

China

RISK & COMPLIANCE REPORT

DATE: January 2017

Executive Summary - China

Sanctions:	EU embargo on arms
FAFT list of AML Deficient Countries	No
Higher Risk Areas:	<p>US Dept of State Money Laundering Assessment</p> <p>Not on EU White list equivalent jurisdictions</p> <p>Corruption Index (Transparency International & W.G.I.)</p> <p>World Governance Indicators (Average Score)</p> <p>Failed States Index (Political Issues)(Average Score)</p>
Medium Risk Areas:	Weakness in Government Legislation to combat Money Laundering
<p>Major Investment Areas:</p> <p>Agriculture - products:</p> <p>world leader in gross value of agricultural output; rice, wheat, potatoes, corn, peanuts, tea, millet, barley, apples, cotton, oilseed; pork; fish</p> <p>Industries:</p> <p>world leader in gross value of industrial output; mining and ore processing, iron, steel, aluminum, and other metals, coal; machine building; armaments; textiles and apparel; petroleum; cement; chemicals; fertilizers; consumer products, including footwear, toys, and electronics; food processing; transportation equipment, including automobiles, rail cars and locomotives, ships, and aircraft; telecommunications equipment, commercial space launch vehicles, satellites</p> <p>Exports - commodities:</p> <p>electrical and other machinery, including data processing equipment, apparel, radio telephone handsets, textiles, integrated circuits</p> <p>Exports - partners:</p> <p>US 17.2%, Hong Kong 15.8%, Japan 7.4%, South Korea 4.3% (2012)</p> <p>Imports - commodities:</p> <p>electrical and other machinery, oil and mineral fuels, optical and medical equipment, metal ores, motor vehicles</p>	

Imports - partners:

Japan 9.8%, South Korea 9.2%, US 7.1%, Germany 5.1%, Australia 4.3% (2012)

Investment Restrictions:

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 might compete with state-sanctioned monopolies or other favored domestic firms.

China has indicated that it plans to restrict foreign investment in resource-intensive and highly-polluting industries, citing some kinds of basic manufacturing as an example. In addition, China appears to discourage foreign investments in sectors: 1) where China seeks to develop domestic firms into globally competitive multinational corporations; 2) that have benefited historically from state-sanctioned monopolies or from a legacy of state investment; or 3) deemed key to social stability. It also discourages investments that are intended to profit from currency, real estate, or asset speculation.

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 fifty 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.

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Section 1 - Background

For centuries China stood as a leading civilization, outpacing the rest of the world in the arts and sciences, but in the 19th and early 20th centuries, the country was beset by civil unrest, major famines, military defeats, and foreign occupation. After World War II, the communists under MAO Zedong established an autocratic socialist system that, while ensuring China's sovereignty, imposed strict controls over everyday life and cost the lives of tens of millions of people. After 1978, MAO's successor DENG Xiaoping and other leaders focused on market-oriented economic development and by 2000 output had quadrupled. For much of the population, living standards have improved dramatically and the room for personal choice has expanded, yet political controls remain tight. Since the early 1990s, China has increased its global outreach and participation in international organizations.



Section 2 - Anti – Money Laundering / Terrorist Financing

FATF status

China is not on the FATF List of Countries that have been identified as having strategic AML deficiencies

Compliance with FATF Recommendations

The FATF has approved and published the follow-up report for China. The first mutual evaluation report of China was adopted in 2007.

China was placed on an enhanced follow-up process as a result of partially compliant and non-compliant ratings in certain of the Core and Key Recommendations in its mutual evaluation report. China reported back at each FATF Plenary on the progress it had made in addressing the deficiencies identified in the mutual evaluation report.

China made significant progress and in October 2008, the Plenary agreed to place China on the regular follow-up process, whereby it would provide the FATF Plenary with annual progress reports.

China took additional action to address the deficiencies in its AML/CFT regime and was therefore taken off the regular follow-up process in February 2012. Henceforth, China will report back to the Plenary on any further improvements to its AML/CFT regime on a biennial basis.

The decision by the FATF to remove a country from the regular follow-up process is based on updated procedures agreed in October 2008. These procedures require a country to have taken sufficient and effective action to address the compliance levels of Core Recommendations 1, 5, 10, 13, SR II and IV and overall sufficient and effective action to address the compliance levels of Key Recommendations 3, 4, 23, 26, 35, 36, 40, SR I, SR III, SR V, where those Recommendations were previously rated as partially compliant or non-compliant. "Sufficient and effective action" is defined as a level essentially equivalent to compliant (C) or largely compliant (LC).

US Department of State Money Laundering assessment (INCSR)

China was deemed a Jurisdiction of Primary Concern by the US Department of State 2016 International Narcotics Control Strategy Report (INCSR).

Key Findings from the report are as follows: -

Perceived Risks:

The development of China's financial sector has required increased enforcement efforts to keep pace with the sophistication and reach of criminal networks. The primary sources of criminal proceeds are corruption, narcotics and human trafficking, smuggling, economic crimes, intellectual property theft, counterfeit goods, crimes against property, and tax evasion. Criminal proceeds are generally laundered via methods that include bulk cash smuggling; trade-based money laundering (TBML); manipulating invoices for services and the shipment of goods; purchasing valuable assets, such as real estate, art, and gold; investing illicit funds in lawful sectors; gaming; and exploiting formal and underground financial systems, in addition to third-party payment systems. Chinese officials have noted that corruption in China often involves state-owned enterprises, including those in the financial sector. According to Global Financial Integrity (GFI), China leads the world in illicit capital flows as measured by trade mis-invoicing – a form of TBML. GFI estimates that approximately \$260 billion left the country in 2013.

While Chinese authorities continue to investigate cases involving traditional money laundering schemes, they have also identified the adoption of new money laundering methods, including illegal private equity fundraising activity, cross-border telecommunications fraud, and corruption in the banking, securities, and transportation sectors. Chinese authorities also have observed that money laundering crimes continue to spread from developed coastal areas such as Guangdong and Fujian provinces to underdeveloped, inland regions.

China is not considered a major offshore financial center; however, China has multiple Special Economic Zones (SEZs) and other designated development zones at the national, provincial, and local levels. SEZs include Shenzhen, Shantou, Zhuhai, Xiamen, and Hainan, along with 14 other coastal cities. As part of China's economic reform initiative, China opened the Shanghai Free Trade Zone in 2013 and Tianjin, Guangdong, and Fujian in 2015.

Chinese foreign exchange rules cap the maximum amount of yuan individuals are allowed to convert into other currencies at approximately \$50,000 each year and restrict them from transferring yuan abroad directly without prior approval from the State Administration of Foreign Exchange. A variety of money laundering techniques are used to circumvent the restrictions, including structuring, using networks of family and friends, transferring value with the help of loved ones emigrating abroad, overseas cash withdrawals using credit cards, TBML, underground remittance systems such as *fei-qian* or "flying money," and organized gaming junkets to Macau and elsewhere. Chinese organized crime is also involved. In addition to capital flight, a substantial amount of money is laundered through the purchase of overseas properties in places such as Vancouver, Sydney, London, San Diego, and New York.

Do FINANCIAL INSTITUTIONS engage in currency transactions related to international narcotics trafficking that include significant amounts of US currency; currency derived from illegal sales in the U.S.; or illegal drug sales that otherwise significantly affect the U.S.: NO

Criminalization of money laundering:

"All serious crimes" approach or "list" approach to predicate crimes: List approach

Are legal persons covered: criminally: YES **civilly:** YES

Know-your-customer (KYC) rules:

Enhanced due diligence procedures for PEPs: Foreign: YES **Domestic:** YES

KYC covered entities: Banks and credit unions, securities dealers, insurance and trust companies, financial leasing and auto finance companies, and currency brokers

REPORTING REQUIREMENTS:

Number of STRs received and time frame: 24,531,000 in 2013

Number of CTRs received and time frame: Not available

STR covered entities: Banks, securities and futures institutions, and insurance companies

money laundering criminal Prosecutions/convictions:

Prosecutions: 11,645 in 2013

Convictions: Not available

Records exchange mechanism:

With U.S.: MLAT: NO **Other mechanism:** YES

With other governments/jurisdictions: YES

China is a member of the FATF as well as the Asia/Pacific Group on Money Laundering (APG) and the Eurasian Group on Combating Money Laundering and Terrorist Financing (EAG), both of which are FATF-style regional bodies.

Enforcement and implementation issues and comments:

While China's October 2011 legislation addressed some deficiencies in the implementation of the requirements of UNSCRs 1267 and 1373, some deficiencies must still be addressed. These include guidance for designated non-financial businesses and professions; delisting and unfreezing procedures; and the rights of bona fide third parties in seizure/confiscation actions. In 2013, the People's Bank of China published new guidance requiring Chinese banks to rate clients' risks based on a variety of factors, conduct internal risk assessments by the end of 2015, and commence implementation of new internal control rules by January 1, 2015. To improve monitoring and reporting on suspicious transactions through bank cards, China issued a Notice on Further Strengthening AML Work on Bank Card Business. In 2015, Chinese authorities issued guidelines for internet finance that include strengthened AML/CFT controls for internet finance operators.

In October 2015, the State Administration of Foreign Exchange (SAFE) published new rules to limit overseas cash withdrawals from credit cards, for the first time putting an annual cap on such overseas cash withdrawals through credit cards. In November, Chinese authorities arrested suspects for illegal foreign-exchange transactions totaling \$64 billion and announced a crackdown on underground banks that assist in the evasion of capital controls and the transfer of funds offshore.

In domestic cases, once an investigation is opened, all law enforcement entities and public prosecutors are authorized to take provisional measures to seize or freeze property in question to preserve the availability of the same for later confiscation upon conviction. Although China's courts are required by law to systematically confiscate criminal proceeds, enforcement is inconsistent and no legislation authorizes seizure/confiscation of substitute assets of equivalent value. Information about the implementation of the 2013 Criminal Procedure Law remains scarce.

The United States and China are parties to the Agreement on Mutual Legal Assistance in Criminal Matters. U.S. law enforcement agencies note China has not cooperated sufficiently on financial investigations and does not provide adequate responses to requests for financial investigation information. In addition to the lack of law enforcement-based cooperation, the Chinese government's inability to enforce U.S. court orders or judgments obtained as a result of non-conviction-based forfeiture actions against China-based assets remains a significant barrier to enhanced U.S.-China cooperation in asset freezing and confiscation.

