



## Request for Company Input on PRC Domestic Innovation Policies

December 15, 2009

The US-China Business Council (USCBC) is seeking member feedback on China's plans to foster "indigenous innovation," or domestically developed intellectual property, and recent moves that could limit access to the government procurement market in China.

On November 15, 2009, the PRC Ministry of Science and Technology (MOST), National Development and Reform Commission (NDRC), and Ministry of Finance (MOF) jointly issued two notices concerning indigenous innovation. These two documents, Circular 618 and a set of related application procedures, lay out rules for a new national-level indigenous innovation product catalogue. Foreign governments and business industry associations have requested that implementation be delayed and discussions held on how China can formulate more competitive approaches to foster innovative capabilities.

Longstanding plans by MOST, MOF, and NDRC call for the development of a national catalogue for government procurement of products that meet indigenous innovation criteria. The application procedures issued in November include a notice that MOF will work with MOST and NDRC to draft a Catalogue of Indigenous Innovation Products for Government Procurement based on the initial product catalogue developed through Circular 618. The government currently aims to certify products in six broad areas through the process detailed in Circular 618, but USCBC believes that future catalogues could include additional product categories. The six areas are computers and application equipment, telecom products, modern office equipment, software, new energy equipment, and high-efficiency energy-saving products.

The following brief provides an overview of China's indigenous innovation policies and outlines some of the potential problems with the policy.

USCBC would like feedback by January 8 in the following areas:

- What impact will China's indigenous innovation policy and the implementation of a national procurement catalogue that favors indigenous innovation products have on your company's ability to sell products in China?
- What specific provisions would your firm like to see changed about Circular 618 or other indigenous innovation policies?
- Is your company currently included in the catalogue? If not, do you have plans to apply for inclusion in any indigenous innovation catalogues?
- How significant is government procurement to your overall sales in China?

Please contact:

- Beijing: Bob Poole, [rpoole@uschina.org.cn](mailto:rpoole@uschina.org.cn), 86-10-6592-0727
- Shanghai: Julie Walton, [jwalton@uschina.org.cn](mailto:jwalton@uschina.org.cn), 86-21-6288-3840
- Washington, DC: Ryan Ong, [ryanong@uschina.org](mailto:ryanong@uschina.org), 202-429-0340

## **Issue Brief:**

# **New Developments in China's Domestic Innovation and Procurement Policies**

### **Overview**

Several USCBC member companies have reported increasing difficulty in making sales to government-related entities in China, be it a government agency, school, hospital, or state-owned enterprise. Some companies attribute this to China's emphasis on "indigenous innovation," defined as domestic products, technologies, and brands—and the measures that central-government agencies have taken to promote Chinese entities, seemingly at the expense of overseas and foreign-invested entities in China. These measures include local indigenous innovation catalogues or "[buy local](#)" regulations.

### **Indigenous Innovation Background**

Indigenous innovation is a policy concept developed by the PRC government to boost the creation and commercialization of proprietary ideas and technologies by Chinese companies. It has been a core component of China's economic development policy for several years. Central-government planners have often expressed their concern that the country's economy and production capacity is heavily reliant on foreign technology. In their view, it was developmentally risky to have foreign-owned patents underlie much of China's economic growth and to allow foreign brands to dominate the marketplace. As the country has advanced economically, some government planners have argued that Chinese-owned patents and trademarks should be the foundation of the country's development.

In 2006, the central government more formally introduced a policy of "indigenous innovation" or "self-innovation," whereby government agencies would work cooperatively to develop measures that would favor products that use Chinese-developed ideas and technology. Since then, several government agencies at the central and local level have implemented preferential policies, product catalogues, financing schemes, and other tools to ensure that the indigenous innovation policy results in the development of Chinese-owned technology and intellectual property (IP).

### **Indigenous Innovation Policy Development and Implementation**

Several PRC government agencies are responsible for developing and implementing indigenous innovation.

