

MEMO

From: APCO Worldwide
Date: December 9, 2009
Re: **Government Procurement Market to Further Tighten for Foreign Products**

Executive Summary

- **Influential Chinese ministries announced the launch of a national program to accredit indigenous innovation products. APCO understands this catalogue would be used for the purposes of government procurement, part of an ambitious agenda to increase innovative ability of Chinese industry.**
- **Accreditation criteria create dim prospects for FIE products receiving approval. This includes tough requirements regarding IPR and origin of commercial trademarks.**

Background

On November 15th, 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 related 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 innovation and technology development, and states a national database of products that meet indigenous innovation certification criteria.

While not explicitly mentioned in the text, evidence including previous written policies, suggest procurement officials will use this new directive to discriminate against foreign products. Thus when government officials place bids for projects, this catalogue will be used as a guideline for selecting Chinese products over their foreign counterparts. In the directive, MOST, NDRC and MOF announced that China will begin accepting applications, and will finalize a national list by the end of this year. The directive stated that in 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.

This directive is part of a wider national policy to promote domestic science and technology development (S&T), moving China up the value-added chain and limiting its current reliance on low-tech manufacturing exports. To help realize this goal, China has formulated a number of government procurement policies to place extra scrutiny over the procurement of foreign goods.

APCO Analysis

The indigenous innovation product list is not a new initiative. In 2006, China's State Council with the support of MOST, 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 onset, this initiative was ridiculed by foreign industry and governments as a protectionist measure not in line with China's WTO commitments. This included China's commitment to eventually join the WTO's Government Procurement Agreement (GPA). (The GPA is a plurilateral component of the WTO that restricts a member countries ability to enact preferential procurement policies.) For these very reasons, along with key agencies' inability to agree upon what constitutes an "indigenous product," the implementation of this catalogue was delayed for over three years.

Due to the current economic downturn, there has been significant attention placed upon stimulating domestic demand. Thus despite commitments from China's President Hu Jintao to "oppose any form of protectionism," several "buy china" procurement initiatives have been introduced at both the local and national level. As APCO previously reported in June of this year, nine central level ministries sent out a directive re-clarifying existing "buy China" policies under the purview of the 4 trillion Yuan stimulus package. These developments forced MOST, NDRC, and MOF to quickly formulate the long delayed national indigenous innovation product catalogue. Draft catalogues were circulated throughout the summer and into the fall, which now seem to only have been provincial versions, since the Nov. 15th directive states the government is still accepting applications for approval.

Impact on Foreign Invested Enterprises (FIEs)

The most significant development for FIEs in this new directive 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 on the China market will be able to receive this accreditation. The addition of this catalogue will only further tighten an already difficult government procurement market.

A nationally formulated catalogue will enable procurement officials to favor Chinese products in a more systematic way. While it still remains unclear to what extent Chinese indigenous innovation products will be given incremental or full preferential treatment, it can be expected that FIEs will face new challenges. In fact FIEs may be faced with devising new methods to remain competitive such as pricing strategies or the introduction of newer, more advanced technology to remain a "non-substitutable."

This directive is an indicator that China is moving forward with institutionalizing its "buy China" policy under the name of promoting "indigenous innovation." This policy with protectionist undertones comes directly on the heels of Chinese statements made at the latest US-China Joint Commission on Commerce and Trade (JCCT) on October 15th to treat foreign products made in China as "domestic products." Given accreditation requirements will be impossible to meet for foreign vendors, it appears Chinese statements at the JCCT have little if any significance.

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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