Embassy of Switzerland **Beijing, 22 February 2006**
DER / LIH / DIB

Seco-Survey on major framework conditions for commerce and foreign direct investment in China: Analysis report

I. Introduction

The State Secretariat for Economic Affairs of Switzerland (Seco) is currently preparing a strategy on future action to improve the bilateral economic and trade framework conditions for the benefit of Swiss companies doing business with and in China. The first stage of this work was to identify and document the major problems faced by Swiss companies to access the Chinese market . To complete information available from different foreign sources and earlier Swiss-China Surveys, the Embassy of Switzerland in Beijing, in cooperation with the Swiss Business Hub China (SBH) and SwissCham China carried out the present survey in November 2005.

In order to obtain the latest available data on problems related to market access, discriminatory measures and more generally relevant framework conditions for doing business in China and an assessment of the overall situation from Swiss firms established in China, a short questionnaire was sent to Chief Executive Officers of the 230 Swiss companies listed in the China Directory 2005. 50 of them replied in time for this report, thus representing 21.7% of participation. To guarantee confidentiality, the data published in this analysis is strictly anonymous and no firm has been named . The Embassy of Switzerland would like to thank once again those who have contributed to this survey.

The questionnaire is structured into Part I (Access to the Chinese market) and Part II (Doing business in China: Local issues and standards). Part I is divided into 6 questions (Import: Tariff barriers; Import: Non-tariff barriers; Import: Technical barriers to trade; Import of services; Foreign direct investment conditions; and Employment of foreign staff). Part II consists of questions 7 to 10 (Intellectual property right protection; Government procurement; Micro-economic issues and other issues).

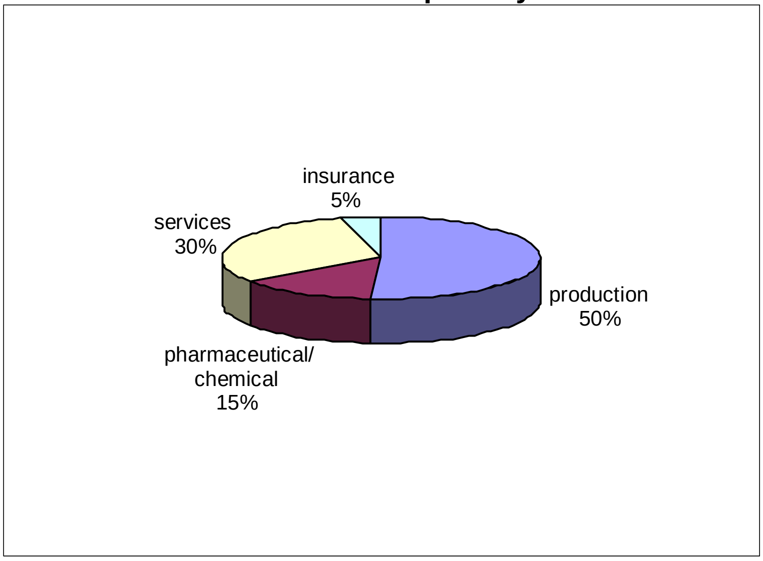
II. Analysis of the survey

Although the support-letter had clearly notified the confidential aspect of the questionnaire, some companies chose not to reply to the survey or to some questions, mostly because of the sensitive nature of the issues and the answers they could provide. Therefore the “no answer”-option was not included in the analysis. “Not applicable” (n/a) was treated as “no problem” in questions 1 – 7, because some firms that would have been in the same situation (n/a) had systematically answered “no problem”. Out of 50 replies 49 were analysed, because the answers given in one reply were inadequate.

Respondents replied by using a 1-5 scale, with 5 representing a “major problem” and 1 “no problem”. Answers of scales 4 and 5 to a question were treated as an explicit indication that some decisions of the surveyed companies were significantly (negatively) affected by that issue. Answers of scales 2 and 3 denoted a problem, but of lesser consequences.

The analysis of the study was carried out by classifying the 49 responses into four sector categories: production (25), pharmaceutical and chemical (7), services (15), and insurances (2). “Production” includes companies in the sector of machinery, metal, textiles, construction, food and beverage, etc. some of which also deal with the distribution and services related to their products. “Services” includes representation and public relations, sales and marketing, legal advising, logistics, forwarding and inspection services, and tourism. The "pharmaceutical and chemical" sector and "insurances" are essentially part of "production" and "services" respectively, but have been separated to better isolate the response of these key industries.

