

MEMO

From: APCO Worldwide

Date: June 19th, 2009

Re: **Government Procurement Circular – ‘Buy Chinese’ Provision**

Executive Summary

- The Chinese government has released a ‘buy Chinese’ directive for all government-invested projects.
- The directive is likely to increase protectionist pressure and although its impact on foreign invested enterprises (FIEs) with significant investment in China is unclear, it raises concerns for all overseas companies over their ability to access opportunities arising from the Chinese government’s stimulus package.

Background

China’s State Council Legislative Affairs Office, National Development and Reform Commission (NDRC) and Ministries of Industry and Information Technology, Housing, Supervision, Transport, Railways, Water Resources and Commerce have jointly released a circular titled “NDRC Department of Law and Regulation [2009] Number 1361”, which includes a ‘buy Chinese’ directive for all projects under the country’s ongoing stimulus package. The circular was released on May 26th 2009 and published on NDRC’s website on June 4th 2009.

The circular states that priority must be given to ‘domestic products’ for all government-invested projects unless the technology, goods or services to be purchased are not available or cannot be obtained under ‘reasonable commercial conditions’ within China. Under circumstances where a product has to be imported, prior approval must be obtained from the Chinese government.

APCO Analysis

A preference for domestic products in Chinese government procurement programmes is not new. In 2002, for instance, the Chinese government introduced the Government Procurement Law which clearly discriminates against foreign products. However, the law has been loosely enforced, and this new circular seems designed to strengthen support for domestic companies.

It should be noted that this move does not appear to contravene international law. Although China filed its application to the WTO Government Procurement Agreement (GPA) at the end of 2007 it is yet to become a member of the GPA. Therefore, the Chinese government’s policy towards foreign products under government procurement is not currently subject to international regulation.

Yet the move does fly in the face of previous Chinese government pronouncements describing the so-called ‘buy American’ provision in the US government’s stimulus package as ‘protectionist poison’.

The Chinese government has sought to justify the circular by stating that its intention is to provide a fairer playing field for all enterprises and to remove the bias local governments have against sourcing from Chinese companies. Regulators claim the prevailing approach taken by local governments has been to set discriminative terms in public tenders to restrict the participation of domestic Chinese companies. For example, some public tenders have required potential bidders to show a long history of industry experience even though the respective industry in China has only emerged in the past few years. As such, alongside the circular the government has announced an investigation in response to complaints

from domestic industry associations that local governments are favoring foreign suppliers for stimulus related projects.

The circular does, however, leave unanswered questions as to what actually constitutes 'domestic'. For example, it is unclear whether FIEs with manufacturing operations in China will be included or excluded from this definition. There is also the additional question of how companies with a strong Chinese identity, but actually registered outside of mainland China (such as Haier and Lenovo) would be defined.

From initial indications it appears that FIEs with significant investment and localization of their products may be included in a "domestic" definition. For instance, after the publication of the circular both Mercedes and BMW were successfully added to government procurement lists. There is speculation that products with over 50 percent of their value added in China will be categorized as domestic. Additionally, language in the circular discusses 'imported products' rather than 'foreign products,' again suggesting that the purpose of the circular is not to impose a blanket ban on any goods or services owned by an overseas company.

However, in reality, this circular is likely to increase pressure on government officials to procure goods and services from primarily domestic Chinese companies, particularly SOEs. Such pressure may not be a result of actual legal requirements in the circular given that a clear definition of 'domestic' is not yet available. Rather, it will likely be triggered mainly by the actions of local officials wishing to show their decisions are fully in line with central government edicts, which is a common trend in the interplay between local and central governments in China's political landscape.

Until the circumstances in which a good or service is defined as being 'domestic' are clarified this issue will remain a high concern for both FIEs with significant investment in China and those seeking to export to China.

The key for FIEs seeking to do business in China will be monitoring how the new circular is implemented and whether local officials will enforce a Chinese preference above and beyond the current existing level of economic nationalism present in China.

Circular 1361 can be found at:

http://www.ndrc.gov.cn/zcfb/zcfbtz/2009tz/t20090604_284262.htm