economic security, MOFCOM, together with other government agencies, may require the parties to terminate the transaction or adopt other measures to eliminate the impact on national economic security.

In February 2011, China released the State Council Notice Regarding the Establishment of a Security Review Mechanism for Foreign Investors Acquiring Domestic Enterprises. The notice established an interagency Joint Conference, led by NDRC and MOFCOM, with the authority to block foreign mergers and acquisitions of domestic firms that it believes may impact national security. The Joint Conference is instructed to consider not just national security but also national economic security and "social order" when reviewing transactions. China has not disclosed any instances in which it invoked this formal review mechanism. Lack of information about China's national security review process reflects the breadth of China's national security concerns, which extend to mechanics of regulatory decisions that are more transparent in the United States and most other developed markets.

Local commerce departments are responsible for flagging transactions that require a national security review when they review them in an earlier stage of China's foreign investment approval process. Some provincial and municipal departments of commerce previously posted on the Internet a Security Review Industry Table listing non-defense industries where transactions may trigger a national security review but MOFCOM has declined to confirm whether these lists reflect official policy. In addition, third parties such as other governmental agencies, industry associations, and companies in the same industry can seek MOFCOM's review of transactions, which can pose conflicts of interest that disadvantage foreign investors. Investors may also voluntarily file for a national security review.

In addition to transforming the current foreign investment regime, the aforementioned MOFCOM draft Foreign Investment Law would also establish a broad and potentially intrusive national security review mechanism. As it is currently envisaged, the national security review could be used to hinder market access and increase the financial burden of foreign investment in China.

Competition Law

Competition Policy, Laws, and Regulations

China has many laws and regulations that concentrate production in certain sectors into monopolies, near-monopolies, or authorized oligopolies. These measures are focused in capital intensive sectors, like electricity and transportation, or in industries such as fixed-line telephony and postal services, in which this approach may be used to ensure national coverage. The measures also target sectors which the government deems vital to national security and economic stability, including defense, energy, and banking. Examples of such laws and regulations include the Law on Electricity (1996), Civil Aviation Law (1995), Regulations on Telecommunication (2000), Postal Law (1986), Railroad Law (1991), and Commercial Bank Law (amended in 2003), among others.

Anti-monopoly Law

China's Anti-monopoly Law (AML) took effect in August 2008 and established an anti-monopoly commission with oversight and coordinating responsibilities. Three agencies share enforcement responsibilities: MOFCOM reviews mergers; NDRC reviews cartel agreements to fix prices, abuse of dominance, and abuse of administrative power involving pricing; and SAIC reviews these same types of activities when they are not directly price-related. After the AML was enacted, MOFCOM, NDRC, SAIC, and other Chinese government ministries and agencies began to formulate implementing regulations, departmental rules, and other measures. Generally, these ministries and agencies have been willing to seek public comment on their proposed measures.

Enforcement

China's enforcement of laws and regulations related to monopolies is uneven. Inconsistent local and provincial enforcement may be exacerbated by local protectionism. Government authorities at all levels in China may also restrict competition with favored firms through various forms of regulation. Official statements frequently suggest these efforts are tied primarily to employment concerns. However, the ultimate beneficiaries of the resulting measures are often unclear. In addition, local governments frequently enact rules that restrict inter-provincial trade, which may also restrict market access for certain imported products, raise production costs, and limit market opportunities for foreign-invested enterprises.

Since the AML went into effect, MOFCOM's oversight of mergers has yielded the most enforcement activity, largely due to the requirement to pre-notify merger transactions. Under the AML, through the end of 2014, China has "unconditionally" approved 961 merger cases and "conditionally" approved 25, according to Chinese statistics. Twenty-one of the 25 cases approved with conditions have involved offshore transactions between foreign parties. The other four transactions involved foreign companies merging with Chinese enterprises. Observers have expressed concern over the speed and inconsistent review process. MOFCOM's March 2014 Provisional Rules on the Applicable Criteria of Streamlined Cases Regarding Concentrations of Undertakings established a procedure for accelerated review.

The NDRC, China's former economic planning agency, enforces the AML's price provisions and launched high-profile investigations of foreign companies in 2014. The majority of cases the NDRC investigated address "horizontal" agreements to set prices or divide the market – a practice that is always illegal in the United States. The smaller number of NDRC investigations into "vertical" price agreements between suppliers and customers and abuse of dominance caused controversy. Seventy-eight percent of NDRC's investigations into "vertical" cases involve foreign firms. There is significant uncertainty about the rules that govern NDRC investigations, which contributes to an impression that they are subject to influence politically and by competitors. In some cases, proposed remedies appear designed not to restore competition, but to compel firms to lower prices regardless of the competitive dynamics of China's market. In 2014, the NDRC reportedly pressured companies it investigated to "cooperate" in the face of unspecified allegations or face steep fines.

At the same time, the NDRC made progress towards greater transparency by releasing aggregate data on investigations and beginning to publicize case decisions. MOFCOM stated it will enforce compliance by Chinese firms with requirements to file notifications for review of proposed mergers and acquisitions. During the U.S-China Joint Commission on Commerce and Trade in December, China's three AML enforcement agencies committed to provide to any party under investigation information about the regulators' competition concerns with the conduct or transaction, treat all business operators equally when enforcing the AML, and allow domestic and foreign legal counsel into AML investigation meetings.

It remains unclear how China will implement the AML with respect to SOEs and government monopolies in industries deemed nationally important. While introductory language in the law says the AML protects the lawful operations of SOEs and government monopolies in industries deemed nationally important, the three AML enforcement agencies have publicly stated that the law applies to SOEs, and have pursued some enforcement actions against them. But concerns remain that enforcement against SOEs will remain limited, especially given China's proactive orchestration of mergers in rail and other strategic sectors that may limit competition and raise prices within China while potentially increasing the competitiveness of Chinese firms in overseas markets.