While China continues to make improvements to its AML/CFT legal and regulatory framework and is gradually making progress toward meeting international standards, implementation and transparency remain lacking, particularly in the context of international cooperation. The Government of the People's Republic of China should expand cooperation with foreign counterparts and pursue international AML/CFT linkages more aggressively. China's Ministry of Public Security should continue ongoing efforts to develop a better understanding of how AML/CFT tools can be used, in a transparent fashion, to support the investigation and prosecution of a wide range of criminal activity. China also should cooperate with international law enforcement to investigate how indigenous Chinese underground financial systems and trade-based value transfer are used to circumvent capital restrictions for illicit outbound transfers and capital flight, and to receive inbound remittances and criminal proceeds for Chinese organized crime. China should enhance coordination among its financial regulators and law enforcement bodies to better investigate and prosecute offenders. The government should ensure all courts are aware of and uniformly implement mandatory confiscation laws.

Current Weaknesses in Government Legislation (2013 INCRS Comparative Tables):

According to the US State Department, China does not conform with regard to the following government legislation: -

Arrangements for Asset Sharing - By law, regulation or bilateral agreement, the jurisdiction permits sharing of seized assets with third party jurisdictions that assisted in the conduct of the underlying investigation.

Cooperates with International Law Enforcement - By law or regulation, banks are permitted/required to cooperate with authorized investigations involving or initiated by third party jurisdictions, including sharing of records or other financial data.

Ability to freeze assets without delay - The government has an independent national system and mechanism for freezing terrorist assets in a timely manner (including but not limited to

bank accounts, other financial assets, airplanes, autos, residences, and/or other property belonging to terrorists or terrorist organizations).

EU White list of Equivalent Jurisdictions

China is not currently on the EU White list of Equivalent Jurisdictions

World Governance indicators

[To view historic Governance Indicators Ctrl + Click here and then select country](#)

Failed States Index

[To view Failed States Index Ctrl + Click here](#)

Offshore Financial Centre

China is not considered to be an Offshore Financial Centre

US State Dept Narcotics Report 2016 (introduction):

Due to its enormous economy, large consumer market with growing disposable income, and expanding global commerce, China has become a hub for illicit drug consumption, drug and precursor chemical trafficking, and money laundering activities.

Synthetic drugs such as methamphetamine and other amphetamine-type stimulants (ATS) such as MDMA (ecstasy) have surpassed heroin to become the most abused drugs in China. China is also a major producer, destination, and transit country for ATS, especially methamphetamine. Despite several successful law enforcement operations in 2015, China's production and export of methamphetamine continues to increase, especially to Indonesia, Malaysia, Australia and New Zealand.

Heroin, traditionally the most widely abused drug in China is gradually being replaced by more readily available synthetic drugs. However, China remains a major destination and transit country for heroin produced in Southwest and Southeast Asia.

Abuse of various new psychoactive substances (NPS) is increasingly prevalent in China. Ketamine is the third most widely abused drug and is categorized as an NPS. China is a major producer and exporter of NPS, which are increasingly in demand in illicit international markets. China's vast chemical and pharmaceutical industries and regulatory loopholes associated with NPS provide an ideal environment for the production and export of these drugs. Nearly all of the NPS seized in North America and Europe have originated from chemical and pharmaceutical businesses in China and can be ordered via the Internet and received in the mail. Chemical alterations of NPS drugs designed to circumvent existing anti-drug laws make efforts to stem the flow of these drugs challenging. In October 2015, however, China announced new controls on 116 NPS, and streamlined the process for controlling additional NPS.

China remains the primary source of the precursor chemicals used to manufacture methamphetamine consumed in the United States and is one of the world's top producers and exporters of precursor chemicals. Although the majority of precursor chemical production and export is intended for legitimate use, precursors are being diverted by transnational criminal organizations to produce illicit drugs. China's close proximity to drug production centers in Southwest and Southeast Asia, insufficient regulatory oversight of the chemical industry, corruption among government and business officials, lower production costs, as well as numerous coastal cities with large precursor chemical factories and modern port facilities, make it an ideal source for precursor chemicals intended for illicit drug production. In a promising development, in late 2015 China criminalized additional activities involving transportation and production of chemicals and simplified the procedure for placing controls on additional chemicals as the need arises.

Corruption

The Ministry of Public Security takes allegations of drug-related corruption seriously, launching investigations when deemed appropriate. Despite efforts to stem drug-related corruption, financial corruption among provincial, prefectural, county, and district government officials continues to be a concern. To date, no senior Chinese official at the central government

level is known to have facilitated the illicit production or distribution of drugs. Similarly, no senior Chinese official from the central government is known to have laundered proceeds from drug-related activities.

China's central government-driven anti-corruption campaign led to the arrests of many lower-level government personnel and some senior-level government officials, most notable Zhou Yongkang, former member of the Political Bureau of the Communist Party of China's Central Committee and Minister of Public Security. Corruption at the provincial, prefecture, and county level outside of Beijing also continues to pose a problem for the central government.

While drug-related corruption exists in China, it is not reported by the government-controlled press, and there is no indication the problem is widespread. However, irregularities within some of the many state-owned enterprises in the chemical and pharmaceutical industries raise questions regarding the government's knowledge and involvement (intentional or inadvertent) with the diversion of precursor chemicals for illicit drug production and the manufacturing of counterfeit pharmaceutical products.

US State Dept Trafficking in Persons Report 2014 (introduction):

China is classified a Tier 2 (watch list) country - a country whose government does not fully comply with the minimum standards and is not making significant efforts to do so.

The People's Republic of China (China or PRC) is a source, destination, and transit country for men, women, and children subjected to forced labor and sex trafficking. Instances of trafficking are pronounced among China's internal migrant population, estimated to exceed 236 million people. Chinese men, women, and children are subjected to forced labor in brick kilns, coal mines, and factories, some of which operate illegally and take advantage of lax government supervision. Forced begging by adults and children occurs throughout China. There are reports that traffickers are increasingly subjecting deaf and mute individuals to forced labor. Media reports indicate that children in some work-study programs supported by local governments and schools are forced to work in factories.

State-sponsored forced labor continues to be an area of significant concern in China. "Reform through labor" (RTL) was a systematic form of forced labor that had existed in China for decades. The PRC government reportedly profited from this forced labor, which required many detainees to work, often with no remuneration, for up to four years. By some estimates, there had been at least 320 facilities where detained individuals worked in factories or mines, built roads, and made bricks. According to reports, several RTL facilities closed by the end of the reporting period; other RTL facilities were turned into state-sponsored drug detention or "custody and education" centers. NGOs and media report that detainees in drug detention centers are arbitrarily detained and some continued to be forced into labor. Women arrested for prostitution are detained for up to two years without due process in "custody and education" centers, and some are reportedly subjected to forced labor. These women are reportedly forced to perform manual labor—such as making tires, disposable chopsticks, or dog diapers—in "custody and education" centers throughout China.

Chinese women and girls are subjected to sex trafficking within China; they are typically recruited from rural areas and taken to urban centers. Well-organized criminal syndicates

and local gangs play key roles in the trafficking of Chinese women and girls in China. Victims are recruited with fraudulent employment opportunities and subsequently forced into prostitution. Girls from the Tibet Autonomous Region are reportedly sent to other parts of China and subjected to forced marriage and domestic servitude.

While many instances of trafficking occur within China's borders, Chinese men, women, and children are also subjected to forced labor and sex trafficking in other countries. Chinese men and women are forced to labor in service sectors, such as restaurants and shops, in overseas Chinese communities. Chinese men experience abuse at construction sites and in coal and copper mines in Africa, and face conditions indicative of forced labor, such as withholding of passports, restrictions on movement, non-payment of wages, and physical abuse. High recruitment fees, sometimes as much as the equivalent of approximately \$70,000, compound Chinese migrant workers' vulnerability to debt bondage. Chinese women and girls are subjected to forced prostitution throughout the world, including in major cities, construction sites, remote mining and logging camps, and areas with high concentrations of Chinese migrant workers. Traffickers recruit girls and young women, often from rural areas of China, using a combination of fraudulent job offers and coercion; traffickers subsequently impose large travel fees, confiscate passports, confine, or physically and financially threaten victims to compel their engagement in prostitution.

Women and children from neighboring Asian countries, including Burma, Vietnam, Laos, Mongolia, and the Democratic People's Republic of Korea (DPRK), as well as from Africa, and the Americas, are subjected to forced labor and sex trafficking in China. During the year, Malagasy women and girls were recruited to work in domestic service in China; some of these women and girls were subsequently subjected to forced labor. Zimbabwean women also reported conditions indicative of labor trafficking in a hostess bar. North Korean women were subjected to forced labor in the agriculture and domestic service sectors. The Chinese government's birth limitation policy and a cultural preference for sons create a skewed sex ratio of 117 boys to 100 girls in China, which may serve to increase the demand for prostitution and for foreign women as brides for Chinese men—both of which may be procured by force or coercion. Women and girls from Burma, Vietnam, Mongolia, Cambodia, Laos, and North Korea are recruited through marriage brokers and transported to China, where some are subsequently subjected to forced prostitution or forced labor.

The Government of the People's Republic of China does not fully comply with the minimum standards for the elimination of trafficking; however, it is making significant efforts to do so. During the reporting period, the PRC's National People's Congress ratified a decision to abolish RTL. Some media and NGOs indicate that the government released detainees from and ceased operations at many RTL camps; others indicate that the government has converted some RTL facilities into different types of detention centers, including state-sponsored drug detention and "custody and education" centers, some of which employ forced labor. The government provided limited information about its investigation, prosecution, and conviction of traffickers; the government's conflation of trafficking with other crimes made it difficult to accurately assess the government's law enforcement efforts to prosecute trafficking offenses. Similarly, the government did not provide sufficiently detailed data to ascertain the number of victims it identified or assisted. In 2013, the government arrested a significant number of women in police raids on prostitution rings; it was unclear whether the government screened these women for indicators of trafficking, whether potential trafficking victims were referred to shelters, or whether potential victims were punished for acts committed as a direct result of being trafficking victims. Chinese

authorities continued to forcibly repatriate some North Korean refugees by treating them as illegal economic migrants—despite reports that many North Korean female refugees in China are trafficking victims.