Distribution of the replies by sector



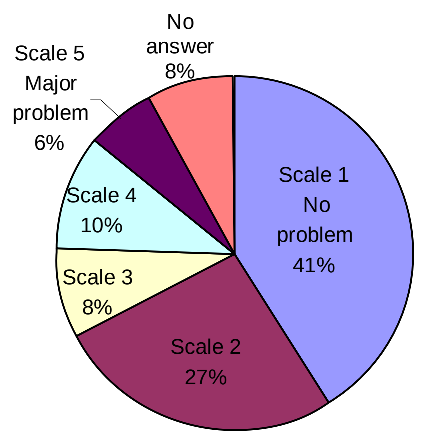
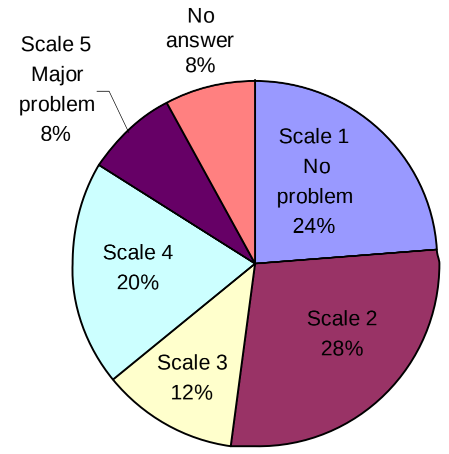
Part I: Access to the Chinese market

1. Import: tariff barriers

There are four types of taxes on goods in China: import duties, consumption tax, VAT and anti-dumping duties. **Import duties** are calculated as a percentage of the CIF (cost insurance freight) price of the goods; **consumption tax** ranges from 3-45% and is essentially applied to luxury goods; most goods are subject to 17% **VAT** with exceptions at 13%; and **anti-dumping duties** are imposed on foreign imports if they are considered to be sold too cheaply.

China has reduced its tariffs significantly – in 2005 China's overall tariff level averaged 9.9% – and most tariff reductions were made in accordance with WTO-specified schedules. To date, China has fulfilled these tariff reduction obligations. 1st January 2005 was the end date for most of China's tariff reduction commitments, with only a few tariff lines subject to further reduction. However, import tariffs remain high in certain sectors.

Is the level of customs duties a problem for your firm?

All answers	Answers from *production* sector firms
	

- Most problems are seen in the production sector: 7 out of the 8 that ticked “4” or “5” in the survey were producers.
- Pharmaceutical and chemical companies saw duties as a minor issue: 5 out of 7 ticked “2” and the remaining 2 had encountered no problem (“1”).
- Service (including insurance) companies were mostly unaffected: only 3 out of the 15 that answered the question mentioned a problem only one for which duties are a major problem (“5”)[1].

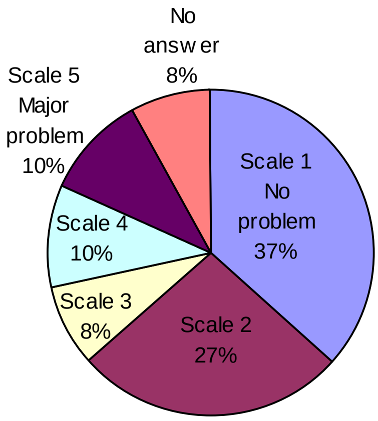
The answers to the survey quite uniformly complained about the tariffs on **imported machines** which are affected by tariffs of up to 10%. Production companies were the most concerned by that. Several answers noted that adding a 17% **VAT** to the duty makes the price of the imported equipment significantly higher, giving advantage to the local industry. However, there were signs of satisfaction regarding the import of **raw materials**. The pharmaceutical and chemical firms did not complain about tariffs and one reported that the tariffs on raw materials are reasonable. Over 80% of the services and insurance sectors do not import and this question was not applicable to them. One firm in that sector reported the cost of importing testing equipment (duty of 7-10%) and another cited that of importing operation software.

2. Import: non-tariff barriers

China has substantially **fulfilled its WTO obligations** as to eliminating non-tariff trade barriers (NTTB) successively. 424 products had been subject to NTTB before accession. On 31 December 2004, import quotas and licensing requirements on 389 goods and on 1 January 2005, the remaining 35 products of mostly auto and auto parts were eliminated. On the other hand other NTTB have emerged as obstacles, including excessively high capitalisation requirements – particularly for the financial services and retail sectors – and the use of phytosanitary standards towards agricultural imports. Furthermore issues such as **transparency and consistency** at customs clearance remain of strong concern. Due to a lack of sufficient information available in English it is difficult for companies to prepare the required documents. There are noticeable inconsistencies between central policies and the

[1] NB Answers such as “not applicable” from companies that don’t have any imports were counted as “no problem” for questions 1 through 4 since some companies which also don’t import answered “no problem”.

local practices at various ports. In some cases, Chinese customs officials aggressively use minimum or reference price lists or another company's import values to challenge **import transaction values**.

<table>
<tr><th colspan="2">Are non-tariff barriers a problem for your firm?</th></tr>
<tr><td>All answers</td><td>Answers from production sector firms</td></tr>
<tr><td>


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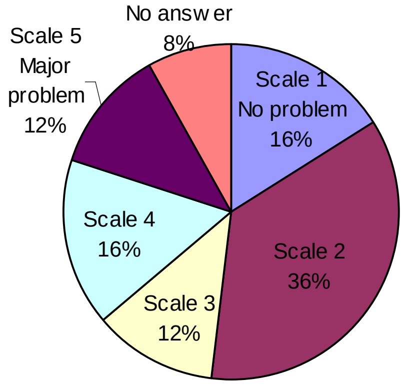


</td></tr>
<tr><td colspan="2">§ Comments below the pie-charts in question 1 still apply.</td></tr>
</table>