On the positive side, Anti-monopoly Law provisions restricting regulators from abusing administrative monopolies, which also appear in NDRC's and SAIC's implementing regulations, could help promote the establishment and maintenance of increasingly competitive markets in China if they are enforced. In addition, China amended its Administrative Procedure Law in

2014 to allow private parties to sue government regulators for restricting competition through abuse of administrative power.

Additional Laws Related to Foreign Investment

China's State Secrets Law gives the government broad authority to classify information as a “state secret,” creating uncertainty and potential risk for investors negotiating with SOEs or operating in sensitive sectors. The Contract Law encourages contractual compliance by providing legal recourse for a breach of contract, although enforcement of judgments continues to be a problem. Additional investment-related laws include, but are not limited to: the Administrative Permissions Law; the Arbitration Law; the Corporate Income Tax Law; the Enterprise Bankruptcy Law; the Foreign Trade Law; the Government Procurement Law; the Insurance Law; the Labor Contract Law; the Law on Import and Export of Goods; and the Securities Law.

Investment Trends

U.S. – China Bilateral Investment Treaty

The United States resumed negotiations of a bilateral investment treaty (BIT) with China in October 2012. At the 2014 U.S.-China Strategic and Economic Dialogue, China agreed to narrow differences and to reach agreement on core issues and major articles of the treaty text with the United States by the end of 2014, and commit to initiate the “negative list” negotiation early in 2015 based on each other’s “negative list” offers. President Obama and President Xi publically highlighted the importance of reaching a U.S.-China Bilateral Investment Treaty (BIT) during President Obama’s state visit to Beijing in November 2014 and committed to dedicate all necessary resources to the negotiations.

Table 1

Measure	Year	Index or Rank	Website Address
TI Corruption Perceptions index	2014	100 of 175	transparency.org/cpi2014/results
World Bank’s Doing Business Report “Ease of Doing Business”	2015	90 of 189	doingbusiness.org/rankings
Global Innovation Index	2014	29 of 143	globalinnovationindex.org/content.aspx?page=data-analysis
World Bank GNI per capita	2013	USD 6,560	data.worldbank.org/indicator/NY.GNP.PCAP.CD

2. Conversion and Transfer Policies

Foreign Exchange

Foreign-invested enterprises in China do not need pre-approval to open foreign exchange accounts and are allowed to retain income as foreign exchange or convert it into renminbi without quota requirements. Foreign exchange transactions on China's capital account no longer require a case-by-case review by the State Administration of Foreign Exchange (SAFE). Instead, designated foreign exchange banks review and directly conduct foreign exchange settlements. The Chinese government registers all commercial foreign debt and limits foreign firms' accumulated medium- and long-term debt from abroad to the difference between total investment and registered capital. However, China has been gradually liberalizing foreign exchange controls, and in April 2014, announced new rules (the Regulations on Forex Capital Pooling Operations and Management of Multinational Companies) that provide greater flexibility in transferring foreign currency for large domestic and foreign multinational firms. Foreign firms must report their foreign exchange balance once per year. In April 15, SAFE announced a further loosening of capital controls for foreign-funded firms, which are now allowed to convert up to 100% of their registered foreign-currency capital into renminbi based on business needs.

Remittance Policies

The following operations do not require SAFE approval: purchase and remittance of foreign exchange as a result of capital reduction, liquidation, or early repatriation of an investment in a foreign-owned enterprise, or as a result of the transfer of equity in a foreign-invested enterprise to a Chinese domestic entity or individual where lawful income derived in China is reinvested.

This would include profit, proceeds of equity transfer, capital reduction, liquidation, and early repatriation of investment.

3. Expropriation and Compensation

Chinese law prohibits nationalization of foreign-invested enterprises except under "special" circumstances. Chinese officials have said these circumstances include national security and obstacles to large civil engineering projects, but the law does not define the term. Chinese law requires compensation of expropriated foreign investments, but does not describe the formula to be used in calculating the amount. The Department of State is not aware of any cases since 1979 in which China has expropriated a U.S. investment, although the Department has notified Congress of several cases of concern.

4. Dispute Settlement

Legal System, Specialized Courts, Judicial Independence, Judgments of Foreign Courts

Chinese officials typically urge firms to resolve disputes through informal conciliation. If formal mediation is necessary, Chinese parties and the authorities typically promote arbitration over litigation. Many contracts prescribe arbitration by the China International Economic and Trade Arbitration Commission (CIETAC). CIETAC, established by the State Council in 1956 under the auspices of the China Council for the Promotion of International Trade (CCPIT), is China's most widely-utilized arbitral body for foreign-related disputes. Some foreign parties have obtained favorable rulings from CIETAC, while others question CIETAC's procedures and effectiveness. Other arbitration commissions exist and are usually affiliated with the government at the provincial or municipal level. The Beijing Arbitration Commission and the Shanghai Arbitration Commission have emerged as serious domestic competitors to CIETAC. For contracts involving at least one foreign party, offshore arbitration may be adopted. Arbitration awards are not always enforced by Chinese local courts. Investors may appeal to higher courts in such cases.

CIETAC is based in Beijing and has four sub-commissions (Shanghai, Shenzhen, Tianjin, and Chongqing). In 2012, CCPIT, under the authority of the State Council, issued new arbitration rules that granted CIETAC headquarters significantly more authority to hear cases rather than its vis-à-vis its sub-commissions. Expecting a loss in revenue, CIETAC Shanghai and CIETAC Shenzhen declared their independence, issued their own rules, and changed their names. As a result, CIETAC disqualified its former Shanghai and Shenzhen affiliates from administering arbitration disputes.

This jurisdictional dispute between CIETAC in Beijing and the former sub-commissions raised serious concerns in the U.S. business and legal communities, particularly regarding the validity of arbitration agreements specifying particular arbitration procedures and the enforceability of arbitral awards issued by the sub-commissions. In 2013, the Supreme People's Court issued a notice clarifying that any lower court that hears a case arising out of the CIETAC split must report the case to the SPC before making a decision. However, the SPC notice is brief and lacks detail on certain issues, including the timeframe for the lower court's decision to reach the SPC and for the SPC to issue its opinion.