US State Dept Terrorism Report 2015

Overview: China's attention to terrorism in 2015 intensified as the country reacted to several incidents that it characterized as domestic terrorism. China continued to escalate its security and surveillance in the Xinjiang Uighur Autonomous Region to prevent additional unrest, including the implementation of stricter controls and curbs on religious practice. The primary focus of China's international counterterrorism efforts remained on the East Turkestan Islamic Movement (ETIM), an organization that China alleges is behind violent incidents in Xinjiang. Government officials often characterized China's restrictive policies in Xinjiang as an effort to prevent additional acts of terrorism and violent extremism.

The Chinese government reported that Chinese citizens operated with the Islamic State of Iraq and the Levant (ISIL) in the Middle East, and has taken action to prevent its citizens from traveling to Syria and Iraq. In November, ISIL claimed to have executed Chinese citizen Fan Jinghui, which prompted strong condemnation from President Xi Jinping. Two weeks later, ISIL posted a song online in Mandarin calling for Chinese Muslims to take up arms against their country.

Counterterrorism cooperation between the United States and China remained limited. The two countries initiated a technical workshop on countering the spread of IEDs and increased consultations aimed at stemming the transnational flow of foreign terrorist fighters, countering terrorist funding networks, increasing information sharing on terrorist threats, and sharing evidentiary best practices.

China held bilateral dialogues on counterterrorism with five countries in 2015, including with the United States in August. China remained engaged in counterterrorism efforts in the Asia-Pacific region and Central Asia. It conducted bilateral and multilateral joint exercises with regional neighbors and through other frameworks, such as the Shanghai Cooperative Organization.

Chinese authorities criticized the United States when it did not follow China's example in characterizing some incidents of violence in China as terrorism. As in previous years, China accused Uighur activists abroad – including in the United States – of complicity in supporting terrorist activity, but has not provided credible evidence to support the claims. China also appeared to apply inconsistent labels to incidents of mass violence involving Han Chinese suspects. For example, and in contrast to the examples discussed below, China designated a series of 17 explosions in September that damaged government buildings and neighborhoods in the Guangxi Autonomous Region, killing seven people and injuring more than 50, a criminal rather than a terrorist act and arrested a suspect surnamed Wei.

2015 Terrorist Incidents: The lack of transparency and information provided by China about violent incidents in China that the government characterized as terrorism greatly complicated efforts to verify details of those and other violent acts. In many of the domestic incidents that China characterized as terrorism, China alleged that ETIM influenced or directed the violence through its online propaganda. China often prevented foreign

journalists and international observers from independently verifying official media accounts, which are often the only source of reporting on violent incidents in its territory. Government authorities heavily restricted foreign and non-state media access to information about 2015 incidents and often limited reporting to official accounts that were not timely and typically lacked detailed information.

The following incidents are examples of incidents the central government considered to be terrorism:

- On March 6, three knife-wielding assailants stabbed and injured nine people at a Guangzhou Railway Station before police fatally shot one of the suspects and captured a second. According to a leaked Guangdong Provincial Public Security document obtained by the media, the attack was likely reprisal for an alleged anti-terrorism raid on an apartment in Shenyang by 200 police officers that left four dead and captured 16 Uighur terrorism suspects.
- On June 24, local police attributed an attack that left 18 people dead (including 15 attackers) to purported ethnic Uighur terrorists. Suspects allegedly attacked police with knives and bombs at a security checkpoint in Kashgar's Tahtakoruk district in Xinjiang.
- Assailants armed with knives attacked the Sogan coal mine in Xinjiang's Aksu Prefecture on September 18, killing approximately 50 people (most of Han Chinese ethnicity), according to official media, which did not report on the attack until November, when reports appeared that a Special Forces unit had conducted a raid and killed 28 suspects from the mine attack. Official accounts eventually described the attackers as part of an alleged terrorist gang who had been radicalized by online overseas propaganda and had been directed by unspecified overseas extremist groups. An official statement from the Ministry of Public Security lauding the raid as a victory in the fight against terrorism was deleted without explanation hours after being posted online. On December 16, the Chinese government posted details and photos of the November raid online.

Legislation, Law Enforcement, and Border Security: In May, the Communist Party of China (CPC) Central Committee and China's State Council issued new measures designed to intensify surveillance and security throughout the country. In addition to increased inspections at all main transportation hubs, including bus and train stations, railways, airports and ports, police would patrol key public sites such as schools, shopping malls, and banks. The measures included an enhanced and vastly expanded video and data surveillance network. More surveillance cameras would be installed and a national population database would be established with citizen identification and credit information.

In December 2015, the National People's Congress Standing Committee approved the country's first comprehensive counterterrorism law to "provide legal support for counterterrorism activities as well as collaboration with the international community." The law broadened China's definition of terrorism and the scope of its counterterrorism measures, and made provisions to establish a counterterrorism intelligence center to better coordinate terrorism response and information sharing across different Chinese government agencies. The law also required foreign firms to provide technical and decryption assistance to Chinese authorities as part of terrorism-related investigations. The legislation stipulated measures on tightening internet security management, inspection of dangerous materials, prevention of

terrorism financing, and border controls. The law's broad definition of terrorism and its new technology-related requirements for foreign telecommunications firms and internet service providers elicited concerns from human rights organizations and business interest groups. Under the new law, the Central Military Commission may authorize the People's Liberation Army to perform counterterrorism operations abroad. The law also provided for punishing news media that reports counterterrorism operations without approval from government authorities.

According to state media, law enforcement authorities in Xinjiang had disrupted 181 "terrorist gangs" since the launch of the 2014 "strike hard" campaign. Extended through 2015, the campaign was an amalgamation of enhanced cultural restrictions and security measures. Meng Jianzhu, Secretary of the Communist Party's Central Political and Legal Affairs Commission, stated at a December 2015 counterterrorism conference in Urumqi that 98 percent of terrorist plots in Xinjiang had been stopped at the planning stage. Due to restrictions on independent reporting, it was difficult to corroborate this as well as other counterterrorism-related claims.

At the same conference, Meng announced several new guidelines regulating Chinese government activities in the fight against terrorism, including several on the use of internet and social media. The new guidelines called for greater cooperation with international counterterrorism bodies; maximum protection for overseas Chinese citizens; destruction of terrorism-related audio and video material; prevention of the dissemination of terrorist information via social media and other online methods; strengthened border controls to prevent terrorists entering China; elimination of religious extremism; and the "education and transformation" of terrorist offenders using "authentic" religious teachings.

Government authorities continued to act against what it alleged were suspected Uighur militants traveling through Southeast Asia. According to international media reports, Thailand repatriated more than 100 Uighur refugees to China after receiving pressure from Chinese authorities. The UN High Commissioner for Refugees criticized Thailand's decision as a violation of international law, and human rights groups voiced concerns that the repatriated group could face harsh treatment once returned to China. State media reported that 13 of those repatriated were involved in terrorist activities, but did not provide evidence to support those claims. According to foreign press reports, some of the refugees were featured in a subsequent media campaign discouraging illegal emigration from Xinjiang.

China continued to stress the importance of counterterrorism cooperation with the United States, but Chinese law enforcement agencies generally remained reluctant to conduct joint investigations or share specific threat information with U.S. law enforcement partners. Despite multiple requests to Chinese law enforcement officials for more detailed background information on Chinese media-reported arrests and operations, U.S. law enforcement agencies received little new information. Overall, China's counterterrorism cooperation with the United States remained limited and was further constrained by China's conflation of religious expression with violent extremism.

Countering the Financing of Terrorism: China is a member of the Financial Action Task Force (FATF), as well as the Asia/Pacific Group on Money Laundering and the Eurasian Group on Combating Money Laundering and Terrorist Financing, both of which are FATF-style regional bodies. China and the United States have met at least once a year (for the last four years) to engage in a technical discussion related to anti-money laundering (AML) and countering the financing of terrorism (CFT). This meeting is known as the AML/CFT Working Group under the

Strategic and Economic Dialogue (S&ED). At the December 2015 meeting, the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN), the U.S. financial intelligence unit (FIU), signed a memorandum of understanding with the China Anti-Money Laundering Monitoring and Analysis Center (CAMLMAC), China's FIU, to support its efforts to combat money laundering, related crimes, and terrorism financing. China's CAMLMAC is not a member of the Egmont Group.

The Chinese government has strengthened its preventive measures to counter terrorism financing, with an emphasis on requiring financial institutions to collect and maintain beneficial ownership information, and making suspicious transaction reports more comprehensive. Additional issues remain to be addressed, including guidance for designated non-financial businesses and professions; procedures for individuals and groups who seek to be delisted; and defining the rights of bona fide third parties in seizure/confiscation actions. For further information on money laundering and financial crimes, see the *2016 International Narcotics Control Strategy Report (INCSR), Volume II, Money Laundering and Financial Crimes*: <http://www.state.gov/j/inl/rls/nrcrpt/2015/>

Countering Violent Extremism: Although China does not have an official strategy or program in place to counter violent extremism, the government implemented a number of programs aimed at countering radicalization and violent extremism, concentrating much of its efforts in Xinjiang. Local counterterrorism working groups have been established at the county, municipal, and provincial levels across China to coordinate "stability maintenance," law enforcement, ethnic and religious affairs. Xinjiang government officials required imams to take political education classes as a means of persuading them to discourage extremism and condemn violence. In Xinjiang, authorities placed restrictions on religious expression, banning the burqa in public spaces in Urumqi and criminalizing unspecified "extremist garments" – clothes or symbols the government associates with terrorism and extremism.

Many Chinese government policies may have exacerbated ethnic tension in Xinjiang and could contribute to increased violent extremism.

International and Regional Cooperation: China continued to promote its commitment to working with the international community on UN Security Council (UNSC) counterterrorism issues. In May 2015 in Nanning, China hosted the 13th ASEAN Regional Forum Inter-Sessional Meeting on Counter-Terrorism and Transnational Crime. China also regularly participated in other multilateral fora that address counterterrorism issues such as the Global Counterterrorism Forum and the APEC Counter-Terrorism Working Group. China also held bilateral counterterrorism dialogues with the Egypt, India, Indonesia, Russia, and the United States.

China cooperated with other nations on counterterrorism efforts through military exercises and assistance. China conducted joint military training with several nations that focused on improving counterterrorism capabilities. In September, China and Pakistan staged "Joint Field Exercise Warrior III," an annual counterterrorism exercise. In October, China and India held "Hand-in-Hand 2015," the fifth counterterrorism drill of its kind since 2007. That same month China hosted members of the Shanghai Cooperation Organization for "Xiamen 2015," an online counterterrorism exercise. In August, China and Russia held their largest-ever joint maritime drill in the Sea of Japan, "Joint Sea II," that included a joint counterterrorism amphibious assault component.