- **State Council Leading Group on Science, Technology, and Education** is comprised of representatives of major ministries and government offices, such as the Ministry of Finance (MOF), National Development and Reform Commission (NDRC), Ministry of Science and Technology (MOST), Ministry of Industry and Information Technology (MIIT), Ministry of Commerce, and the Chinese Academy of Social Sciences, among others. Led by Premier Wen Jiabao, this group under the State Council is responsible for discussing, reviewing, and approving major policies and strategies on science and technology (S&T) and coordinates relevant departments and localities to implement key tasks and projects. The group has been involved in formulating indigenous innovation policy since 2005 and is the principal venue for integrating indigenous innovation policy among the various agencies involved.
- **MOST** is responsible for leading the reform of China's S&T system and formulating S&T strategies, policies, and laws and regulations. Responsible for China's overall innovation strategy, MOST is

tasked with accrediting indigenous innovation products and formulating and developing indigenous innovation product catalogues.

- **NDRC** is the PRC government's chief ministry-level macroeconomic planning body. NDRC sets China's long-term national economic development agenda, from which ministries devise and implement their own policies. Importantly, S&T and innovation are outgrowths of these long-term economic development policies.
- **MOF** oversees government procurement and sets procurement criteria for indigenous innovation products the government uses. Procurement is the lifeline of China's indigenous innovation strategy, because government purchases are a major source of funding for companies engaged in the research and development (R&D) of innovative products.
- **MIIT** is built around the core functions of the old Ministry of Information Industry, including regulation of electronics and information product manufacturing. It is also responsible for crafting and implementing China's industrial policies, of which innovation is an essential component.

### **Implementation of indigenous innovation**

As with all major economic development plans, the central government first crafts broad policy documents that outline the principles for implementing the specific policy. Then, the relevant ministries and commissions—at both the central and local levels—work to create specific measures that implement the policy based on the principles in the broader documents.

At the center of China's indigenous innovation drive is the [Medium- and Long-term National Plan for Science & Technology Development \(2006-20\)](#) (国家中长期科学和技术发展规划纲要) and a follow-up [document on its supporting policies](#), both released in 2006 by the State Council. The plan and its supporting policies formally introduced the concept of indigenous innovation into China's national industrial policy and laid out several goals, including

- Developing a system to evaluate and qualify indigenous innovation products;
- Establishing a system to use government funds to buy indigenous innovation products; and
- Giving preferential treatment in the government procurement process to indigenous innovation products.

### **What qualifies as an indigenous innovation product?**

At the end of 2006, MOST, MOF, and NDRC jointly released Trial Measures for the Administration of the Accreditation of National Indigenous Innovation Products, which define the kinds of products that can receive indigenous innovation status. To qualify as indigenous innovation, a product must

- Have been produced by an enterprise that has full ownership of IP in China via its own technological innovation activities; or the Chinese enterprise, work unit, or citizen has, by legal means, obtained the China IP rights or usage rights;
- Have a trademark that is owned by a Chinese company and registered in China;
- Embody a high degree of creativity and innovation—for example, a product that masters core technologies or improves product functions by applying new technologies; and
- Offer a high degree of reliability and dependable quality, with certification from the China National Certification Administration or its provincial departmental branches.

Accredited products are eventually listed in product catalogues that governments at various levels use to guide their procurement decisions.

Over the past three years, a number of provincial and municipal governments have developed their own product catalogues, which include lists of products accredited as indigenous innovation (see Appendix 2). To date, almost no products produced at a foreign-invested facility have received accreditation. In Shanghai, of the 523 products listed in its catalogue, only two are produced by FIEs—and those are from Chinese-foreign joint ventures with majority Chinese ownership. Jiangxi's catalogue lists several products developed by Jiangling Motor Co., a local automotive enterprise in which Ford Motor Co. is a joint-venture partner. Of Beijing's 42 qualified products, just one comes from a foreign company. Moreover, some of these catalogues also restrict domestically made products from other provinces, though such restrictions may not be explicit. For example, Wuhan's catalogue is largely comprised of local products from Wuhan and surrounding Hubei province, though the catalogue does not explicitly limit eligibility to local products.

MOST is currently working on a national-level catalogue. It is not yet clear whether localities will be allowed to keep their separate, previously developed catalogues or if the central government will require them to submit their lists for inclusion in the national catalogue.