Legal Code

China lacks a unified written "Commercial Law." Rules governing commercial activities are present in various laws, regulations, and judicial interpretations, including China's Civil Law, Contract Law, Partnership Enterprises Law, Security Law, Insurance Law, Enterprises Bankruptcy Law, Labor Contract Law and Implementing Regulations, and Supreme People's Court Interpretation on Several Issues Regarding the Application of the Contract Law. China does not have specialized commercial courts, but recently initiated a three-year pilot program to establish three specialized IPR courts in Beijing, Guangzhou, and Shanghai. These specialized IPR courts will serve as trial courts for certain IPR cases the resolution of which benefits from technical training, including cases related to patents, well-known trademarks, computer software, and trade secrets. The IPR Courts will also hear appeals of other IPR disputes originating in their geographical jurisdiction; the Beijing IPR court will conduct reviews of patent and trademark validity appealed from the responsible IP offices. In addition, many lower level courts outside of these geographic regions have designated specific IPR tribunals to hear IPR disputes.

Lack of Judicial Independence

Formal commercial disputes between investors are heard in economic courts. China's Constitution provides a legal basis for China's courts to independently exercise adjudicative power, and several laws have provisions stating that courts are not subject to interference by administrative organs, public organizations, or individuals. However, in practice, China’s court system is not independent of the government or the Chinese Communist Party, which often intervene in disputes. Interference takes place for many reasons, including:

- Courts fall under the jurisdiction of local governments.
- Courts budgets are appropriated by local administrative authorities.
- Judges in China have administrative ranks and are managed as administrative officials.
- The Chinese Communist Party is in charge of the appointment, dismissal, transfer, and promotion of administrative officials.
- China’s Constitution stipulates that local legislatures appoint and supervise the courts.
- Corruption may also influence local court decisions.

In practice, China's court system is not independent of the government, and the government often intervenes in disputes. The U.S. business community consistently reports that Chinese courts, particularly the lower courts, are susceptible to outside (political) influence, lack the sophistication to understand complex commercial disputes, and operate opaquely. U.S. companies often avoid challenging administrative decisions or bringing commercial disputes before a local court for fear of political retaliation.

Reports of business disputes involving violence, death threats, hostage-taking, and travel bans involving Americans continue to increase, although American citizens and foreigners in general do not appear to be more likely than Chinese nationals to be subject to this treatment. Police are often reluctant to intervene in what they consider to be internal contract disputes.

Fourth Plenum Reforms

The Chinese Communist Party’s (CCP) October 2014 Fourth Plenum Decision called for the strengthening of “rule of law” through top-down judicial, legal, and administrative reforms. The Fourth Plenum Decision set six major tasks: improving the Constitution-centered legal system “with Chinese socialist characteristics” and strengthening the implementation of the Constitution; promoting administration by law and speedily moving toward a government ruled by laws; safeguarding judicial justice; improving judicial credibility; promoting the public’s awareness of rule of law; and enhancing and improving the party’s leadership in comprehensively promoting the rule of law. Since the conclusion of the Fourth Plenum, the Communist Party has moved forward with several preliminary measures to implement these reforms, including the establishment of some new courts and the promulgation of rules prohibiting official interference in judicial cases. If successful, these reforms could result in fairer judicial procedures and allow companies to pursue judicial or administrative action in a district outside of their base of operations. However, the Communist Party clearly emphasized in the Fourth Plenum that it remains above the law. Many observers say “rule by law” is a more accurate description of the party's Fourth Plenum goals. Ultimately, the implementation of these reforms will be a significant challenge for the Communist Party, and even if the reforms are successful, it could be many years before they begin to have a significant effect.

Bankruptcy

In June 2007, China's new Enterprise Bankruptcy Law came into force. For both foreign investors as well as domestic companies, the bankruptcy process is rarely used to wind down company operations or seek protection from creditors, due to the incomplete nature of the legal regime and judicial inexperience in this area of corporate law.

Investment Disputes

The Chinese government and judicial system do not maintain a public record of investment disputes. The Supreme People's Court maintains a count of the annual number of cases involving foreigners tried throughout China, but does not specify the types of cases, identify civil or commercial disputes, or note foreign investment disputes. Rulings in some cases are open to the public.

International Arbitration

China has bilateral investment agreements with over 100 countries and economies. The majority of these agreements set mediation, domestic remedies and international arbitration as the means to settle disputes. However, investor-state disputes leading to arbitration are rare in China.

There are few precedents where Chinese courts have recognized and enforced foreign court judgments. Articles 281 and 282 of China's Civil Procedure Law covers the recognition and enforcement of the effective judgments of foreign courts by the court system of China. According to these laws, if the courts determine, after reviewing the foreign courts' judgments, China's treaty obligations, reciprocity principles, basic principles of Chinese laws, China's sovereignty, security, and social public interests, the Chinese courts shall issue verdicts to recognize the effectiveness of foreign court judgments and issue enforcement orders if enforcement is needed. China has concluded 27 bilateral agreements on the recognition and enforcement of foreign court judgments, but none with the United States. China's recognition of judgments by U.S. courts can be inconsistent, according to anecdotal reports.

ICSID Convention and New York Convention

China is a member of the International Center for the Settlement of Investment Disputes (ICSID) and has ratified the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention). The domestic legislation that provides for enforcement of foreign arbitral awards related to these two Conventions include the Arbitration Law, adopted in 1994; the Civil Procedure Law adopted in 1991 and amended in 2012; the Law on Chinese-Foreign Equity Joint Ventures adopted in 1979 and amended most recently in 2001; and a number of other laws with similar provisions. Moreover, Chinese Arbitration Law has embraced many of the fundamental principles of The United Nations Commission on International Trade Law's Model Law on International Commercial Arbitration.