International Sanctions

There is currently an EU embargo on arms.

For further information: -

http://ec.europa.eu/external_relations/cfsp/sanctions/docs/measures_en.pdf

Index	Rating (100-Good / 0-Bad)
Transparency International Corruption Index	40
World Governance Indicator – Control of Corruption	50

US State Department

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 anti-corruption efforts. Senior officials and family members are suspected of using connections to avoid investigation or prosecution for alleged misdeeds.

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 Committee enforce ethics guidelines and party discipline. China's National Audit Office also inspects accounts of SOEs and government entities.

Anti-corruption measures

China has stepped up efforts against corruption in Party ranks. President Xi Jinping has said that endemic corruption threatens the Party's survival and has vowed to go after high-flying "tigers," as well as lowly "flies." New anti-corruption measures, part of November 2013 Third Plenum reforms, signaled an intensified push to fight graft. The Third Plenum documents implored public officials to "keep power within the cage of regulations," criticized material excess, and called for senior officials to disclose their wealth. Premier Li Keqiang said China has "zero tolerance" for corruption. However, individual citizens who have called for officials to disclose their public assets in support of the government's anti-corruption goals have been subject to criminal prosecution.

In 2013, China engaged in an intensive and large-scale anti-corruption campaign, during which 31 central government SOE officials of director general rank or higher were

investigated for graft by the Party's Organization Department. Eight cases were transferred to the judicial authorities. High profile SOE executives were investigated and charged with corruption. Overall in 2013, Chinese Communist Party discipline organs investigated 173,000 corruption cases and disciplined 182,000 officials, of which 9,600 criminal suspects were transferred to judicial authorities. Nationally, prosecutorial authorities accused 51,000 officials of graft and job-related crimes, and courts nationwide concluded 23,000 graft and bribery cases.

China's anti-corruption crackdown could curb abuse of administrative powers by government officials aligned with private sector patrons; however, selective application of anti-corruption rules may also raise concerns among foreign companies in China.

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.

Corruption and Government Transparency - Report by Global Security

Political Climate

The People's Republic of China is governed by the Communist Party of China (CPC), which in late 1978 embarked on a reform process to combine socialism with a market economy. The implemented economic reforms have gradually created economic development with unprecedented growth rates. However, it has also given rise to widespread corruption as the opportunities for public officials to engage in corruption and enrich themselves have multiplied. This poses a serious challenge to the Chinese political leadership, who are aware that their legitimacy is tied to curbing corruption and maintaining economic progress. The current president, Xi Jinping, who took office in March 2013, is seen as having a strong stance against corruption and as being pro-business, according to a BBC News special report on China's Leaders. Since assuming office, President Xi has vowed to fight corruption, and promised to fight 'tigers' and 'flies', by which he referred to high and low-ranking officials, according to an April 2013 article by The New York Times. Several high-ranking government officials, including the former director of the transport bureau, Zhang Shuguang, the former railway minister, Liu Zhijun and the former deputy of the National Development and Reform Commission, Liu Tienan, were charged with corruption and abuse of office. One of the anti-corruption strategies taken by the new leaders is to toughen controls on military licence plates. According to a 2013 article by The Wall Street Journal, abuse of licence plates has been regarded as one of the most visible forms of corruption in China.

Despite the most recent crackdown on corrupt government officials, corruption continues to be a widespread problem in China today. The Chinese government acknowledges that corruption is a major threat to both the country's economic development and political stability and has been pursuing a vigorous anti-corruption campaign. The CPC ratified a five-year Anti-Corruption Plan (2008-2012) (in Chinese), which emphasises that the anti-corruption work should combine punishment with education and better supervision of public officials. The second five-year Anti-Corruption Plan (2013-2017) has also been ratified by the CPC in

August 2013, according to an August 2013 news article published by Sina. In December 2010, for the first time the Chinese government released a white paper on corruption issued by the Cabinet. The document expresses the Chinese government's will to strengthen its efforts in fighting corruption. Furthermore, effective from 1 May 2011, bribery of foreign government officials and officials of international public organisations became criminalised under the Criminal Law.

In recent years, successful prosecutions and arrests in high profile corruption cases have taken place. For example, in August 2013, China witnessed its biggest political scandal involving former Communist Party Chief in Chongqing Bo Xilai. Bo was accused of taking advantage of his position to seek profits for others and receiving massive bribes personally and through his family. [Click here](#) to read more about the Bo Xilai scandal and the latest development. Despite efforts by the government in the fight against corruption, 35% of Chinese households surveyed by Transparency International's Global Corruption Barometer 2010/2011 consider the government's anti-corruption initiatives to be 'ineffective', and 46% of the households perceive that the level of corruption in China has increased over the past 3 years (China is not included in TI's GCB 2013 survey). Despite the obstacles posed by corruption, foreign investors are not being scared off. In fact, China is considered to be the most attractive investment destination by investors, as illustrated in Congressional Research Service Report 2013, where China is listed as the second largest FDI recipient in 2012.

Business and Corruption

The most important part of the Chinese business culture is probably the establishment of close and long-lasting personal ties called *guanxi* in Chinese. It is important to have in mind that *guanxi*-related gift-giving could be considered bribery in most foreign companies; therefore, companies are strongly advised to consider the value and type of gifts they would like to offer to business partners in China beforehand. A July 2013 news article by The Atlantic reports that gift-giving culture in the form of red envelopes (*Hong Bao*) or gift cards is endemic in China. The news article is based on the post of a popular blog among Chinese netizens, in which a real estate company's gift-giving list consisting of different government officials was exposed. It is said that the amounts ranging from RMB 1,000 to RMB 3,000 were given to officials in order to, for instance, register businesses and obtain licenses to pollute. Corruption in China is endemic within the public and the private sector, despite the fact that both passive and active bribery are considered a serious crime, which can lead to life imprisonment and, in the most serious cases, the death penalty. Business executives surveyed by the World Economic Forum's Global Competitiveness Report 2013-2014 report that public funds are sometimes diverted to companies, individuals or groups due to corruption, and that the lack of ethical behaviour of companies in their interactions with public officials, politicians and other companies represents a competitive business disadvantage for China. Congressional Research Service Report 2013 suggests that widespread government corruption, financial fraud and misuse of investment funds, resulting from a general lack of rule of law, poses a serious barrier for doing business in China. Kickbacks in the pharmaceutical industry haven proven to be endemic, as illustrated by several most recent corruption scandals involving international pharmaceutical companies such as GlaxoSmithKline and Sanofi. [Click here](#) to read more about the GSK bribery scandal. Foreign companies should be aware that when conducting business in China, the state and CPC are frequently key stakeholders, and companies will invariably be in contact with the authorities, either central or local level, at every phase of the business process. This is further supported by Congressional Research Service Report 2013, which warns that government 'connection' is

an essential determinant of successful business. Companies are strongly recommended to develop, implement, and strengthen integrity systems when planning to do and when already doing business in China.

Third parties, such as agents and distributors, are commonly used in China as a way of lowering transaction costs and thus generating higher profits. However, companies should note that corruption prevention controls are difficult to enforce when dealing with Chinese agents and distributors. Some companies have been known to use these kinds of intermediaries as a useful channel for outsourcing corruption to avoid direct involvement with corrupt activities. These agent companies are often one-man companies that are extremely difficult to control and that need to be checked thoroughly, as companies can be held legally responsible for bribes paid by their agents. Companies should also be wary of an individual's credentials, as there is a widespread use of false degrees and titles. Thus, it is highly recommended that a thorough screening of agents and potential partners is conducted. For further information, see this portal's due diligence tools.

China's anti-corruption activities were in the past largely targeted towards Chinese settings. Today, the campaign is more comprehensive and an increasing number of foreign and multinational companies have come under scrutiny and been accused of corrupt practices by the authorities, such as the most recent GSK bribery scandal. This trend signals an end to the common belief that corrupt activities are found mostly in the interaction between Chinese companies and government offices and do not involve foreign investors. Transparency International's Bribe Payers Index 2011 shows that Chinese companies' ethical track record when operating abroad is questionable, with the surveyed business executives perceiving Chinese companies to be the second most likely to engage in bribery abroad, after Russia.

Regulatory Environment

With China's entrance into the WTO, many laws and regulations are being harmonised to meet WTO requirements. Since 2002, China has made attempts to join the Government Procurement Agreement (GPA), which calls for more transparent and non-discriminatory conditions for international competition. As of September 2013, China is still in the process of acceding to the GPA. Although much progress can be witnessed, as reported by the US Department of State 2013, China is still trying to protect its 'vital industries and key fields', which is defined 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'. In 2006, China introduced a series of policies linking government procurement to indigenous innovation by Chinese firms, which sparked strong criticism from foreign investors calling the policies discriminatory. In July 2011, the government removed three of the controversial indigenous innovation rules a move that has been praised by many foreign businesses.

China is constantly enacting new laws and regulations and revising existing ones and, according to the World Economic Forum Global Competitiveness Report 2013-2014, the surveyed business executives give a score of 4.3 on a 7-point scale to the burden of government regulation, (1 being 'extremely burdensome' and 7 'not burdensome'), representing a competitive advantage for doing business in China. However, a 2013 Business Confidence Survey conducted by the European Union Chamber of Commerce in China reveals that 30% of the surveyed European businesses perceived Chinese government policies to have become less fair to them over the past two years, and one of the most

significant regulatory obstacle perceived by business respondents is the discretionary enforcement of regulations. Figures from the World Bank & IFC's Doing Business 2013 show that to start a business in China, companies need to spend an average of 33 days and go through 13 administrative procedures at a cost of 2.1% of the GNI per capita, which is more complicated and time-consuming than the OECD average. According to the US Department of State 2013, the government owns all land in the country; however, individuals and companies can own and transfer long-term leases, as well as structures and personal property.

Commercial disputes are heard in the economic courts, which, like other Chinese courts, are not considered independent of the government. Corruption is also found within the judicial system and may influence court decisions. There are examples of local officials ignoring court rulings, making enforcement of court decisions an area requiring improvement. Although there has been an increase in the use of litigation to settle disputes, according to the US Department of State 2013, Chinese authorities usually encourage companies to resolve disputes through informal conciliation. Otherwise, arbitration is encouraged when mediation is called for, typically through the China International Economic and Trade Arbitration Commission (CIETAC). Many foreign companies hesitate to settle through arbitration because it is a very time-consuming and unreliable process in China. The US Department of State 2013 further reports that although a few foreign companies have received a favourable ruling from CIETAC, many still question its reliability. Companies should note that foreign arbitration is a possibility and provisions for it can be included in their contracts; China is a member of the International Centre for the Settlement of Investment Disputes (ICSID) and has ratified the New York Convention 1958. However, companies should not expect foreign court decisions to be enforced in China, as this rarely occurs. Companies can also access the Lexadin World Law Guide for a collection of legislation in China.