### **Main Advantage of Indigenous Innovation Label: Preference in Government Procurement**

The primary and most explicit benefit conferred upon products that receive indigenous innovation recognition is preference in government procurement. The size of China's government procurement market is difficult to calculate because schools, hospitals, museums, think tanks, state-owned enterprises, and other public entities are subject to varying degrees of influence from central and local governments. Even excluding these entities from the government procurement system, however, China's vast government bureaucracy at the central and local level presents substantial commercial opportunities across a wide range of industry sectors.

In addition to granting priority in government procurement, Selected Supporting Policies for the 2006-2020 Medium and Long-Term Science and Technology Development Plan (2006) also favor indigenous innovative products in price-based bidding. Article 23 states that during the price-based bidding process, if the price of an indigenous innovative product is higher than others, the company producing the product may reduce the price in its bid; if the price is not higher than other products, the government agency must procure the indigenous product. In addition, several articles of the [2007 Evaluation Measures on Indigenous Innovation Products for Government Procurement](#) award indigenous innovation products special treatment:

- **Article 13** provides that indigenously innovative products shall be given preference at a margin of 5-10 percent in the event that price is the sole determining factor.
- **Article 14** states that indigenous innovation products may enjoy an additional 4 to 8 percent boost in their technical and price evaluations if comprehensive evaluation methods are used. When provincial authorities use comprehensive methods, they weigh technical merit and other technology-related factors alongside the product price to create an overall score, which is used to select the most competitive products.
- **Article 24** calls for establishing a government system for initial purchasing and ordering that will encourage the commercialization of products with indigenous innovation accreditation. The government should purchase the first set of innovative products created by domestic enterprises, universities, and research institutes if the products are thought to have future wide-market potential. The article aims to give such products a stronger foothold in the market.

## Potential Problems and Concerns for Foreign Companies

Many foreign companies have noted the difficulty their products will have in qualifying for China's various indigenous innovation catalogues for two reasons:

- **Patents** Products are required to have IP owned by an entity in China.
- **Trademarks** Products must have their original, first registration of trademarks within China.

The primary concern of foreign companies is that they will be excluded from selling to China's government procurement market simply because they have developed IP and owned trademarks in other jurisdictions. Though many countries have government procurement policies that require a certain amount of local content, the current international norms for government procurement do not include IP ownership requirements.

USCBC members have typically invested in China to serve the China market. They employ thousands of employees, pay taxes, and contribute positively to the overall economic and technological development of the market. In many cases, the parent company has licensed certain technology to its China subsidiaries to expand upon or develop new product for China, thereby bringing innovative products to China's market, even if the patent or trademark itself is owned in another jurisdiction. New indigenous innovation regulations could therefore limit/slow the introduction of innovative products into China

The biggest obstacle for foreign companies is the requirement that the applying China entity fully owns the IP and first register the trademark in China. Some companies are concerned about IP protection in China, but the bigger issue is structural: Companies must be able to sell their products and services globally to remain competitive, rather than be restricted to only selling products in a market that are based on IP developed in that market.

## Late 2009 Developments

NDRC, MOST, and MOF released two circulars in November 2009: application procedures and a notice that lays out provincial responsibilities for the new central-level indigenous innovation catalogue. The documents included a December 10, 2009 deadline for companies to submit applications for indigenous innovation status and a December 30, 2009 deadline for provinces to make recommendations to the central government for the scope of the catalogue.

Four of the six areas identified for inclusion in the indigenous innovation catalogue are information-technology related: computers; communication (believed to include mobile phones); office equipment (such as scanners); and software. The remaining two are related to new-energy equipment and energy-efficient products. In addition to concerns about the transparency of the process used to issue these circulars, Section IV of the application procedures reiterates seven conditions, including the patent and trademark restrictions that will likely exclude foreign companies from qualifying their product. The November 15 notice does not appear to include any new requirements, but as the first national catalogue, its impact will likely exceed that of the local catalogues.