Duration of Dispute Resolution

Article 270 of China's Civil Procedure Law states that time limits in civil cases do not apply to cases involving foreign investment. According to the 2012 CIETAC Arbitration Rules, in an ordinary procedure case, the arbitral tribunal shall render an arbitral award within six months (in foreign-related cases) from the date on which the arbitral tribunal is formed. In a summary procedure case, the arbitral tribunal shall make an award within three months from the date on which the arbitral tribunal is formed. In a domestic arbitration case, the arbitral tribunal shall render an arbitral award within four months from the date on which the arbitral tribunal is formed. At the request of the arbitral tribunal and with the approval of the Secretary General of the CIETAC, the time period of rendering an arbitral award may be extended..

5. Performance Requirements and Investment Incentives

WTO/TRIMS

When joining the World Trade Organization (WTO) in 2001, China committed to eliminate and cease the enforcement of trade and foreign exchange balancing requirements; local content and export performance offsets; and technology transfer requirements made effective through laws, regulations, and other measures. China also committed to lift within two years all measures applicable to motor vehicle producers that restrict categories, types, or models of vehicles permitted for production, and to increase limits within which investment in motor vehicle manufacturing could be approved by provincial governments.

Investment Incentives

Many localities – including special economic zones, development zones, and science parks – court foreign investors with packages of reduced income taxes, resource and land use fees, and import/export duties, as well as priority treatment in obtaining basic infrastructure services, streamlined government approvals, and funding support for start-ups. These packages may also stipulate export, local content, technology transfer, or other requirements.

Research and Development

There is no express prohibition against foreign firms participating in research and development programs China finances. In certain sectors where China does not possess the expertise to conduct advanced research, foreign participation is generally encouraged. However, a large number of sectors which China deems sensitive to national security, including broadly defined "economic security," are effectively closed to investment from U.S. and other foreign firms.

Performance Requirements

China has committed to eliminate export performance, trade and foreign exchange balancing, and local content requirements. China has also committed to enforce only technology transfer rules that do not violate World Trade Organization (WTO) standards on IP and trade-related investment measures. In practice, however, local officials and some regulators prefer investments that develop favored industries and support the local job market. Provincial and municipal governments often restrict access to local markets, government procurement, and public works projects even to firms that have invested in the province or municipality. In addition, Chinese regulators have reportedly pressured foreign firms in some sectors to disclose IP content or license it to competitors, sometimes at below market rates.

Data Storage

In China, as elsewhere, there are vast opportunities in cloud computing. A broad range of companies are using online data storage to capture cost savings and easier access to data. However, regulatory restrictions, including mandatory source code or IP disclosure requirements in testing and certification regimes related to government procurement, prescriptive technology adoption requirements (often in the form of domestic standards that diverge from global standards), and operational restrictions such as privacy measures, data center colocation, and cross-border data flow restrictions, limit foreign companies' ability to invest in China's emerging cloud industry. For example, a draft counterterrorism law that began working its way through the legislative process in early December 2014 contains troubling requirements for ICT companies, including data-localization provisions. This draft law would require all telecommunications and Internet businesses to place all data-related equipment and store all domestic user data within China. At the 24th U.S.-China Joint Commission on Commerce and Trade in 2013, China agreed to provide foreign enterprises fair and equitable participation in the development of its strategic emerging industries, including cloud computing.

6. Right to Private Ownership and Establishment

In China, all commercial enterprises require a license from the government. There is no broad right to establish a business. Disposition of an enterprise is also tightly regulated. The Administrative Permissions Law requires reviews of proposed investments for conformity with Chinese laws and regulations, and is the legal basis for China's complex approval system for foreign investment.

7. Protection of Property Rights

Real Property

The Chinese legal system mediates acquisition and disposition of property. Chinese courts have an inconsistent record in protecting the legal rights of foreigners.

Tangible Property Rights

All land in China is owned by the State. Individuals and firms, including foreigners, can own and transfer long-term leases for land, structures, and personal property, subject to many restrictions. China's Property Law stipulates that residential property rights will be automatically renewed while commercial and industrial grants shall be renewed absent a conflicting public interest. A number of foreign investors have seen their land-use rights revoked when neighborhoods are slated by the government for development. Investors report compensation in these cases has been nominal.

China's Securities Law defines debtor and guarantor rights and allows mortgages of certain types of property and other tangible assets, including long-term leases as described above. China does not have laws or regulations prohibiting foreigners from buying non-performing debt, which they may acquire through state-owned asset management firms. However, in practice, China uses bureaucratic hurdles that limit foreigners' ability to liquidate assets in order to discourage them from purchasing non-performing debt.

Intellectual Property Rights

China has updated many of its laws and regulations to comply with the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) and other international agreements. However, there are still aspects of China's IPR legal and regulatory regime that the United States believes fall short of international best practices, and, if improved, would provide greater protection to IPR. Furthermore, effective enforcement of China's IPR laws and regulations remains a significant challenge.

In general, criminal penalties for infringement are not applied on a frequent and consistent enough basis to significantly deter ongoing infringement. Furthermore, administrative sanctions are typically non-transparent and are so weak as to lack a deterrent effect. Because of relatively low damage awards, civil litigation against IPR infringement continues to have a limited effect. For detailed information on China's environment for IPR protection and enforcement, please see the following reports:

Office of the United States Trade Representative's (USTR) 2014 Special 301 Report (see section on China):
https://ustr.gov/sites/default/files/2015-Special-301-Report-FINAL.pdf

USTR's 2014 National Trade Estimate Report on Foreign Trade Barriers in China (see section on IPR):
http://www.ustr.gov/sites/default/files/2014%20NTE%20Report%20on%20FTB%20China.pdf

USTR's 2014 Report to Congress on China's WTO Compliance (see section on IPR):
https://ustr.gov/sites/default/files/2014-Report-to-Congress-Final.pdf

For additional information about treaty obligations and points of contact at local IP offices, please see WIPO's country profiles at http://www.wipo.int/directory/en/.