Section 3 - Economy

Since the late 1970s China has moved from a closed, centrally planned system to a more market-oriented one that plays a major global role - in 2010 China became the world's largest exporter. Reforms began with the phasing out of collectivized agriculture, and expanded to include the gradual liberalization of prices, fiscal decentralization, increased autonomy for state enterprises, growth of the private sector, development of stock markets and a modern banking system, and opening to foreign trade and investment. China has implemented reforms in a gradualist fashion. In recent years, China has renewed its support for state-owned enterprises in sectors considered important to "economic security," explicitly looking to foster globally competitive industries. After keeping its currency tightly linked to the US dollar for years, in July 2005 China moved to an exchange rate system that references a basket of currencies. From mid 2005 to late 2008 cumulative appreciation of the renminbi against the US dollar was more than 20%, but the exchange rate remained virtually pegged to the dollar from the onset of the global financial crisis until June 2010, when Beijing allowed resumption of a gradual appreciation and expanded the daily trading band within which the RMB is permitted to fluctuate. The restructuring of the economy and resulting efficiency gains have contributed to a more than tenfold increase in GDP since 1978. Measured on a purchasing power parity (PPP) basis that adjusts for price differences, China in 2013 stood as the second-largest economy in the world after the US, having surpassed Japan in 2001. The dollar values of China's agricultural and industrial output each exceed those of the US; China is second to the US in the value of services it produces. Still, per capita income is below the world average. The Chinese government faces numerous economic challenges, including: (a) reducing its high domestic savings rate and correspondingly low domestic consumption; (b) facilitating higher-wage job opportunities for the aspiring middle class, including rural migrants and increasing numbers of college graduates; (c) reducing corruption and other economic crimes; and (d) containing environmental damage and social strife related to the economy's rapid transformation. Economic development has progressed further in coastal provinces than in the interior, and by 2011 more than 250 million migrant workers and their dependents had relocated to urban areas to find work. One consequence of population control policy is that China is now one of the most rapidly aging countries in the world. Deterioration in the environment - notably air pollution, soil erosion, and the steady fall of the water table, especially in the North - is another long-term problem. China continues to lose arable land because of erosion and economic development. The Chinese government is seeking to add energy production capacity from sources other than coal and oil, focusing on nuclear and alternative energy development. Several factors are converging to slow China's growth, including debt overhang from its credit-fueled stimulus program, industrial overcapacity, inefficient allocation of capital by state-owned banks, and the slow recovery of China's trading partners. The government's 12th Five-Year Plan, adopted in March 2011 and reiterated at the Communist Party's "Third Plenum" meeting in November 2013, emphasizes continued economic reforms and the need to increase domestic consumption in order to make the economy less dependent in the future on fixed investments, exports, and heavy industry. However, China has made only marginal progress toward these rebalancing goals. The new government of President Xi Jinping has signaled a greater willingness to undertake reforms that focus on China's long-term economic health, including giving the market a more decisive role in allocating resources.

Agriculture - products:

world leader in gross value of agricultural output; rice, wheat, potatoes, corn, peanuts, tea, millet, barley, apples, cotton, oilseed; pork; fish

Industries:

world leader in gross value of industrial output; mining and ore processing, iron, steel, aluminum, and other metals, coal; machine building; armaments; textiles and apparel; petroleum; cement; chemicals; fertilizers; consumer products, including footwear, toys, and electronics; food processing; transportation equipment, including automobiles, rail cars and locomotives, ships, and aircraft; telecommunications equipment, commercial space launch vehicles, satellites

Exports - commodities:

electrical and other machinery, including data processing equipment, apparel, radio telephone handsets, textiles, integrated circuits

Exports - partners:

US 17.2%, Hong Kong 15.8%, Japan 7.4%, South Korea 4.3% (2012)

Imports - commodities:

electrical and other machinery, oil and mineral fuels, optical and medical equipment, metal ores, motor vehicles

Imports - partners:

Japan 9.8%, South Korea 9.2%, US 7.1%, Germany 5.1%, Australia 4.3% (2012)

Banking

Regulators: People's Bank of China and China Banking Regulatory Commission

Tasked to formulate and implement monetary policy, the People's Bank of China (PBOC) is China's central bank and reports to the State Council. The State Council, however, maintains oversight of the PBOC and makes all final decisions on China's major financial and monetary policy issues. According to the 1995 Central Bank Law, the PBOC has full autonomy in applying monetary instruments, including setting interest rates for commercial banks and trading in government bonds. It maintains the banking sector's payment, clearing and settlement systems, and manages official foreign exchange and gold reserves. The PBOC also oversees the State Administration of Foreign Exchange (SAFE) in the setting of foreign exchange policies.

The China Banking Regulatory Commission (CBRC) was launched on April 28, 2003 to improve the efficiency of bank supervision and allow the PBOC to further focus on the country's macro-economic and currency policy and to take over the bank supervisory role

from the PBOC. According to the official announcement the CBRC posted on its website, the CBRC is responsible for “the regulation and supervision of banks, asset management companies, trust and investment companies as well as other deposit-taking financial institutions. Its mission is to maintain a safe banking system in China.”

State-Owned Commercial Banks – The ‘Big Four’

At present, four major state-owned banks, the Industrial and Commercial Bank of China (ICBC), the Bank of China (BOC), the China Construction Bank (CCB), and the Agricultural Bank of China (ABC), dominate the banking system and together account for well over half of all loans and deposits in China's banks. Several have become some of the largest banks in the world as valued by market capitalization, with ICBC and ABC having conducted the largest IPOs in history in 2006 and 2010, respectively. While the State, operating through the Ministry of Finance, continues to own a majority stake in each of these institutions, they all are publicly listed in Chinese stock markets and also on international bourses. The “Big Four” (along with the Bank of Communications) constitute the absolute majority of bank lending in China. Bank lending remains the most important financing vehicle in the country; equity finance and the corporate bond market remain very small in comparison, while bank lending constitutes roughly 80% of total lending

Foreign Banks in China

China has in steps opened its banking sector to foreign participation, lifting the previous geographic and client restrictions, and allowing foreign banks to conduct RMB-denominated business with local Chinese clients. In December 2006, “The Regulations of the PRC on Administration of Foreign-funded Banks” promulgated by the State Council went into effect. Although foreign banks gained access to the local currency-based retail banking business in 2006, and no longer face geographic and client restrictions on operations, they still must adhere to China's strict regulatory requirements to conduct retail business. Foreign banks' presence in the Chinese market remains very small, falling to 1.75% of total lending by the end of 2010. They are unable to fully engage in the bond trading and underwriting market, offer the full range of derivatives and hedging products, purchase securities firms outright or build their branch network beyond one or two new offices annually. To become a locally incorporated bank in China, a foreign bank needs to apply to the Chinese Banking Regulatory Commission, but separately must win approval from SAFE to bring working capital onshore, frequently a lengthy process.

Stock Exchange

China's securities sector is comprised of three main types of institutions: securities organisations, futures and fund institutions. Securities organisations are institutions that provide intermediary services to security market participants. Sector. China has two stock exchanges—the Shanghai Stock Exchange and the Shenzhen Stock Exchange.

Executive Summary

China maintains a more restrictive foreign investment regime than its major trading partners, including the United States. In 2013, the flow of new Chinese direct investment into the United States eclipsed that of the United States into China, according to widely-cited estimates by the Rhodium Group, a leading private consultancy focused on U.S.-China investment. However, the total stock of U.S. investment in China remains significantly higher than the total stock of Chinese investment in the U.S., at US \$70 billion compared to just US \$17 billion as of the end of 2012, according to the Ministry of Commerce (MOFCOM) China Commerce Yearbook 2012 (the latest year for which China's bilateral data is available). 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 concerns about rising costs, difficulty in finding qualified human resources, and the discretionary authority Chinese regulators have to discriminate against foreign investors, both in the establishment and operational phases.

Over the past year, there were several positive signs that China's new leaders are committed to redefining the State's role in the economy. Xi Jinping, in his first year as State president and head of the Communist Party, has worked to consolidate power and pushed for economic reform to further open the economy to private capital, including international investors in some sectors. Major developments in 2013 include:

- In July, China made a landmark decision to negotiate a high-standard bilateral investment treaty (BIT) with the United States that would be based on the U.S. model BIT approach to national treatment, which covers both the "pre-establishment" and post-establishment phases of investment, and delineates a clear "negative list" of negotiated exceptions.
- In September, China established the Shanghai Pilot Free Trade Zone, partly to test reforms to the investment registration regime and to open previously closed sectors to foreign investment.
- In November 2013, at the Third Plenum meeting of the 18th Party Congress, the Chinese Communist Party unveiled an ambitious reform agenda that directs the authorities to broaden foreign investment access and underscores the leadership's commitment to allow market forces to play a "decisive" role in allocating resources and driving economic growth.

Although the Chinese Communist Party says it expects to "fulfill" the Third Plenum reform agenda by 2020, a detailed reform roadmap and reform timing is lacking for many economic sectors. Foreign investors remain concerned about discriminatory industrial policies, opaque investment approval procedures used to achieve industrial policy goals and a lack of effective administrative and legal recourse if an investment approval is conditioned or denied. Poor enforcement of intellectual property rights (IPR), the forced transfer of technology, and lack of rule of law are additional concerns.

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), the U.S.-China Strategic and Economic Dialogue (S&ED) and the U.S.-China Investment Forum. BIT negotiations are an additional opportunity to encourage China's economic reforms, integrate China into a global rules-based system, and level the playing field for U.S. businesses. 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. For China to achieve its ambitious economic growth goals, its investment regime will have to change to permit greater competition across a broader range of sectors.

1. Openness to, and restrictions upon, foreign investment

Attitude Toward FDI

The Chinese government has stated that it welcomes foreign investment. China attracted US \$118 billion in worldwide foreign direct investment (FDI) in 2013, second only to the United States. 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 protection, a lack of transparency, corruption, and an unreliable legal system.