On December 10, 2009, USCBC joined 33 other trade associations from Canada, Europe, Japan, South Korea, and the United States to ask the ministries to delay implementation of the circular and engage with industry on how to advance China's science and technology goals and promote innovation through a fair and transparent selection process. The US government has also raised concern about the policy with the PRC government. USCBC is seeking member company input on the impact of the policy and possible solutions that would address the restrictions on government procurement market access.

## **Appendix 1: Policy and Regulatory Framework Surrounding Indigenous Innovation**

The central government has released various policies and regulatory measures to implement its indigenous innovation policy. Below is a list of some of these regulatory measures.

### **PRC Government Procurement Law (2002)**

中华人民共和国政府采购法

[www.people.com.cn/GB/jinji/20020629/764316.html](http://www.people.com.cn/GB/jinji/20020629/764316.html)

This law establishes the foundation for government procurement, noting that PRC government agencies should purchase domestic goods and services unless the required items cannot be obtained within China or under “reasonable commercial circumstances.” The law applies to all purchases made by central-, provincial-, and local-government agencies.

### **Medium- and Long-term National Plan for Science and Technology Development (2006-20)**

国家中长期科学和技术发展规划纲要

[http://www.gov.cn/jrzq/2006-02/09/content\\_183787.htm](http://www.gov.cn/jrzq/2006-02/09/content_183787.htm)

This plan introduces the concept of indigenous innovation into China’s national industrial policy and lays out key principles that government agencies should follow when implementing indigenous innovation.

### **Selected Supporting Policies for the 2006-20 Medium and Long-Term Science and Technology Development Plan (2006)**

国务院关于印发实施《国家中长期科学和技术发展规划纲要（2006—2020年）若干配套政策的通知

[http://www.gov.cn/zwqk/2006-02/26/content\\_211553.htm](http://www.gov.cn/zwqk/2006-02/26/content_211553.htm)

These policies further detail how the principles of indigenous innovation should be implemented and entrusts MOF and other agencies with setting the standards for what will be considered a domestic product.

### **Trial Measures for the Administration of the Accreditation of National Indigenous Innovation Products (2006)**

国家自主创新产品认定管理办法（试行）

[www.csoet.cn/n16/n1100/n38116/n38723/205126.html](http://www.csoet.cn/n16/n1100/n38116/n38723/205126.html)

These measures set up the specific certification criteria for evaluating and certifying indigenous innovation products, including ownership of core intellectual property and trademarks by the applying China-based company.

### **Evaluation Measures on Indigenous Innovative Products for Government Procurement (2007)**

自主创新产品政府采购评审办法

[www.gov.cn/ztlz/kjfzgh/content\\_883671.htm](http://www.gov.cn/ztlz/kjfzgh/content_883671.htm)

These measures lay out the advantages that accredited products enjoy in the government procurement process, including price deduction and extra consideration in technology and quality evaluations.

### **Administrative Measures for the Government to Initially and Selectively Purchase Indigenous Innovation Products (2007)**

自主创新产品政府首购和订购管理办法

[www.gov.cn/ztlz/kjfzgh/content\\_883647.htm](http://www.gov.cn/ztlz/kjfzgh/content_883647.htm)

These measures require government agencies to make initial purchases of newly developed products by domestic companies that are not currently competitive in the marketplace. Products are designated in the Catalogue of Indigenous Innovation Products, and government agencies are required to purchase those products, which will eventually be used in government-funded investment projects.

**Notification Regarding the Launch of National Indigenous Innovation Product Accreditation Work for 2009**

开展2009年国家自主创新产品认定工作的通知

([http://www.most.gov.cn/tztg/200911/t20091115\\_74197.htm](http://www.most.gov.cn/tztg/200911/t20091115_74197.htm))

This notification details to relevant authorities the application and review process for products applying for indigenous innovation status.

## Appendix 2: Recently Released Indigenous Innovation Product Catalogues

Several provincial- and municipal-level governments have released indigenous innovation product catalogues since 2006, when the central government formally introduced indigenous innovation policy, and others are holding successive rounds of product evaluation for future editions. These catalogues are valid for three years. As of mid-October 2009, 14 provincial and municipal governments had released their own catalogues and an additional two—Beijing and Fujian—had updated existing catalogues. Five governments released catalogues for the first time this year: Chengdu, Sichuan; Jiangxi; Shanghai; Tianjin; and Wuhan, Hubei.