Resources for Rights Holders

Contact at Embassy Beijing:

- Joel B. Blank
- Intellectual Property Attaché
- 86-10-8531-4812
- Joel.Blank@trade.gov

Local lawyers list: http://beijing.usembassy-china.org.cn/acs_legal.html

8. Transparency of the Regulatory System

China's legal and regulatory system is complex and Chinese regulators and other government authorities inconsistently enforce regulations, rules, and other regulatory documents. Foreign investors rank inconsistent and arbitrary regulatory enforcement and lack of transparency among the major problems they face in China's market.

The State Council's Legislative Affairs Office (SCLAO) has issued instructions to Chinese agencies to publish all foreign trade- and investment-related laws, regulations, rules, and policy measures in the MOFCOM Gazette, in accordance with China's WTO accession commitment. In addition, it has also issued notices to require its own departments and other central government agencies to post proposed trade- and economic-related administrative regulations and departmental rules on the official SCLAO website for public comment. However, the SCLAO and ministries falling under the State Council continue to post only a fraction of draft administrative regulations and departmental rules on the SCLAO website for a 30-day public comment period. Comment periods can be extremely brief, and the impact of public comments on final regulations is not clear.

Moreover, there are an increasing number of regulatory policies for which public comment is not sought before they are finalized. Foreign investors report that Chinese regulators at times rely on unpublished internal guidelines that nonetheless affect their businesses.

State actions motivated by a perceived need to protect social stability or achieve other political goals can affect foreign investors. Access to foreign online resources, including news, cloudbased business services, and virtual private networks (VPNs), is often and increasingly restricted without official acknowledgement or explanation. Foreign-invested companies have also reported threats of retaliation by the government for actions taken by the U.S. and other foreign governments at the WTO.

9. Efficient Capital Markets and Portfolio Investment

China’s leadership aims to build a modern, developed, multi-tiered capital market. Bank loans continue to provide the majority of credit in China, although other sources of capital, such as corporate bonds, trust loans, equity financing, and private equity financing, are expanding their scope, reach, and sophistication. Regulators use administrative methods to control credit growth, although market-based tools such as interest rate policy play an increasingly important role.

The People's Bank of China (PBOC), China's central bank, has gradually increased flexibility for banks in setting interest rates; the floor on the lending rate was removed in 2013. The PBOC has increased flexibility on deposit rates and has said that the ceiling on deposit rates will be gradually lifted, possibly within the next year. Favored borrowers, particularly SOEs, benefit from greater access to capital and lower financing costs, as lenders perceive these entities to have an implicit government guarantee and hence lower risk profiles. Small- and medium-sized enterprises (SMEs), by contrast, experience the most difficulty obtaining bank financing, and instead, often finance investments through retained earnings or informal channels, including other Chinese firms or private lenders. In recent years, China’s “shadow banking” sector, which includes vehicles such as wealth management and trust products, has grown rapidly. The Chinese authorities have taken successive steps to increase the transparency and strengthen the supervision of these activities, while also permitting their continued development, as in many cases, these products increase channels for private firms to obtain capital at market rates. In 2014, the government also announced a pilot program that will allow private investors to establish small commercial banks, with an expansion of this pilot in 2015.

Non-bank financing has expanded over the last few years, including through public listing of stock, either inside or outside of China, and more firms are issuing bonds. Most foreign portfolio investment in Chinese companies occurs on foreign exchanges, primarily in New York and Hong Kong. In addition, China has significantly expanded quotas for certain foreign institutional investors to invest in domestic stock markets, and has approved a two-way cross-border equity direct investment scheme between Shanghai and Hong Kong, which will allow Chinese investors to trade designated Hong Kong-listed stocks through the Shanghai Exchange, and vice versa. Direct investment by private equity and venture capital firms is also rising rapidly, although from a small base.

Money and Banking System, Hostile Takeovers

After several years or rapid credit growth, China's banking sector faces asset quality concerns. The reported non-performing loans (NPL) ratio rose to 1.64 percent at the end of 2014, up from 1 percent at the end of 2013. China's total banking assets hit 172.3 trillion yuan by December 2014, up 13.87 percent from a year earlier, and accounting for over 20 percent of global banking assets. The Big 5 state-owned commercial banks account for almost 50 percent of China's banking sector assets. The People's Bank of China operates as China's central bank.

10. Competition from State-Owned Enterprises

China's leading SOEs benefit from preferential government policies and practices aimed at developing bigger and stronger national champions. SOEs enjoy favored access to the most essential economic inputs (land, hydrocarbons, finance, telecoms, electricity) and considerable power in the markets for others (steel, minerals). SOEs have long enjoyed preferential access to credit and the ability to issue publicly traded equity and debt. According to some Chinese academics, provincial governments have used their power to manipulate industrial policies to deny operating licenses in order to persuade reluctant owners to sell out to bigger state-owned suitors.

The November 2013 Third Plenum agenda calls for SOEs to remain a key part of China's economic system, even as China makes them more efficient and transparent by limiting their monopoly power and preferential access to factors of production to improve their contribution to economic development. The Third Plenum meeting called for a "mixed ownership" economic structure, which would allow for private and state-owned businesses to co-exist in the domestic economy and proposed greater balance between private and state-owned businesses, including access to factors of production, competition on a level-playing field, and equal legal protection.

The Third Plenum Decision explains that SOEs will focus resources in areas that "serve state strategic objectives." However, experts point out that SOEs continue to hold dominant shares in their respective industries, regardless of whether they are strategic, which may further restrain private investment in the economy. Moreover, the application of China's Anti-monopoly Law, together with other industrial policies and practices that are selectively enforced by the authorities, protect SOEs from private sector competition.

Investment Restrictions in "Vital Industries and Key Fields"

The December 2006 Guiding Opinions Concerning the Advancement of Adjustments of State Capital and the Restructuring of State-Owned Enterprises called on China to consolidate and develop its state-owned economy, including enhancing its control and influence in "vital industries and key fields relating to national security and national economic lifelines." The document defined "vital industries and key fields" as "industries concerning national security, major infrastructure and important mineral resources, industries that provide essential public goods and services, and key enterprises in pillar industries and high-tech industries."