For more information, AmCham China's 2013 American Business in China White Paper can be found here: <http://www.amchamchina.org/whitepaper>

FDI Statistics from MOFCOM can be found here:

http://www.fdi.gov.cn/1800000121_10000177_8.html

Other Investment Policy Reviews

Organization for Economic Cooperation and Development (OECD)

China is not a member of the Organization for Economic Cooperation and Development (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 here:

<http://www.oecd.org/daf/inv/internationalinvestmentagreements/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 here:

http://www.wto.org/english/tratop_e/tpr_e/tp364_e.htm

IMF information can be found here:

<http://www.imf.org/external/country/Chn/>

Laws/Regulations of FDI

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 might 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 Chinese Communist Party interests, and as such, does not consistently protect individual rights or effectively resolve disputes. The current system is still developing 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.

The administrative regulations and regulatory documents 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, including, 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 2013

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.

An abridged English version of the Third Plenum *Decision on Major Issues Concerning Comprehensively Deepening Reforms* (Third Plenum Decision) can be found here: http://www.china.org.cn/china/third_plenary_session/2013-11/16/content_30620736.htm

In December 2013, MOFCOM solicited comments on revisions to three basic laws on foreign investment, with a view of unifying domestic and foreign investment regulatory regimes. These revisions could significantly change China's foreign investment management regime by extending national treatment to the market access phase, subject to limited exceptions spelled out in a "negative list." There is no timetable to complete the revision.

Industrial Strategy

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), 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; to encourage foreign multinationals to set up regional headquarters and research and development (R&D) centers in China; to encourage foreign investment in production services such as modern logistics, software development, engineering design, vocational skills training, information consulting, technology, and intellectual property (IP) services; to "steadily open up" banking, securities, insurance, telecom, fuel, and logistics industries; to "gradually open up" education and sports; to guide foreign capital to enter healthcare, culture, tourism, and home services; and to encourage foreign capital to enter creative design.

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 have said they must often weigh China's market potential and its interest in attracting technology against China's inability or unwillingness to protect investors' IP.

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* (Foreign Investment Catalogue, or Catalogue), most recently revised in December 2011, and maintained by MOFCOM and 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 that do not meet the goals of China's economic development plans.

The English version of the 2011 Foreign Investment Catalogue can be found here:

<http://english.mofcom.gov.cn/article/policyrelease/aaa/201203/20120308027837.shtml>

Problems with the Catalogue

The Catalogue reflects China's market access restrictions. Contradictions between it 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, foreign investment is required to take the form of cooperative joint ventures and partnerships.
- In the distribution of audio-visual products, foreign investment is only permitted in the form of cooperative joint ventures.
- 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
 - 49% in basic telecom enterprises
 - 50% in life insurance firms
 - 49% in security investment fund management companies

Mandatory 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 recent 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*. According to the *Catalogue of Investment Projects subject to Government Ratification*, all proposed foreign investment projects in China must be submitted for "review and ratification" by NDRC or provincial or local Development and Reform Commissions, depending on the sector and value of the investment. In October 2004, the NDRC issued *Interim Measures for the Administration of Examining and Ratifying Foreign Investment Projects* to guide the ratification of foreign investment projects. NDRC's approval process includes assessing the project's compliance with China's laws and regulations, its national security implications, 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. The State Council may also weigh in for high-value projects in "restricted" sectors.

In December 2013, China released a revised *Catalogue of Investment Projects subject to Government Ratification*, which narrows the scope of foreign investment projects subject to NDRC ratification and no longer requires approval for every foreign investment project. According to the revised *Catalogue of Investment Project subject to Government Ratification*, NDRC ratification only applies to projects over \$300 million for the "encouraged" category of the Foreign Investment Catalogue or projects and over \$50 million for investments into "restricted" categories in the Foreign Investment Catalogue. Provincial governments can ratify real estate projects in the "restricted" category of the Foreign Investment Catalogue and other projects in this category below \$50 million. Local governments can ratify projects in the "encouraged" category under \$300 million. Any other foreign-invested project not listed in the *Catalogue of Investment Projects subject to Government Ratification* no longer requires ratification, and instead only requires "filing-for-record" with local governments. This is significant progress. When announcing the reforms, NDRC stated that the latest revision was conducted in accordance with the principles of "pre-establishment" market access and a "negative list"-based approach, and estimated the number of projects requiring approval by the central authorities would decrease by 60%.

The *Catalogue of Investment Projects subject to Government Ratification* can be found here: http://www.gov.cn/zwqk/2013-12/13/content_2547379.htm

Approvals

Based on the three foreign investment laws, once NDRC approves the foreign investment project, foreign investors must apply to 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

MOFCOM revision plans

In December 2013, MOFCOM initiated a process to revise China's three main laws governing foreign investment. One of the goals of its revisions is to update China's laws to reflect a system whereby some foreign investments require approval, while others merely require filing for record.

Anti-monopoly review and the 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 further below, on Competition Law. Article 31 of China's Anti-monopoly Law (AML) 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 a 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, and 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 defense security but also national economic security and basic social order implications when reviewing transactions.

Local commerce departments are responsible for screening whether relevant transactions require a national security review when they examine transactions under 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. Investors may also voluntarily file for a national security review.

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 concentrated 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. 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 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 Anti-monopoly Law was issued, MOFCOM, SAIC, NDRC, 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.

China's Anti-monopoly Law establishes that merger reviews may consider the impact of deals on China's national economic development. As a step to improve the transparency of enforcement, MOFCOM has committed since November 2012 to disclose information about unconditionally approved cases on a quarterly basis going forward. The NDRC launched several high-profile anti-monopoly investigations in 2013, which focused on the prices charged to Chinese customers. The result of these investigations was often that targeted companies, both foreign and domestic, lowered prices in China for their goods, services, and IP.

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 Anti-monopoly Law 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 Anti-monopoly Law, through March 2014, China has "unconditionally" approved 728 merger cases and "conditionally" approved 23. Twenty of the 23 cases approved with conditions have involved offshore transactions between foreign parties. The other three transactions involved foreign companies merging with Chinese enterprises. MOFCOM blocked one acquisition when a U.S. company tried to acquire a well-known Chinese firm. Observers have expressed concern over the speed of MOFCOM's 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.

In 2013, NDRC increased its enforcement activity noticeably, particularly against foreign enterprises. In addition, U.S. industry has expressed concern about insufficient predictability, fairness, and transparency in NDRC's investigative processes, including NDRC pressure to "cooperate" in the face of unspecified allegations or face steep fines. U.S. industry also has reported pressure from NDRC against seeking outside counsel, in particular international counsel, or having counsel present at meetings.

It remains unclear how China will implement the Anti-monopoly Law with respect to SOEs and government monopolies in industries deemed nationally important. One provision in the Anti-Monopoly Law protects the lawful operations of SOEs and government monopolies in industries deemed nationally important. Although another, ambiguous provision of the Anti-monopoly Law suggests such enterprises may be subject to a different standard, the three Anti-monopoly Law enforcement agencies have publicly stated that the law applies to SOEs, and have pursued enforcement actions against them. To date, China has enforced the Anti-Monopoly Law against SOEs, but concerns remain that enforcement against SOEs will be more limited and regarding the role of industry trade associations in the enforcement process. On the flip 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.

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

Investment Climate Indices and Rankings

Measure	Year	Rank or value	Website Address
TI Corruption Perceptions index	2013	(80 of 177)	http://cpi.transparency.org/cpi2013/results/
Heritage Foundation's Economic Freedom index	2013	(137 of 178)	http://www.heritage.org/index/ranking
World Bank's Doing Business Report "Ease of Doing Business"	2013	(96 of 189)	http://doingbusiness.org/rankings
Global Innovation Index	2013	(35 of 142)	http://www.globalinnovationindex.org/content.aspx?page=gii-full-report-2013#pdfopener
World Bank GNI per capita	2012	5,720 USD	http://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.

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

Overview

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). 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. 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, 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. 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 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 Beijing disqualified CIETAC Shanghai and CIETAC Shenzhen from administering arbitration disputes.

This dispute between CIETAC Beijing and its sub-commissions has raised serious concerns in the U.S. business and legal communities. The dispute is particularly concerning for foreign companies with existing contracts that identify Shanghai or Shenzhen as the location for arbitration, as it is unclear whether CIETAC Shanghai or CIETAC Shenzhen would have the legal authority to arbitrate, whether a court would enforce an arbitral decision by either of those bodies, or whether such an arbitration clause would be deemed null and void for vagueness under China's Arbitration Law. Formal commercial disputes between investors are heard in economic courts. In practice, China's court system is not independent of the

government, and the government often intervenes in disputes. Corruption may also influence local court decisions, and local officials may disregard the judgments of domestic courts. China's legal system rarely enforces foreign court judgments.

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.

Investor-state disputes leading to arbitration are rare in China. China has never lost an arbitration case resulting from an investment dispute. 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).

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 or IPR courts. Instead, local courts usually convene specialized tribunals to hear or try commercial disputes and IPR tribunals to hear or try IPR disputes. The Chinese Communist Party's Third Plenum Decision, released in 2013, announced initiatives to strengthen IPR protection and explore establishing specialized IPR courts. The 2014 Working Report of the Supreme People's Court recommended establishing specialized IPR courts.

Lack of Judicial Independence

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, and local officials may disregard the judgments of domestic courts.

Third Plenum reforms

The Chinese Communist Party's November 2013 Third Plenum Decision announced reforms to judicial management, including plans for unified provincial management of personnel and budgets for local courts and the intention to explore establishing judicial jurisdiction separate from administrative divisions, to ensure consistent and proper implementation of Chinese law. Some local courts, such as Shanghai, have already embarked on the reform process. If successful, reforms would enhance judicial independence.

Enforcing judgments of foreign courts

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 conclude, after reviewing the effective foreign courts' judgments in accordance with international treaties concluded or acceded by China or in accordance with reciprocity principles, that the judgments do not violate the basic principles of Chinese laws or China's sovereignty, security, and social public interest, 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.

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. The verdicts or rulings of most cases are open to the public.

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 new 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.