Beijing Catalogue 4: 9 products, 09/10/2009

<http://www.bjkw.gov.cn/n1143/n1240/n1405/n1901/8035039.html>

Chengdu Catalogue 1 for public notice: 52 products, 03/24/2009

[http://www.caigou2003.com/gpnews/zizhu/200903/20090324090020\\_271174.html](http://www.caigou2003.com/gpnews/zizhu/200903/20090324090020_271174.html)

Fujian Catalogue 1: 24 products, 06/02/2009

<http://www.fujian.gov.cn/zwgk/tzsggg/200905/P020090522406865129997.xls>

Catalogue 2: 56 products, 07/31/2009

<http://www.fujian.gov.cn/zwgk/tzsggg/200908/P020090812379757185105.xls>

Jiangxi Catalogue 1: 474 products, 07/27/2009

<http://www.jxstc.gov.cn/ReadNews.asp?NewsID=3683>

Shanghai Catalogue 1: 523 products, 08/21/2009

<http://www.stcsm.gov.cn/Detail/Detail.aspx?tbno=106&cols=%E9%80%9A%E7%9F%A5%E5%91%8A%E7%A4%BA%E6%98%BE%E7%A4%BA%E6%A0%87%E9%A2%98%2C%E6%AD%A3%E6%96%87&id=c96ae2d8-6dc6-43c7-b9f8-b5fed984a921>

Tianjin Catalogue 1: 156 products, 06/30/2009

[www.ccg.gov.cn/loadfile/200971658471734580377.doc](http://www.ccg.gov.cn/loadfile/200971658471734580377.doc)

Wuhan Catalogue 1: 99 products, 12/17/2008

<http://www.wh.gov.cn/cms/publish/wuhan/2008-12/22/1200812220921310350.html>

## Appendix 3: Technology Products Eligible for Accreditation and Inclusion in China's New Indigenous Innovation Product Catalogue

According to Section III and Appendix 2 of the November 2009 application procedures, only those products listed below—taken from the 2006 National Catalogue of New and High-Technology Products—are eligible for accreditation and inclusion in the new catalogue.

### Products Eligible for Accreditation and Inclusion in the New Indigenous Innovation Catalogue

Reference code*	Computer and application devices
01010001	Super computer
01010002	High-performance computer
01010003	Server
01010004	Work station
01010005	Micro computer
01010006	Laptop computer
01010007	Digital-simulation computer
01010008	Industrial-control computer
01010009	Micro hard-disc driver
01010010	Computer digital signals processing board
01010011	Computer and communication-security board
01010012	Graph-and-image processing equipment
01010013	Voice-recognition equipment
01010014	Network switch
01010015	Modem
01010016	Ethernet card
01010017	Internet protocol telephone gateway
01010018	High-grade router
01010019	Firewall equipment
01010020	Local area network security system
01010021	Financial-data encrypter
01010022	Commercial point-of-sale encrypter
01010023	Banknote counter
01010024	Banknote and coin-recognition receptor
01010025	Fingerprint acquisition system
01010026	Laser scanning phototypesetting equipment and system

Reference code*	Communication products
01020001	Testing equipment for data services network
01020002	SCDMA repeater station
01020003	3G mobile communication base station antenna
01020004	Core network equipment shared by WCDMA and TD-SCDMA
01020005	WCDMA equipment on wireless side
01020006	TD-SCDMA equipment on wireless side
01020007	Comprehensive test instrument for TD-SCDMA terminals
01020008	Radio monitoring and positioning system

01020009	Ethernet passive optical fiber access equipment
01020010	MSTP optical transmission system
01020011	SDH optical fiber transmission system
01020012	Optical wavelength division multiplexer
01020013	Global positioning system
01020014	GSM cellular mobile communication system
01020015	CDMA 3G-cellular mobile communication system