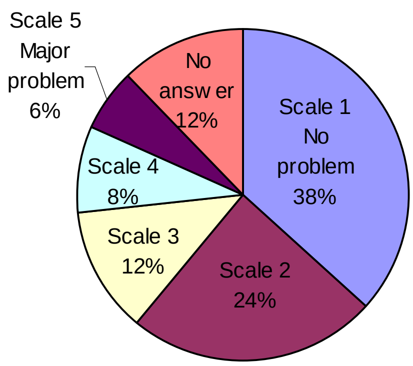
Again, NTTB mainly affect the production companies which import goods and raw materials. By far the most important issues lie in the **complex import procedures** (paperwork, numerous steps required to receive an HS number, etc.) which were highly time-consuming. The second most cited issue was the **discretionary customs valuation** – as mentioned above – including problems such as confusing or unclear classification of imports, inconsistencies between ports or cities and even officers. Thirdly, problems with **import licensing and restrictions** (for example machines of a certain age cannot be imported). However, **quotas** didn't seem to be a systematic problem. It was also remarked that **investigations** may not be in line with legal requirements. These problems result in **delays** (up to several weeks) and **extra costs**. Among the few 'non-producers' that mentioned their experience with imports, complex procedures, licensing and inspection – and the cost and delays these entail – were pointed out.

3. Import: technical barriers

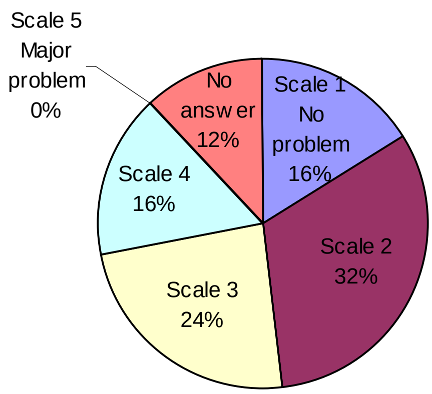
China is basically in **compliance with WTO requirements**. However, it continues to use the standards development process to set technical barriers on trade in order to favour domestic companies over foreign competitors. Since 2003 manufacturers of more than 130 types of products need to apply for and receive the **China Compulsory Certification (CCC)** before the products can be imported, advertised, or used for any commercial purpose in China. The cumbersome process demands an onsite inspection at the applicant's factory in its home country by an accredited Chinese CCC organisation at the applicant's costs.

Are technical barriers a problem for your firm?

All answers



Answers from production sector firms

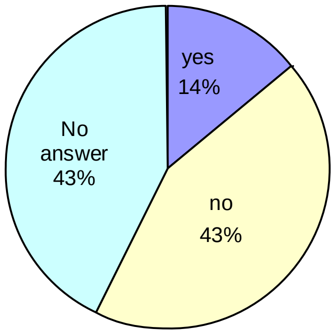
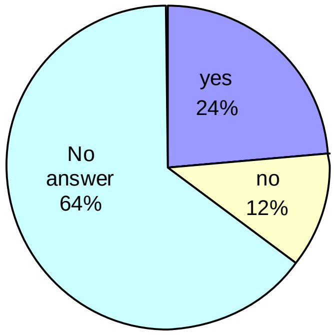


§ Comments below the pie-charts in question 1 still apply.

As for the previous questions, the issue of technical barriers mainly affected production companies. CCC is notably the most problematic issue as it entails extra cost and delays. This was followed by other quality certifications, requirements of re-labelling goods in Chinese and **product registration** (which causes a duplication of tests which have already been done in the West). More specifically, imports of electric or electronic related parts, components and tools require additional approvals (and delays), as was remarked in several answers. A restriction from the government on wooden packages was also mentioned more than once. Further, a multinational company complained of different/stricter requirements in its sector compared to those of many countries.

Within the 'production' category, the metal industry companies mentioned no or few technical barriers in their answers. Similarly, technical barriers were scarcely problematic for the pharmaceutical and chemical companies. While within the service sector, CCC were noted by companies importing goods for distribution and technical barriers more generally by companies whose clients have imports.

International technical standards are partially or entirely applicable for almost 60% of the companies that answered the question. But it is difficult to find a trend in the answers of the survey.

<table>
<tr><th colspan="3">Are international technical standards applicable in your field of activity recognised in China?</th></tr>
<tr><td>Production sector</td><td>Pharmaceutical and chemical sector</td><td>Service and insurance sector</td></tr>
<tr><td>
</td><td>
</td><td>
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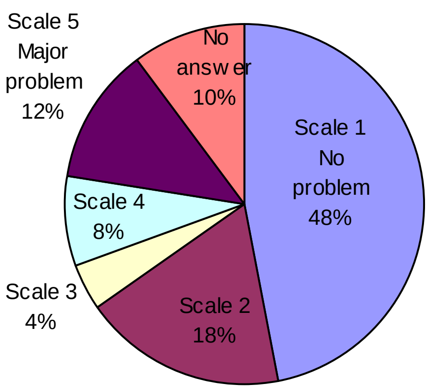
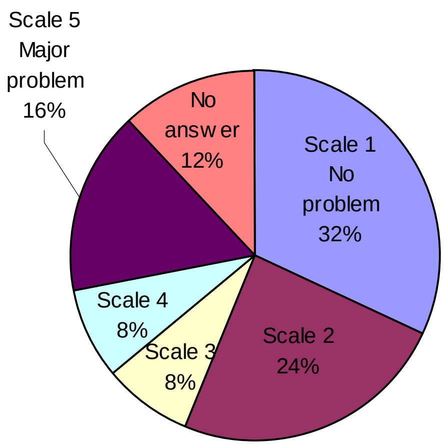
</table>