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, and information and communications technology (ICT) companies are faced with increasing competitive pressure to migrate services to the cloud to take advantage of the cost benefits and greater flexibility of online data storage and service provision. 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, conspire to limit foreign companies' ability to invest in China's emerging cloud industry. At the 24th U.S.-China Joint Commission on Commerce and Trade (JCCT), China agreed to provide foreign enterprises fair and equitable participation in the development of its SEIs, 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. Right Protection of Property Rights

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) 2013 Special 301 Report (see section on China):

<http://www.ustr.gov/sites/default/files/05012013%202013%20Special%20301%20Report.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 2013 Report to Congress on China's WTO Compliance (see section on IPR):

<http://www.ustr.gov/sites/default/files/2013-Report-to-Congress-China-WTO-Compliance.pdf>

For additional information about treaty obligations and points of contact at local IP offices, please see WIPO's country profiles:

<http://www.wipo.int/directory/en/>

Embassy point of contact: Bridget Davis (DavisBM@state.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 and policies 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. Likewise, Chinese agencies rarely solicit public comment on draft regulatory documents that directly implicate citizens' rights and obligations. 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, cloud-based 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 and in regards to outbound Chinese investment.

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, and the PBOC has said that the ceiling on deposit rates will be gradually lifted and removed within the next several years. Increased flexibility has squeezed the net interest margin of banks (i.e., the gap between deposit and lending rates), which has cut into the profits of China's banking sector. 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 products 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.

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.

10. Competition from State-Owned Enterprises

Overview

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."

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.

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 and is less widely accepted there 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.

12. Political Violence

The risk of political violence directed at foreign companies operating in China remains small. Occasional violent but unconnected protests have occurred in all parts of China, but such mass incidents generally involved 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. In the fall of 2012, against a backdrop of rising tensions between China and Japan over territorial issues, some businesses owned or perceived to be owned by Japanese in multiple Chinese cities faced Chinese protests. Economic activity between China and Japan has suffered as a result.

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 anti-corruption efforts. Senior officials and family members are suspected of using connections to avoid investigation or prosecution for alleged misdeeds.

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 Committee enforce ethics guidelines and party discipline. China's National Audit Office also inspects accounts of SOEs and government entities.

Anti-corruption measures

China has stepped up efforts against corruption in Party ranks. President Xi Jinping has said that endemic corruption threatens the Party's survival and has vowed to go after high-flying "tigers," as well as lowly "flies." New anti-corruption measures, part of November 2013 Third Plenum reforms, signaled an intensified push to fight graft. The Third Plenum documents implored public officials to "keep power within the cage of regulations," criticized material excess, and called for senior officials to disclose their wealth. Premier Li Keqiang said China has "zero tolerance" for corruption. However, individual citizens who have called for officials to disclose their public assets in support of the government's anti-corruption goals have been subject to criminal prosecution.

In 2013, China engaged in an intensive and large-scale anti-corruption campaign, during which 31 central government SOE officials of director general rank or higher were investigated for graft by the Party's Organization Department. Eight cases were transferred to the judicial authorities. High profile SOE executives were investigated and charged with corruption. Overall in 2013, Chinese Communist Party discipline organs investigated 173,000 corruption cases and disciplined 182,000 officials, of which 9,600 criminal suspects were transferred to judicial authorities. Nationally, prosecutorial authorities accused 51,000 officials of graft and job-related crimes, and courts nationwide concluded 23,000 graft and bribery cases.

China's anti-corruption crackdown could curb abuse of administrative powers by government officials aligned with private sector patrons; however, selective application of anti-corruption rules may also raise concerns among foreign companies in China.

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.

14. Bilateral Investment Agreements

China has signed 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>

The United States and China concluded a bilateral taxation treaty in 1984. The two countries resumed negotiations toward a bilateral investment treaty (BIT) in October 2012, following the conclusion of the U.S. model BIT review process. At the 2013 U.S.-China Strategic and Economic Dialogue, China agreed to conduct negotiations based on the concepts of "pre-establishment" national treatment, which would expand market access for foreign investors, and a "negative list" of negotiated exceptions to national treatment and other core treaty obligations.

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 issues 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 is an enduring challenge.

In particular, the rocky implementation of new visa rules introduced in the past year led to significant delays for foreign employees waiting to obtain visas. Companies have more frequently cited 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 high labor costs.

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. The right to strike is not protected by law. However, worker protests and work stoppages occur regularly. 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, Chinese labor laws generally meet international labor standards. Enforcement of existing labor laws and regulations, however, is inconsistent.

17. Foreign Trade Zones/Free Trade Zones

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. While the current negative list closely mirrors China's Foreign Investment Catalogue, Shanghai officials have committed to working with relevant ministries in Beijing to release a revised negative list by mid-2014, although the municipal government has not indicated the sectors or investment areas where foreign market access will expand. As of September 2013, 7,772 companies had registered in the free trade zone, including 661 foreign-invested firms. To date, 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.

18. Foreign Direct Investment Statistics

Data Limitations

Investment from and to some economies, including but not limited to the British Virgin Islands, the Cayman Islands, Hong Kong, and Macau, may mask the ultimate source/destination of the investment. Some analysts have noted that investment from and to Taiwan may be underreported.

Chinese FDI data do not include much of the high dollar-value minority equity stakes that American financial services firms have taken in major Chinese lenders. In addition, China does not classify reinvested locally-generated profits as new investment. MOFCOM's data tracks 2003 forward.

FDI as a Percentage of Gross Domestic Product

According to MOFCOM's 2013 China Commerce Year Book, China's FDI stock equaled 16 percent of its gross domestic product (GDP) in 2012.

Foreign Direct Investment Flows for 2012 (Top 10 Sources of Origin)

Country/Economy of Origin	Millions of U.S. Dollars
Hong Kong	65,561
British Virgin Islands	7,831
Japan	7,352
Singapore	6,305
South Korea	3,038
Taiwan	2,847
United States	2,598
Cayman Islands	1,975

Samoa	1,744
Germany	1,451

Source: China Commerce Yearbook 2013

Cumulative* Foreign Direct Investment for 2012 by Selected Source of Origin

Country/Economy of Origin	Millions of U.S. Dollars
Hong Kong	874,596
British Virgin Islands	129,402
Japan	87,246
United States	70,190
Singapore	59,261
Taiwan	57,046
South Korea	52,892
Cayman Islands	25,805
Samoa	19,928
Germany	19,761

Source: China Commerce Yearbook 2013

*Cumulative values are totals of the data collected each year, are not adjusted for inflation, and do not account for divestment.

Flow of Outbound Direct Investment for 2012 (Top 10 Destinations)

Destination	Millions of U.S. Dollars
Hong Kong	51,238
United States	4,048
Kazakhstan	2,996
United Kingdom	2,775

British Virgin Islands	2,239
Australia	2,172
Venezuela	1,542
Singapore	1,519
Indonesia	1,361
Luxembourg	1,133

Source: China Commerce Yearbook 2013

Stock of Outbound Direct Investment for 2012 (Top 10 Destinations)

Destination	Millions of U.S. Dollars
Hong Kong	306,372
British Virgin Islands	30,851
Cayman Islands	30,072
United States	17,080
Australia	13,873
Singapore	12,383
Luxembourg	8,978
United Kingdom	8,934
Kazakhstan	6,251
Russia	4,888
South Africa	4,775

Source: China Commerce Yearbook 2013

Section 5 - Government

Chiefs of State and Cabinet Members:

For the current list of Chiefs of State and Cabinet Members, please access the following - [Central Intelligence Agency online directory of Chiefs of State and Cabinet Members of Foreign Governments](#)

Legal system:

civil law influenced by Soviet and continental European civil law systems; legislature retains power to interpret statutes; note - criminal procedure law revised in early 2012

International organization participation:

ADB, AfDB (nonregional member), APEC, ARF, ASEAN (dialogue partner), BIS, CDB, CICA, EAS, FAO, FATF, G-20, G-24 (observer), G-77, IADB, IAEA, IBRD, ICAO, ICC (national committees), ICRM, IDA, IFAD, IFC, IFRCs, IHO, ILO, IMF, IMO, IMSO, Interpol, IOC, IOM (observer), IPU, ISO, ITSO, ITU, LAIA (observer), MIGA, MINURSO, MONUSCO, NAM (observer), NSG, OAS (observer), OPCW, PCA, PIF (partner), SAARC (observer), SCO, SICA (observer), UN, UNAMID, UNCTAD, UNESCO, UNFICYP, UNHCR, UNIDO, UNIFIL, UNISFA, UNMIL, UNMISS, UNMIT, UNOCI, UNSC (permanent), UNTSO, UNWTO, UPU, WCO, WHO, WIPO, WMO, WTO, ZC

Section 6 - Tax

Exchange control

Foreign currency transactions are controlled by the State Administration of Foreign Exchange Control and its branch offices. Financial institutions cannot engage in foreign exchange business without prior approval.

Treaty and non-treaty withholding tax rates

China has signed **112 agreements** (103 DTC and 9 TIEA agreements) providing for the exchange of information.

Jurisdiction	Type of EOI Arrangement	Date Signed	Date entered into Force	Meets standard	Contains paras 4 and 5	
Albania	DTC	13 Sep 2004	28 Jul 2005	Unreviewed	No	
Algeria	DTC	6 Nov 2006	27 Jul 2007	Unreviewed	No	
Argentina	TIEA	13 Dec 2010	16 Sep 2011	Yes	Yes	
Armenia	DTC	5 May 1996	28 Nov 1996	Unreviewed	No	
Australia	DTC	17 Nov 1988	28 Dec 1990	Yes	No	
Austria	DTC	10 Apr 1991	1 Nov 1992	No	No	
Azerbaijan	DTC	17 Mar 2005	17 Aug 2005	Unreviewed	No	
Bahamas, The	TIEA	1 Dec 2009	28 Aug 2010	Yes	Yes	
Bahrain	DTC	16 May 2002	15 Aug 2002	Yes	No	
Bahrain	DTC Protocol	16 Sep 2013	not yet in force	Unreviewed	Yes	
Bangladesh	DTC	12 Sep 1996	10 Apr 1997	Unreviewed	No	
Barbados	DTC	15 May 2000	27 Oct 2000	Yes	Yes	
Belarus	DTC	17 Jan 1995	3 Oct 1996	Unreviewed	No	
Belgium	DTC	7 Oct 2009	not yet in force	Yes	Yes	
Belgium	DTC	18 Apr 1985	11 Sep 1987	Yes	No	
Bermuda	TIEA	3 Dec 2010	3 Nov 2011	Yes	Yes	
Bosnia and Herzegovina	DTC	2 Dec 1988	16 Dec 1989	Unreviewed	No	
Botswana	DTC	11 Apr 2012	not yet in force	Unreviewed	Yes	
Brazil	DTC	5 Aug 1991	6 Jan 1993	Yes	No	
Brunei Darussalam	DTC	21 Sep 2004	29 Dec 2006	No	No	
Bulgaria	DTC	6 Nov 1989	25 May 1990	Unreviewed	No	
Canada	DTC	12 May 1986	29 Dec 1986	Yes	No	
Cayman Islands	TIEA	26 Sep 2011	15 Nov 2012	Yes	Yes	
Croatia	DTC	9 Jan 1995	18 May 2001	Unreviewed	No	
Cuba	DTC	13 Apr 2001	17 Oct 2003	Unreviewed	No	
Cyprus	DTC	25 Oct 1990	5 Oct 1991	Yes	No	
Czech Republic	DTC	28 Aug 2009	4 May 2011	Yes	Yes	
Denmark	DTC	16 Jun 2012	28 Dec 2012	Yes	Yes	

