

## MEMO

From: APCO Worldwide  
Date: December 17, 2009  
Re: New Restrictions on Access to Chinese Government Procurement Market

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### Executive Summary

- The Chinese government has announced the launch of a national program to accredit “indigenous innovation” products. APCO understands this program would be used for the purposes of government procurement, part of an ambitious agenda to promote the development of indigenous innovation by Chinese enterprises.
- Strict accreditation criteria mean products made by Foreign Invested Enterprises (FIEs) have limited prospects of securing approval, and may therefore be shut out of China’s government procurement market.
- Foreign governments and trade associations have raised complaints, but they are unlikely to see a full retraction.

### Background

On Nov. 15, 2009, China’s Ministry of Science and Technology (MOST), the National Development and Reform Commission (NDRC), and the Ministry of Finance (MOF) jointly published a new directive relating to government procurement titled the “*Notification Regarding the Launch of National Indigenous Innovation Product Accreditation Work for 2009.*” The directive aims to promote the usage of Chinese products and encourage an increase in domestic innovation and technology development, and it states that a national catalogue of products that meet indigenous innovation certification criteria will be created.

The most significant development for FIEs is that the cloud of mystery surrounding the definition of an “indigenous innovation” product has finally been lifted. Specifically, in order to receive accreditation, a product must meet the following key criteria (*below is an abridged version*):

- Product has “indigenous IPR;” secondary product development, usage and market placement is not subject to foreign restrictions.
- Product commercial trademark was initially registered within China, *i.e.*, brand originated in China.
- Product must have reliable quality and has completed relevant testing and certification by national or local accreditation agencies.

Given these requirements, it is unlikely that the majority of products developed and sold by FIEs in the China market will be able to receive accreditation. Consequently this directive is likely to result in Chinese products being favored over their foreign counterparts during the government procurement process, or FIEs being forced to transfer their IPR to China in order to qualify.

In the directive, MOST, NDRC and MOF announced that China will begin accepting applications and will finalize a national list of accredited products by the end of 2009. During 2010 the Chinese government will focus on accreditation of computing and application hardware, telecommunications products, modern office equipment, software, new energy and related hardware, along with high-efficiency energy saving products. More products are expected to be added in the future. The amount of business at stake isn't clear, but according to the MOF, total government procurement in China was valued at USD 88 billion in 2008.

### **APCO Analysis**

This directive is part of a wider national policy to promote domestic science and technology development, limit China's current reliance on low-tech manufactured products and encourage FIEs to move R&D to China by placing restrictions over imported technology. To help realize this goal, China has formulated a number of policies to place extra scrutiny over the procurement of foreign goods. In 2006, China's State Council developed the *"Supporting Policies for Implementing the National Outlines for Medium and Long-term Planning for Scientific and Technological Development,"* which explicitly stated a national catalogue of indigenous products would be created for use by China's procurement officials. From the outset, this initiative was characterized by some foreign industry and governments as a protectionist measure not in line with China's WTO commitments. For these reasons, along with key agencies' inability to agree upon what constitutes an "indigenous product," the implementation of this catalogue was delayed for more than three years.

However, the directive is also an indicator that China may well be moving forward with institutionalizing its "buy China" policy under the name of promoting "indigenous innovation." Due to the current economic downturn, there has been significant attention placed upon stimulating domestic demand. Despite commitments from China's President Hu Jintao to "oppose any form of protectionism," several "buy China" procurement initiatives have recently been introduced at both the local and national level. As APCO previously reported in June 2009, nine central level ministries sent out a directive re-clarifying existing "buy China" policies under the purview of the RMB 4 trillion stimulus package. This climate of promoting domestic demand probably placed pressure on line ministries to help spur demand by quickly formulating the long-delayed national indigenous innovation product catalogue.

### **Recent Developments**

In response to this new policy, foreign governments and industry associations have taken measures to put pressure on China to drop the regulation. On December 10, 2009, more than 30 trade groups sent a formal letter of complaint to the Ministers of MOST, MOF and NDRC, while governments from the United States, EU and Japan have communicated their concerns. Despite this pressure, it seems unlikely that the measure will be fully retracted, as it will not be difficult for the Chinese government to assert indigenous innovation itself has little to do with foreign access to its markets. Officials are likely to state this "accreditation" is merely a way of recognizing the accomplishments of domestic firms, and that China does not treat foreign products unfairly and indeed welcomes foreign applications.

## Impact on FIEs

It remains unclear to what extent Chinese indigenously innovated products will be given incremental or full preferential treatment; however, it can be expected that FIEs will face new challenges and greater business risk as procurement officials are now enabled to favor Chinese products in a more systematic way. Regardless of the way this directive is characterized by Chinese officials, its promulgation will only further tighten an already difficult government procurement market for most foreign players, although a minority that become accredited may see their sales increase.

FIEs will, therefore, be faced with having to devise new methods to remain competitive, such as pricing strategies or the introduction of more advanced technology to remain a “non-substitutable” product. Another option is to place greater emphasis on after sales service and support, an area where domestic companies remain weak. However, given the tense political climate due to current international opposition, it is recommended companies wait for the next few months to see how this issue plays out amongst governments and industry associations, rather than proactively and independently raising the issue with the Chinese government.

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## CONTACT INFORMATION

For further information on how APCO Worldwide can help your organization to understand China’s government procurement regulations and implications for your organization, please contact:

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