4. Import of services

China has abided by the WTO agreement of market-opening measures, but simultaneously maintained or even **set up non-tariff barriers to entry that effectively have precluded foreign companies from attaining full market access in services**. Affected sectors are banking, insurance, legal services, telecommunications, construction, architectural and engineering services, postal and express delivery services, and distribution and retail services.

<table>
<tr><th colspan="2">Is the import of services a problem for your firm?</th></tr>
<tr><td>All answers</td><td>Answers from production sector firms</td></tr>
<tr><td>
</td><td>
</td></tr>
<tr><td colspan="2">§ About a third (8) of the production companies don't import services or don't have problems.
§ 6 of the 7 pharmaceutical and chemical firms had little ("2") or no problem with import of services.
§ 12 of the 17 services and insurance firms either don't import services or don't have a problem.</td></tr>
</table>

Though it might be expected that the service industry's companies would be most affected, it was Swiss production companies that voiced the most complaints in their answers to the question. This is in all likelihood due to the fact that the service providers that answered the survey are already in the Chinese market.

Among companies' complaints, the **limits to using technical and engineering services from abroad were frequently mentioned**. Payments for foreign technicians or engineers are nearly impossible because of currency transfer regulations and having to prove to the authorities why these people are being paid. Consequently, companies can't use foreign and even their own (worldwide) company's technical/engineering services, meaning they have to contract another company which entails at best a lot of paperwork, however it may also add costs and a loss of business. One comment explains that these restrictions "derive from the fact that foreign companies are encouraged to transfer technology and know-how but related activities afterwards are restricted in many cases to the local suppliers and foreign suppliers are simply excluded".

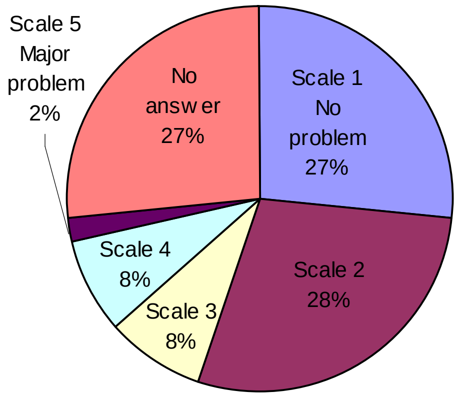
The second most mentioned difficulties regard financial services, in particular **international money transfers and inter-company payments**. These often require many documents, take longer than elsewhere and are sometimes impossible. Problems with logistic services – such as having to physically transfer goods from a Free Trade Zone – may also cause delays and extra cost. Finally, in one specific case, China didn't accept the multinational company's global insurance policy, meaning that it had to buy local insurance on top of that.

In the service sector there were a couple of remarks: the services of an inspection company cannot be accredited and approved in China causing delays; and there are problems with foreign legal practice in China. Other answers were either not clear or detailed enough to comment on them here.

5. Investment (FDI) conditions

In line with China's pledges to the WTO agreements, the operating environment for foreign investment has improved in a number of sectors, including telecommunications, automotive, insurance and retail. **Research and development (R&D) environment** has been enhanced. Over 200 R&D centres in China are foreign-funded, taking advantage of the large pool of professional researchers on relatively low wages. **Some restricted sectors**, including retail, wholesales, distribution, telecommunications, securities, banking and tourism have started to become more open to foreign investors. In spite of China's commitment to WTO agreements, protectionism of local governments can block implementation and hinder efforts for increased transparency.

Since 1997, the number of wholly foreign owned enterprises (WFOE) each year has surpassed that of joint ventures. In 2004, WFOE accounted for 70.4% of all foreign invested companies, while 26.5 were joint ventures. (Foreign investors have also been converting joint ventures into WFOE in recent years). This trend is likely to accelerate as China relaxes restrictions on foreign investments in various sectors.

Are the investment conditions in China a problem for your firm? (all answers)

§ 13 of 49 firms didn't answer the question, 13 answered "no problem" and 14 "2". § Only 5 companies are dissatisfied ("4" or "5") by the current environment (4 of them in the production sector).

Virtually all the Swiss production companies that replied to the survey were WFOE. Among the pharmaceutical and chemical companies that replied there are a few WFOE and a couple of joint ventures, a representative office and a holding group. In services and insurance, the respondents were mainly representative offices, with a couple of joint ventures and WFOE; a couple were branch offices and one secured distribution.