Jurisdiction	Type of EOI Arrangement	Date Signed	Date entered into Force	Meets standard	Contains paras 4 and 5	
Ecuador	DTC	21 Jan 2013	not yet in force	Unreviewed	Yes	
Egypt	DTC	13 Aug 1997	24 Mar 1999	Unreviewed	No	
Estonia	DTC	12 May 1998	8 Jan 1999	Yes	No	
Ethiopia	DTC	14 May 2009	25 Dec 2012	Unreviewed	No	
Finland	DTC	25 May 2010	25 Nov 2010	Yes	Yes	
Former Yugoslav Republic of Macedonia	DTC	9 Jun 1997	29 Nov 1997	Yes	No	
France	DTC	30 May 1984	21 Feb 1985	Yes	No	
Georgia	DTC	22 Jun 2005	10 Nov 2005	Unreviewed	No	
Germany	DTC	10 Jun 1985	14 May 1986	Yes	No	
Greece	DTC	3 Jun 2002	11 Nov 2005	Yes	No	
Guernsey	TIEA	27 Oct 2010	17 Aug 2011	Yes	Yes	
Hong Kong, China	DTC	10 Dec 2003	8 Dec 2006	Yes	Yes	
Hungary	DTC	17 Jun 1992	31 Dec 1994	Yes	No	
Iceland	DTC	3 Jun 1996	5 Feb 1997	Yes	No	
India	DTC	18 Jul 1994	21 Nov 1994	Yes	No	
Indonesia	DTC	7 Nov 2001	25 Aug 2003	Yes	No	
Iran	DTC	20 Apr 2002	14 Aug 2003	Unreviewed	No	
Ireland	DTC	19 Apr 2000	6 Apr 2001	Yes	No	
Isle of Man	TIEA	26 Oct 2010	14 Aug 2011	Yes	Yes	
Israel	DTC	8 Apr 1995	1 Jan 1996	Yes	No	
Italy	DTC	31 Oct 1986	13 Dec 1990	Yes	No	
Jamaica	DTC	4 Jul 1996	16 Mar 1997	No	No	
Japan	DTC	6 Sep 1983	26 Jun 1984	Yes	No	
Jersey	TIEA	29 Oct 2010	10 Nov 2011	Yes	Yes	
Kazakhstan	DTC	12 Sep 2001	27 Jul 2003	Unreviewed	No	
Korea, Republic of	DTC	28 Mar 1994	27 Sep 1994	Yes	No	
Kuwait	DTC	25 Dec 1989	20 Jul 1990	Unreviewed	No	
Kyrgyzstan	DTC	24 Jun 2002	29 Mar 2003	Unreviewed	No	
Lao People's Democratic Republic	DTC	25 Jan 1999	22 Jun 1999	Unreviewed	No	
Latvia	DTC	7 Jun 1996	27 Jan 1997	Unreviewed	Yes	
Lithuania	DTC	3 Jun 1996	18 Oct 1996	Yes	No	
Luxembourg	DTC	12 Mar 1994	28 Jul 1995	No	No	
Macao, China	DTC	15 Jul 2009	15 Sep 2010	Yes	Yes	
Malaysia	DTC	23 Nov 1985	14 Sep 1986	No	No	
Malta	DTC	23 Oct 2010	25 Aug 2011	Yes	Yes	
Mauritius	DTC	1 Aug 1994	4 May 1995	Yes	Yes	
Mexico	DTC	12 Sep 2005	1 Mar 2006	Yes	No	
Moldova, Republic of	DTC	7 Jun 2000	26 May 2001	Unreviewed	No	
Mongolia	DTC	26 Aug 1991	23 Jun 1992	Unreviewed	No	
Morocco	DTC	27 Aug 2002	16 Aug 2006	Unreviewed	No	
Nepal	DTC	14 May 2001	31 Dec 2010	Unreviewed	No	
Netherlands	DTC	13 May 1987	5 Mar 1988	No	No	
New Zealand	DTC	16 Sep 1986	17 Dec 1986	Yes	No	
Nigeria	DTC	15 Apr 2002	21 Mar 2009	Unreviewed	No	
Norway	DTC	25 Feb 1986	21 Dec 1986	Yes	No	

Jurisdiction	Type of EOI Arrangement	Date Signed	Date entered into Force	Meets standard	Contains paras 4 and 5	
Oman	DTC	25 Mar 2002	20 Jul 2002	Unreviewed	No	
Pakistan	DTC	15 Nov 1989	27 Dec 1989	Unreviewed	No	
Papua New Guinea	DTC	14 Jul 1994	16 Aug 1995	Unreviewed	No	
Philippines	DTC	18 Nov 1999	23 Mar 2001	Yes	No	
Poland	DTC	7 Jun 1988	1 Jan 1990	Yes	No	
Portugal	DTC	21 Apr 1998	7 Jun 2000	Yes	No	
Qatar	DTC	2 Apr 2001	21 Oct 2008	Yes	No	
Romania	DTC	16 Jan 1991	5 Mar 1992	Unreviewed	No	
Russian Federation	DTC	27 May 1994	1 Jan 1998	Yes	No	
San Marino	TIEA	9 Jul 2012	not yet in force	Yes	Yes	
Saudi Arabia	DTC	23 Jan 2006	1 Sep 2006	Yes	No	
Serbia	DTC	21 Mar 1997	1 Jan 1998	Unreviewed	No	
Seychelles	DTC	26 Aug 1999	17 Jan 2000	Yes	No	
Singapore	DTC	11 Jul 2007	18 Sep 2007	Yes	Yes	
Slovakia	DTC	11 Jun 1987	23 Dec 1987	Yes	No	
Slovenia	DTC	13 Feb 1995	27 Dec 1995	Yes	No	
South Africa	DTC	25 Apr 2000	7 Jan 2001	Yes	No	
Spain	DTC	22 Nov 1990	20 May 1992	Yes	No	
Sri Lanka	DTC	11 Aug 2003	22 May 2005	Unreviewed	No	
Sudan	DTC	30 May 1997	9 Feb 1999	Unreviewed	No	
Sweden	DTC	16 May 1986	3 Jan 1987	Yes	No	
Switzerland	DTC	6 Jul 1990	27 Sep 1991	No	No	
Switzerland	DTC	25 Sep 2013	not yet in force	Unreviewed	Yes	
Syrian Arab Republic	DTC	31 Oct 2010	1 Sep 2011	Unreviewed	Yes	
Tajikistan	DTC	27 Aug 2008	28 Mar 2009	Unreviewed	Yes	
Thailand	DTC	27 Oct 1986	29 Dec 1986	Unreviewed	No	
Trinidad and Tobago	DTC	18 Sep 2003	22 May 2005	No	No	
Tunisia	DTC	16 Apr 2002	23 Sep 2003	Unreviewed	No	
Turkey	DTC	23 May 1995	20 Jan 1997	Yes	No	
Turkmenistan	DTC	13 Dec 2009	30 May 2010	Unreviewed	No	
Uganda	DTC	11 Jan 2012	not yet in force	Unreviewed	Yes	
Ukraine	DTC	4 Dec 1995	18 Oct 1996	Unreviewed	No	
United Arab Emirates	DTC	1 Jul 1993	5 Jun 1994	Yes	No	
United Kingdom	DTC	26 Jul 1984	23 Dec 1984	Yes	No	
United States	DTC	30 Apr 1984	22 Oct 1986	Yes	No	
Uzbekistan	DTC	3 Jul 1996	3 Jul 1996	Unreviewed	Yes	
Venezuela	DTC	17 Apr 2001	23 Dec 2004	Unreviewed	No	
Viet nam	DTC	17 May 1995	18 Oct 1996	Unreviewed	No	
Virgin Islands, British	TIEA	7 Dec 2009	30 Dec 2010	Yes	Yes	
Zambia	DTC	26 Jul 2010	30 Jun 2011	Unreviewed	Yes	

Methodology and Sources

Section 1 - General Background Report and Map

(Source: [CIA World Factbook](#))

Section 2 - Anti – Money Laundering / Terrorist Financing

	Lower Risk	Medium Risk	Higher Risk
FATF List of Countries identified with strategic AML deficiencies	Not Listed	AML Deficient but Committed	High Risk
Compliance with FATF 40 + 9 recommendations	>69% Compliant or Fully Compliant	35 – 69% Compliant or Fully Compliant	<35% Compliant or Fully Compliant
US Dept of State Money Laundering assessment (INCSR)	Monitored	Concern	Primary Concern
INCSR - Weakness in Government Legislation	<2	2-4	5-20
US Sec of State supporter of / Safe Haven for International Terrorism	No	Safe Haven for Terrorism	State Supporter of Terrorism
EU White list equivalent jurisdictions	Yes		No
International Sanctions UN Sanctions / US Sanctions / EU Sanctions	None	Arab League / Other	UN , EU or US
Corruption Index (Transparency International) Control of corruption (WGI) Global Advice Network	>69%	35 – 69%	<35%
World government Indicators (Average)	>69%	35 – 69%	<35%
Failed States Index (Average)	>69%	35 – 69%	<35%
Offshore Finance Centre	No		Yes

Section 3 - Economy

General Information on the current economic climate in the country and information on imports, exports, main industries and trading partners.

(Source: [CIA World Factbook](#))

Section 4 - Foreign Investment

Information on the openness of foreign investment into the country and the foreign investment markets.

(Source: [US State Department](#))

Section 5 - Government

Names of Government Ministers and general information on political matters.

(Source: [CIA World Factbook](#) / <https://www.cia.gov/library/publications/world-leaders-1/index.html>)

Section 6 - Tax

Information on Tax Information Exchange Agreements entered into, Double Tax Agreements and Exchange Controls.

(Sources: [OECD Global Forum on Transparency and Exchange of Information for Tax Purposes](#) [PKF International](#))

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