At the time the document was published, the Chairman of the State-owned Assets Supervision and Administration Commission (SASAC) listed industries in which the State should maintain "absolute control" (aviation, coal, defense, electric power and the State grid, oil and petrochemicals, shipping, and telecommunications) and "relative control" (automotive, chemical, construction, exploration and design, electronic information, equipment manufacturing, iron and steel, nonferrous metal, and science and technology). China maintains that these lists do not reflect its official policy. In some cases, more than 50 percent ownership in some of these industries has been permitted on a case-by-case basis, especially if a particular expertise or technology is deemed important at the time.

China's current agriculture trade rules, regulations, and limitations on foreign agricultural investment severely restrict the contributions of American agriculture companies and, subsequently, the many potential benefits to China's agriculture sector. China's agriculture investment restrictions also appear to be at odds with the objectives of China's 12th FYP, which emphasizes the need to shift more resources to agriculture and food production in order to improve people's lives and meet China's food security and food safety needs. China's State Assets Law is intended to safeguard China's economic system, promote the "socialist market economy," fortify and develop the state-owned economy, and enable SOEs to play a leading role in China's economy, especially in "vital industries and key fields." The law requires China to adopt policies to encourage SOE concentration and dominance in industries vital to national security and "national economic security."

OECD Guidelines on Corporate Governance of SOEs

China's State-owned Assets Supervision and Administration Commission of the State Council (SASAC), the main regulator of central state-owned enterprises (SOEs), participates in the OECD Working Party on State-Ownership and Privatization Practices (WPSOPP). China has indicated to the Working Party that it intends to use OECD guidelines to improve the professionalism of its SOEs, including making boards more independent from political influence. However, despite China's Third Plenum commitments – to foster "market-oriented" reforms in China's state sectors – Chinese officials and SASAC have made minimal progress to fundamentally change regulation and business conduct of SOEs.

Shortly after the annual National People's Congress meeting in 2014, SASAC released a plan to "deepen" economic reforms, entitled "Guiding Opinions for Deepening SOE Reforms." The guidelines were drafted by former SASAC officials. As a next step, SASAC planned to "strategically" define SOEs as either "public-interest" SOEs or "competitive" SOEs; however, these reforms were not carried out during the reporting period. Analysts have discussed the need to push forward a clear separation of SOE administration and policy functions. Reform-oriented supporters suggest that one office should focus on the "administration" of SOEs, to ensure they run efficiently and provide an adequate rate of return, while a separate office should focus on the policy-making role. Currently, both functions are intertwined in SASAC.

Economic analysts have indicated that "vested interests" remain a major impediment to SOE reforms. SOEs enjoy preferential access to a disproportionate share of available capital, whether in the form of loans or equity. SOE executives often outrank their SOE regulators, which minimizes SASAC and other government regulators' effectiveness. Moreover, SOE executives are often promoted to high-ranking positions in the Central Party or local government positions, which further complicates the regulation of Chinese SOEs.

Sovereign Wealth Funds

China's principal sovereign wealth fund is China Investment Corporation (CIC), which was established in 2007. CIC is overseen by a board of directors and a board of supervisors and invests on a 10-year time horizon, using rolling annualized returns to evaluate performance. China's sovereign wealth is also invested by a subsidiary of SAFE, a government agency that reports directly to the PBOC. The SAFE Administrator serves concurrently as a PBOC Vice Governor. While CIC publishes an annual report containing information on its structure, investments, and returns, SAFE does not. China's National Social Security Fund also makes investments using China's sovereign wealth. The Silk Road Fund, established at the end of 2014, is also designed to use China's sovereign wealth to make investments abroad.

11. Corporate Social Responsibility

Corporate social responsibility (CSR), or what is increasingly known as sustainability, is a relatively new concept for domestic companies in China, where it is less widely accepted than in the United States. Investors looking to partner with Chinese companies or expand operations with Chinese suppliers face challenges ensuring domestic firms meet internationally recognized, voluntary industry standards in such areas as labor, the environment, and good manufacturing practices. China's 12th FYP highlights sustainability issues as a means to draw attention to the subject. Foreign-invested enterprises tend to follow generally accepted CSR principles, and most report annually on their CSR policies and achievements.

OECD Guidelines for Multinational Enterprises

In the past year China has appeared more willing to engage in dialogue around international standards for responsible investment. For example, in 2014 China signed an MOU with OECD and have indicated possible interest in establishing a National Contact Point, as required of all governments adhering to the OECD Guidelines for Multinational Enterprises. China also participated in OECD's 2014 Global Forum on Responsible Business Conduct (RBC) and plans to participate in the next Global Forum scheduled for June 2015. Additionally, the Chinese Chamber of Commerce of Metals, Minerals and Chemical Importers and Exporters (CCCMC), a government-affiliated chamber, signed a separate MOU with the OECD in October 2014 to help Chinese companies implement responsible business conduct policies in global mineral supply chains.

12. Political Violence

The risk of political violence directed at foreign companies operating in China remains small. Every year there are reportedly many tens of thousands of protests. The government is adept at handling them without violence, but given the number of mass incidents annually, the potential for violent flare-ups is real. Violent but unconnected protests that have occurred throughout China generally involved ethnic tensions or local residents protesting corrupt officials, environmental and food safety concerns, confiscated property, and disputes over unpaid wages. In several recent examples, workers and mid-level managers have protested against corporate merger and acquisition decisions on the grounds that employees were not consulted. There have also been a small number of cases of foreign businesspeople being trapped in China during a business dispute.

13. Corruption

Overview

Corruption remains endemic in China. The lack of an independent press, as well as the fact that all bodies responsible for conducting corruption investigations are controlled by the Chinese Communist Party, hamper the transparent and consistent application of anti-corruption efforts.

According to Chinese law, accepting a bribe is a criminal offense with a maximum punishment of life in prison or death in "especially serious" circumstances. The maximum punishment for offering a bribe to a Chinese official is five years in prison, except when there are "serious" or "especially serious" circumstances, when punishment can range from five years to life in prison. A February 2011 amendment to the Criminal Law made offering large bribes to foreign officials or officials of international organizations a punishable offense, although there has yet to be a prosecution.