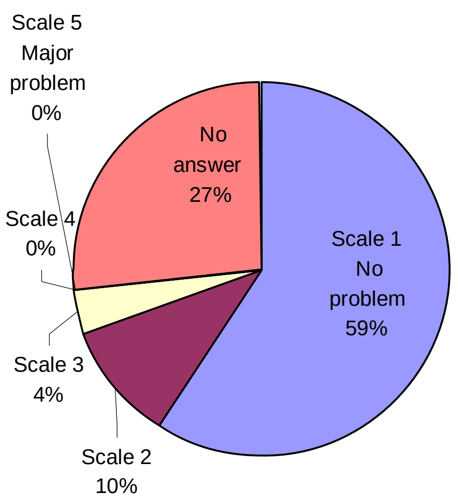
A few complaints related to **royalty** were voiced: some delays to the approval of the license agreement were experienced by a production company making them unable to remit royalty abroad; the tax office didn't fully accept the calculated royalties of another production firm; and a service provider found royalty difficult to get approved. A few companies (production sector) admitted not being in the position to **repatriate capital** yet. The main comments among those who did have problems regarded the complexity of the process. One mentioned the fact that a company can't repatriate capital unless profits are high, and another that it is nearly impossible to voluntarily reduce the share of capital in China. One insurance company also wasn't able to repatriate capital. Only one pharmaceutical and chemical company said they'd had faced restrictions but didn't give any details. Though a number of service firms made comments, overall they haven't had any problems: one comment related to the **minimum taxation** required for the head representative office, another that **withholding tax** often applies.

Again, relatively few complaints were voiced regarding restrictions limiting foreign investment, but the majority of them regarded the obtainment of **bank loans**. The issue on the limit of bank loans (30% of the invested capital) was brought up by one production company, and one company in services mentioned the restrictions in the investment sum allowing to extend loans to WFOE. One production firm experienced restrictions in areas of special government interest to promote local enterprises. More comments were made in services regarding the rigidity of the **tax system**, the restrictions in opening new **branches**, **investment sums** and **equity ceilings**. Regarding the latter, a company noted the equity ceilings for joint ventures in its business (50%) and for buying into a Chinese company (25%).

Most companies have not had problems with **transfer pricing** yet, but several showed concern about the future, especially in the production sector's answers. One production company's response explains that transfer pricing is a major problem in China "because the tax authorities do not have a basic understanding about transfer pricing and they usually do not accept the evidence provided by taxpayer even though it shows that the price is in an arm's length. The tax authorities have already assigned a target to the audit team which is unfair to the taxpayer." Another production company complained that they are "increasingly being challenged by various authorities (no national guidance)". Further a third company noted that customs don't accept a huge decrease in transfer pricing from Europe. Two companies out of the seven pharmaceutical and chemical companies that replied to the survey mentioned they had problems but gave no details. Most responding companies of the service sector didn't face problems with respect to transfer pricing. One (law firm) did remark that the tax system is rigid (and it is hard to get Switzerland based lawyers' fees into account). Another (international forwarding) noted that transfer pricing are difficult to apply to the service industry.

Switzerland and China have two major bilateral agreements – Double Taxation Avoidance Agreement (DTAA) and Development and Protection of Investment (BIT).

Does your firm face any problem relating to interpretation or implementation of these agreements? (all answers)



§ Only 7 out of 49 companies that answered the question replied something else than "no problem"

Very few problems were brought up on the bilateral agreements. One company complained that the contents of the bilateral agreements are not clear. A representative office mentioned that PRC tax law often contain provisions that make the DTAA irrelevant. A legal service firm also said that DTAA is only partly applicable.

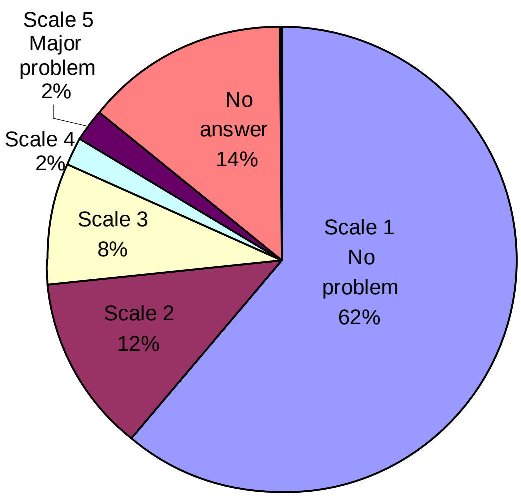
A production company commented: "Most of the tax officials in China do not have knowledge and exposure to the double tax treaty. It gives a huge problem to taxpayer when we apply for something because there is no process which could follow in a lot of the municipal tax authorities. The agreement itself is fine and the OECD is updating the model periodically which will be adopted by the Chinese authorities finally."

A further question was asked as to whether companies were aware of any discrimination against Swiss firms in comparison with other foreign investors. To this question, all but one had no knowledge of discrimination, that they had been treated fairly. The one which replied affirmatively did not give any further detail; one answer insisted that the contrary was probably true (positive discrimination toward Swiss firms compared to others) and one mentioned that certain political decisions take into account the weight of the partner and that Switzerland may lack the necessary political backing.