**Reference code\*    Modernized office equipment**

01040001	Digital copier
01040002	High-speed fax machine
01040003	Video telephone
01040004	Color laser printer
01040005	Digital camera
01040006	High-performance single-lens reflex camera
01040007	Microphotographic camera

**Reference code\*    Software**

01070001	Operating system
01070002	Database management system
01070099	Office software package
01070009	Chinese information processing platform
01070020	Security software
01070021	Security analysis software
01070027	Auditing software
01070028	Antivirus software
01070029	Network monitoring system
01070023	Finance software
01070025	Basic geographic information system

**Reference code\*    New energy and equipment**

07010001	Gas turbine/stream turbine combined-cycle power generation set
07010002	Supercritical or ultra-supercritical high-temperature high-pressure turbine power generation set
07010003	Proton exchange membrane fuel cell (REMFC)
07010004	REMFC power generation device
07010005	Zinc-nickel accumulator
07010006	Zinc-silver accumulator
07010007	Large-capacity lithium-ion battery
07010008	High-energy lithium ion battery
07010009	Cylinder zinc-air battery
07010010	Photovoltaic power-generation system
07010011	Solar panel modules
07010012	Controller for photovoltaic power generation
07010013	Inverter for photovoltaic power generation
07010014	LED lamp subject to solar energy infrared control
07010015	Flat-plate solar water heater
07010016	Pressurized vacuum-tube solar collector

07010017	Solar thermal power-generation system
07010018	Solar air-conditioning system
07010019	Large wind-power generation set combined to the grid
07010020	Power generator of the large wind-power generation set combined to the grid
07010021	Blade of the large wind-power generation set combined to the grid
07010022	Electronic control system of the large wind-power generation set combined to the grid
07010023	Centralized and remote monitoring system at wind farm
07010024	Medium-sized wind-power generation set
07010025	Controller of the wind-power generation set not combined to the grid
07010026	Biomass carbonization and pyrolysis system
07010027	Biomass compression equipment
07010028	Biomass circulating fluidized bed gasification device
07010029	Biomass gasification system equipment
07010030	Biomass gasification power generation set
07010031	Complete set of equipment for power generation using garbage
07010032	Methane centralized-gas supply system
07010033	Internal combustion machine-power generation set using methane
07010034	Efficient methane-desulfurization equipment
07010035	Complete set of equipment for power generation using terrestrial heat
07010036	Complete set of equipment for power generation using wave tides
07010037	Power generation device using waves
07010038	Complete set of smart electric-power switch equipment
07010039	Distribution network automatic-switch equipment
07010040	High-voltage vacuum circuit breaker using permanent magnetic actuator
07010041	Organic composite insulator
07010042	Dry current transformer
07010043	High-voltage direct-current converter transformer
07010044	Smoothing reactor

**Reference code\*    Highly energy-efficient products**

07020001	High frequency induction-heating power supply
07020002	Epoxy resin dry-type transformer
07020003	Capacity-regulated transformer with winding core
07020004	Three-phase distribution transformer sealed with amorphous alloy
07020005	Smart reactive-power compensation device
07020006	Heat-pipe heat exchanger
07020007	Electronic ballast for high-power gas discharge lamps
07020008	Water heater (set) of air-source heat pump
07020009	Large device for recovery of heat from cement clinker on dry basis
07020010	Electronic expansion valve
07020011	Liquid rheostat starting-speed regulator
07020012	Energy-efficiency control device for centralized air-conditioning system
07020013	Blast-furnace top-pressure recovery turbine unit
07020014	Circulating fluidized bed boiler
07020015	Controllable atmosphere furnace
07020016	Pulverized coal burner exclusively for rotary kiln
07020017	Full-automatic burner

07020018	Heavy oil burner
07020019	Converting arc welder
07020020	Digital-control converting welder
07020021	Membrane separation plant for making nitrogen
07020022	High intensity infrared quick heating equipment

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\*Note: Item code as listed in the 2006 National Catalogue of New and High-Technology Products.  
Source: Application Procedures for Indigenous Innovation Product Status, released by the PRC Ministry of Finance, Ministry of Science and Technology, and National Development and Reform Commission.