The Supreme People's Procuratorate and the Ministry of Public Security investigate criminal violations of laws related to anti-corruption, while the Ministry of Supervision and the Chinese Communist Party Discipline Inspection Commission enforce ethics guidelines and party discipline. China's National Audit Office also inspects accounts of state-owned enterprises (SOEs) and government entities.

Anti-corruption measures

China is in the midst of the most intensive and large-scale anti-corruption campaign it has seen in decades, with investigations reaching into all sectors of the government, military and SOEs. President Xi Jinping has said that endemic corruption threatens the Party's survival. The Party announced at its annual plenums in 2013 and 2014 its intention to press ahead with judicial and administrative reform and to more thoroughly fight corruption. Key Party meetings in late 2014 and early 2015 pledged to use judicial reforms to institutionalize the fight against corruption, but concrete measures are only just beginning to emerge. To enhance regional anti-corruption cooperation, the 26th Asia-Pacific Economic Cooperation (APEC) Ministers Meeting adopted the Beijing Declaration on Fighting Corruption in November 2014.

In 2014, more than 70 senior SOE officials were investigated for graft by the Party's Organization Department. Several high profile SOE executives were investigated and charged with corruption, including former oil-sector executives and the head of the country's SOE oversight body. Also in 2014, Chinese Communist Party discipline organs have investigated 226,000 cases and disciplined 232,000 officials, of which 12,000 criminal suspects were transferred to judicial authorities. Courts nationwide concluded 31,000 graft and bribery cases involving 44,000 people, and sentenced 2,349 people. China's overseas fugitive-hunting campaign captured 749 fugitives suspected of official crimes.

China's anti-corruption crackdown could curb abuse of administrative powers by government officials colluding with private sector patrons; however, inconsistent and discretionary application of anti-corruption rules may also raise concerns among foreign companies in China. To fight rampant commercial corruption in the medical/pharmaceutical sector, China's health authority issued "black lists" of firms and agents involved in commercial bribery. Several of these "black listed" firms were foreign. Additionally, anecdotal information suggests many government officials are slowing approval of foreign investment projects so as not to arouse corruption suspicions.

The Communist Party is constantly on guard against threats to political or social stability. It views independent criticism of the Party as dangerous, and therefore citizens who have called for officials to disclose their public assets or have campaigned against officials' misuse of public resources have been subject to criminal prosecution.

UN Anticorruption Convention, OECD Convention on Combatting Bribery

China ratified the United Nations Convention against Corruption in 2005 and participates in Asia-Pacific Economic Cooperation (APEC) and Organization for Economic Cooperation and Development (OECD) anti-corruption initiatives. China has not signed the OECD Convention on Combating Bribery.

Resources to Report Corruption

The following government organizations receive public reports of corruption:

- Anti-Corruption Reporting Center of the CPC Central Commission for Discipline Inspection and the Ministry of Supervision
-Telephone Number: 010-12388

14. Bilateral Investment Agreements

China has bilateral investment agreements with over 100 countries and economies, including Austria, the Belgium-Luxembourg Economic Union, Canada, France, Germany, Italy, Japan, South Korea, Spain, Thailand, and the United Kingdom. China's bilateral investment agreements cover expropriation, arbitration, most-favored-nation treatment, and repatriation of investment proceeds. They are generally regarded as weaker than the investment treaties the United States seeks to negotiate.

A list of China signed BITs can be found here:
http://tfs.mofcom.gov.cn/article/Nocategory/201111/20111107819474.shtml

China maintains twelve Free Trade Agreements (FTAs) with its trade and investment partners, and is negotiating or implementing an additional eight FTAs. China's FTA partners include ASEAN, Singapore, Pakistan, New Zealand, Chile, Peru, Costa Rica, Iceland, Switzerland, Hong Kong, Macao and Taiwan. China has recently concluded FTA negotiations with Korea and Australia, both of which include a chapter on investment.

Bilateral Taxation Treaties

The United States and China concluded a bilateral taxation treaty in 1984. In the fall of 2012, the United States resumed negotiation of a bilateral investment treaty.

15. OPIC and Other Investment Insurance Programs

The United States suspended Overseas Private Investment Corporation (OPIC) programs in the aftermath of China's crackdown on Tiananmen Square demonstrators in June 1989. OPIC honors outstanding political risk insurance contracts. The Multilateral Investment Guarantee Agency, an organization affiliated with the World Bank, provides political risk insurance for investors in China. Some foreign commercial insurance companies also offer political risk insurance, as does the People's Insurance Company of China.

16. Labor

Human resource challenges remain a major concern for American companies operating in China. Labor costs are the problem most often cited, followed closely by difficulties in finding and retaining talent, particularly at the management level and highly skilled technical staff. Navigating evolving labor and social insurance laws and implementation rules also remains a challenge.

In particular, trial implementation regulations issued in November 2014 to clarify new visa rules introduced in 2013 has led to uncertainty rather than clarity for foreign companies trying to obtain visas for their employees traveling to China. Companies continue to cite China's poor air quality and pollution generally as causing difficulties in trying to attract and retain qualified foreign talent. Together, these issues contribute to higher labor costs, and in response, a small but increasing number of foreign companies are planning to move capacity or investments outside of China.

Independent trade unions are illegal in China. The Trade Union Law gives the All-China Federation of Trade Unions (ACFTU) control over all union organizations and activities, including enterprise-level unions. The ACFTU is a Chinese Communist Party organ chaired by a member of the Politburo, and its priority task is to "uphold the leadership of the Communist Party." The ACFTU and its provincial and local branches aggressively organize new constituent unions and add new members, especially in large, multinational enterprises, but these enterprise-level unions do not generally participate actively in employee-employer relations. The right to strike is not protected by law. However, worker protests and work stoppages occur with increasing regularity especially in labor intensive and sunset industries. Official forums for mediation, arbitration, and similar mechanisms of alternative dispute resolution are generally ineffective in resolving disputes.