6. Employment of foreign staff

Under the current regulations in China, foreign employees are excluded from the Chinese social security system. This situation can lead to **high personal risk and high additional costs for foreign passport holders without "expatriate contracts",** where the company covers most costs related to insurance and maintains the home country social benefit structure if applicable.

Do you face any problems when hiring staff from abroad? (all answers)



§ 30 of 49 companies that answered the question had "no problem" hiring foreign staff, a further 10 ticked "2" or "3".

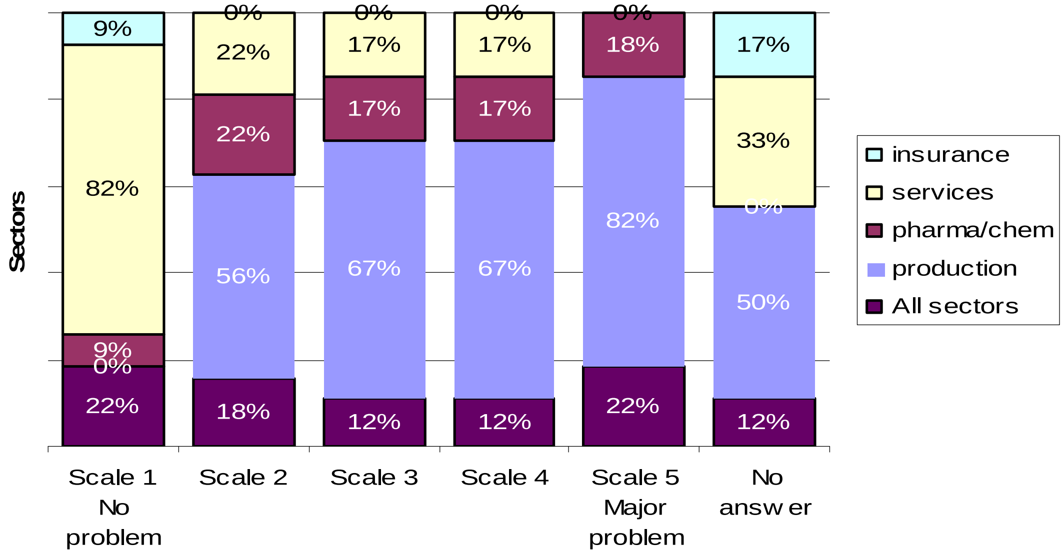
The overall view on **hiring foreign staff** is vastly more positive than negative. Among the problems outlined by all sectors confused were "some restrictions on the level of expatriates who can be allowed to apply for the spouse's "resident card"," the complex registration procedures and the short length (1 year) of a visa validity. Respondents were hoping for improvements in lowering the personal income tax rates, extending the residence permit period (to two years), simplification and faster release of the visa, employment, and residence permit obtainment procedures.

Part II: Doing Business in China: Local issues and standards

7. Intellectual property right (IPR)

Despite the promulgation of new IPR rules and progress made on IPR legislation, major concerns remain in various areas, such as protection of confidential information, unfair behaviours and poor enforcement of IPR laws. Enforcement efforts have been increased, but inadequate penalties for violations remain. At the local level, enforcement efforts are hindered by unsatisfactory coordination among Chinese government ministries and agencies, local protectionism and corruption, high thresholds for initiating investigations and prosecuting cases, lack of training, and inadequate and non-transparent processes.

Is intellectual property protection a problem for your firm?
(distribution of replies by sector)



§ Two-thirds of the companies have a problem (“2” through “5”)

§ Intellectual protection is clearly more of a problem for production companies (52% ticked “4” or “5”, whereas 20% ticked “1” or “2”) and less for services (7% to 73% respectively)

Production sector (pharmaceutical and chemical sector *in italic*)

Just under half the respondents admitted not having had any major problems as yet. *Though all but one or two firms of the pharmaceutical and chemical sector are currently affected, most voiced their concern with regards to the system.* However the system is unsatisfactory and often referred to as a major problem for production companies. The main problems cited were:

- The lack of law enforcement and implementation (in particular at provincial level)
- Sentences for infringements too light
- The infringing companies were protected by the local government
- The procedures to receive legal or administrative support are too complex
- The burden of proof is too heavy
- No protection for SMEs – they aren’t taken seriously

Most companies were affected by piracy, such as:

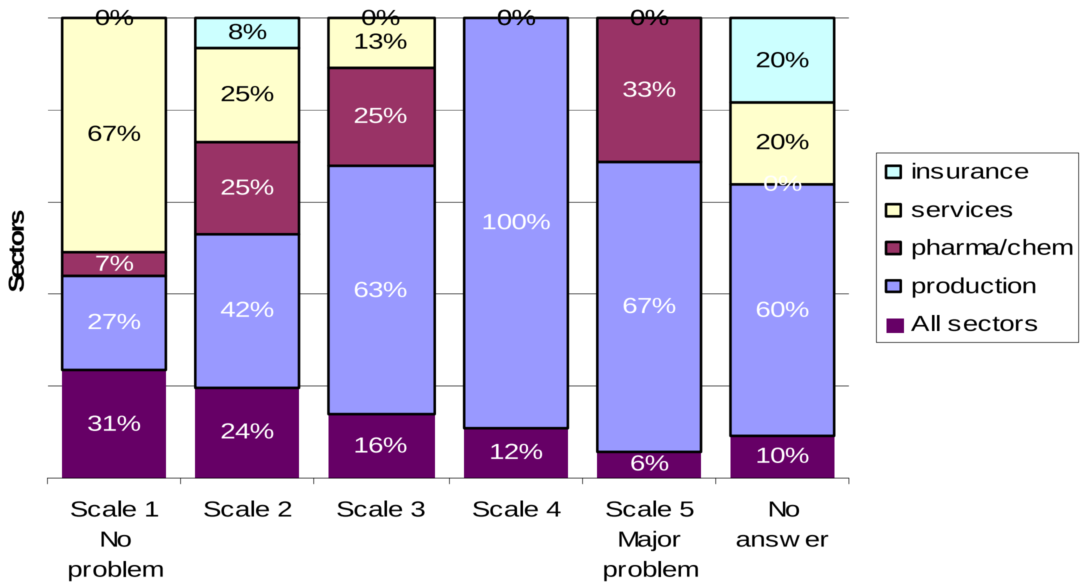
- Unauthorized use of product trademark
- Similar design of logo/name
- Copy of designs and/or related marketing material/tools
- Counterfeits and imitations
- Infringed patents
- Theft of data and know-how
- “Forced” transfer of technology
- *Backlog of patents and trademark applications*
- *Ignoring patents and direct competition to patented products with bad quality copies*

A number of firms mention the measures taken to protect their intellectual property, for example: making innovative patents, developing and putting new products on the market very quickly, keeping their know-how in Switzerland, and not storing data or documentation in their Chinese facilities.

To the question “what changes would you wish to be introduced?” companies said:

- Enforcement of IPR laws/regulations
- Respect of international standards
- Stricter punishments/ higher sentences
- Clearer rules and speedier process
- Wider/better protection of foreign companies
- Efforts should be made at all levels of authority
- More transparence in the legal system
- Simplified procedures of complaint

To which extent is your company affected by issues related to IPR enforcement? (distribution of replies by sector)



§ Comments below the charts above still apply

Service sector

Many companies gave no answers to the questions regarding intellectual property protection, but a few mentioned some problems they had encountered including copying/pirating of marketing products and one specific case of counterfeited reports. The latter case caused troubles to the company and their clients, and though they reported it to the government, the authorities have not reacted.

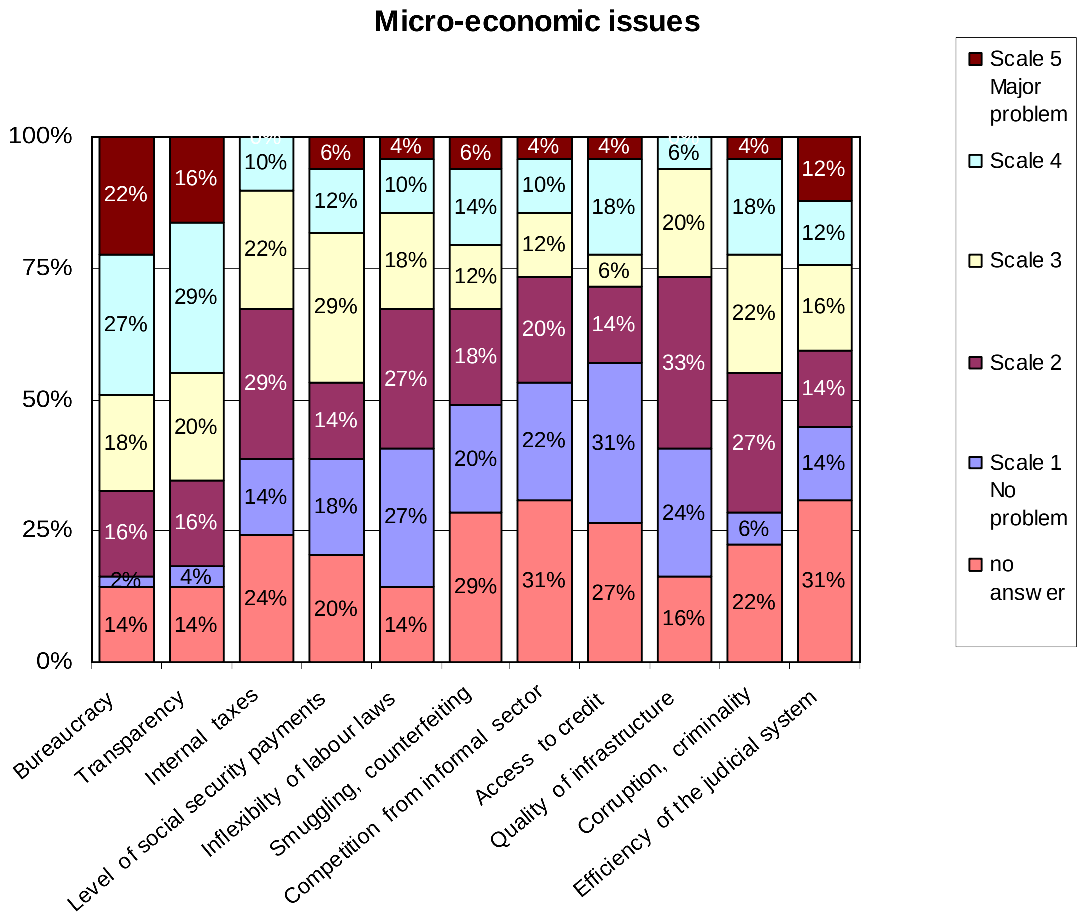
8. Government procurement

Over 50% of production companies and over 20% of service firms participate in government procurement (GP). Almost all the machine producers take part. Discrimination practices and no requirement for GP in the corresponding business sector usually explained why over 40% of the production group, over 70% of the pharmaceutical and chemical companies, and over