China has not ratified core International Labor Organization conventions on freedom of association and collective bargaining, but has ratified conventions prohibiting child labor and employment discrimination. Apart from a lack of freedom of association and the right to strike, on paper, Chinese labor laws generally meet international labor standards. Enforcement of existing labor laws and regulations, however, is inconsistent.

17. Foreign Trade Zones/Free Ports/Trade Facilitation

China's principal customs bonded areas include Shanghai, Tianjin, Shantou, three districts within Shenzhen (Futian, Yantian, and Shatoujiao), Guangzhou, Dalian, Xiamen, Ningbo, Zhuhai, and Fuzhou. Besides these official duty-free zones identified by China's State Council, numerous economic development zones and open cities offer similar privileges and benefits to foreign investors.

In September 2013, the Shanghai Municipal government and the State Council announced the establishment of the China (Shanghai) Pilot Free Trade Zone (SFTZ), which condensed four previously existing bonded areas into a single free trade zone. The goal of the SFTZ is to provide a trial ground for trade and investment liberalization measures and to introduce services sector reform, especially in financial services, that China expects to eventually introduce in other parts of the domestic economy. Shanghai officials tout the use of a negative list, to spell out sectors where national treatment does not apply, as a key reform introduced in the zone. Shanghai officials released a revised negative list in June 2014 that reduced the number of entries, but many foreign firms complained that this was done by combining entries and reducing barriers mostly in sectors that do not affect foreign firms. According to free trade zone officials, there are over 12,000 entities registered throughout the free trade zone, including 1,600 foreign firms. The municipal and central government have released a number of administrative and sector-specific regulations and circulars that outline the procedures and regulations in the zone, and expanded the zone's area to 120.7 square kilometers, an increase from its original 28.78 square kilometer size.

On December 12, 2014, Premier Li Keqiang chaired a State Council Executive Committee meeting to create three new free trade zones in Fujian, Tianjin, and Guangdong as well as an expanded area for Shanghai's already existing pilot free trade zone. Since then, a draft to adjust relevant laws and regulations on investment in the new free trade zones was discussed in the Standing Committee of the National People's Congress (NPC). On December 28, the NPC

Standing Committee authorized the State Council to offer preferential policies in the new free trade zones. The three new zones are expected to be announced in 2015. The effect of the investment climate will depend on the package of reforms included in the announcement of the FTZs, the scope of the negative lists, details on bonded warehouses and customs duties, and specifics on financial reforms and incentive policies.

18. Foreign Direct Investment and Foreign Portfolio Investment Statistics

Table 2: Key Macroeconomic Data, U.S. FDI in Host Country/Economy

	Host Country Statistical source*		**USG or international statistical source**		**USG or International Source of Data: BEA; IMF; Eurostat; UNCTAD, Other**
Economic Data	**Year**	**Amount**	**Year**	**Amount**	
Host Country Gross Domestic Product (GDP) ($M USD)	2013	8,523,829	2013	9,240,270	www.worldbank.org/en/country

Foreign Direct Investment	**Host Country Statistical source***		**USG or international statistical source**		**USG or international Source of data: BEA; IMF; Eurostat; UNCTAD, Other**
U.S. FDI in partner country ($M USD, stock positions)	2013	73,010	2013	61,534	Bureau of Economic Analysis
Host country's FDI in the United States ($M USD, stock positions)	2013	21,899	2013	8,073	Bureau of Economic Analysis
Total inbound stock of FDI as % host GDP	2013	16%	N/A	N/A	N/A

* National Bureau of Statistics of PRC; China Commerce Yearbook; MOFCOM

Table 3: Sources and Destination of FDI

According to MOFCOM's 2013 China Commerce Year Book, the top five destinations for China's Outward Direct Investment from 2003-2012 are: Hong Kong, British Virgin Islands, Cayman Islands, United States, and Australia.

Direct Investment from/in Counterpart Economy Data					
From Top Five Sources/To Top Five Destinations *(US Dollars, Millions)*					
Inward Direct Investment			**Outward Direct Investment**		
Total Inward	2,068,027	100%	Total Outward	N/A	100%
China, P.R.: Hong Kong	1,112,242	48%			
Virgin Islands, British	330,624	14%			
Japan	147,594	6%			
Singapore	101,619	4%			
United States	76,465	3%			
"0" reflects amounts rounded to +/- USD 500,000.					

Source: IMF Coordinated Direct Investment Survey

Table 4: Sources of Portfolio Investment

IMF Coordinated Portfolio Investment Survey data for China are unavailable.

19. Contact for More Information

Bridget Davis
Investment Officer
Economic Section

55 Anjialou Road, Chaoyang District, Beijing, P.R. China
0086-10 8531-3000
Beijinginvestmentteam@state.gov

Other useful online resources:

Chinese Government:

- Chinese Embassy in Washington, D.C.: http://www.china-embassy.org/eng/
- Ministry of Commerce: http://english.mofcom.gov.cn/
- Invest in China: http://www.fdi.gov.cn/pub/FDI_EN/default.htm
- National Development and Reform Commission: http://en.ndrc.gov.cn/
- State Administration of Foreign Exchange: http://www.safe.gov.cn/
- State Administration of Taxation http://www.chinatax.gov.cn/n6669073/index.html

United States Government:

- U.S. Embassy in Beijing (Doing Business in China): http://beijing.usembassy-china.org.cn/business.html
- U.S. Department of State travel information: http://travel.state.gov/
- U.S. Trade Representative: http://www.ustr.gov/
- U.S. Department of Commerce: http://www.export.gov/
- U.S. Department of the Treasury: http://www.treasury.gov/Pages/default.aspx
- Export Import Bank: http://www.exim.gov/
- Overseas Private Investment Corporation (OPIC): http://www.opic.gov/
- U.S. Trade and Development Agency: http://www.ustda.gov/