70% of the service category didn't participate in GP. Discrimination of GP can be observed in one of the following forms:

- Indirectly giving advantage to local companies and state-owned enterprises
- Personal relationship (guanxi) and money under the table
- Unclear information given to foreign companies
- Local preferential treatment

9. Microeconomic issues



In this section Swiss companies doing business in China were asked whether they experienced difficulties in micro-economic issues. Several of them were negatively affected by the following problems:

Bureaucracy was the most widespread concern for Swiss companies in this part of the survey: 84% of all participating companies ticked 2, 3, 4 or 5. 49% of all respondents answered 4 or 5 to this question, while the figure for the production industry alone lay at 60%. Companies complained about: unpredictable procedures, time consuming and complicated paperwork, number of approvals required, different standards in different governmental departments and cities, no time limitations to take decisions, burdensome inspections, personal relationship (guanxi), problems dealing with local governments, and insufficient communication between government functions. Some companies noticed improvements in bureaucracy, but further progress is still needed.

Transparency affected 82% of the surveyed companies (2, 3, 4 or 5) and was the second most significant barrier to trade and investment. China has published many new laws and regulations on Internet, but has not yet met WTO transparency standards. Copies of laws at local level are still difficult to obtain, and there are often internal guidelines on implementation that are not published. Government agencies regularly fail to provide a reasonable time frame to comment before implementing regulations. 60% of the participating companies of the production industry were very unsatisfied in this respect. Main problems mentioned in the survey included: legal uncertainty/ unclear and unpredictable rules, regulations and answers, regulations made/ implemented without prior notice, some changes to rules published other not, frequent changes to regulations, slow pace of information distribution and application of new regulations, and personal relationships (guanxi).

Corruption and criminality also exist and are further serious problems. Over 70% of the participating companies marked 2, 3, 4 or 5 and 22.5% of responses of scales 4 and 5 criticised those issues. But according to some respondents of the survey the situation in China is better than in other comparable countries.

Not as many as it could have been expected of the respondents criticised the **efficiency of judicial system** (over 55% answered 2, 3, 4 and 5). Some production as well as some service firms admitted avoiding to have to deal with the judicial system. A number of them have had little or even no experience with the Chinese judicial system. Others complained about the complexity, the dependency, and the poor predictability of the judicial structure. Companies from the pharmaceutical and chemical sector encountered problems when existing regulations (tax and VAT) don't apply, especially to local competitors.

Participants – especially producers (cf. bureaucracy and transparency) – were slightly less dissatisfied with the problem fields "internal taxes" and "level of social security payments". Over 60% of responses (scale 2, 3, 4 and 5) faced those two difficulties. Production companies highlighted: inefficient and unpredictable **internal taxes**, high VAT compared to neighbouring countries, and double taxation. Non-profit representative offices and other service firms faced issues with the tax-bureau, minimum tax requirements, and high tax payments. Some companies were more positive in this respect and expected improvements in different treatment of foreign and local firms. The **level of social security payments** was observed to be comparatively high by international standards, but wages remain low. According to a production company this issue will become a problem in the long run, if salaries rise.

51% of firms that ticked 2, 3, 4 and 5 for "**smuggling and counterfeiting**" noted that they remain serious barriers to trade and investment for those that are confronted to that problem. Local Chinese companies have copied simpler Swiss made machines. Other competitors have smuggled spare parts – e.g. from Hong Kong – into China. Unfair competition has arisen from local rivals who get raw material at lower cost. Some service companies admitted that much has been done by the Chinese government to improve the situation, but further progress is still required.

Access to credit (23% of all responses ticked 4 or 5), **inflexibility of labour laws** (14%), **competition from the informal sector** (14%), and **quality of infrastructure** (6%) were seen as less serious concerns than the others. Among specific problems, a production company spent several months without having access to money in Chinese banks. Regarding the question on "inflexibility of labour laws", companies noted that clear rules in English were unavailable, local regulations were unclear, laws applied more stringently for foreign companies, and that the laws are being completed but there is insufficient monitoring of the implementation.

10. Other issues

Production companies and firms in the pharmaceutical and chemical sector saw other, namely the following problems:

- Trading rights and distribution regulations are too complicated and still unclear with WTO-rules' implementation.
- Late granting of full trading and distribution rights (Low information available on how and when, and needs to be improved).
- No distribution and trade companies are allowed to register unless in free trade zone (Foreign companies need to set up a representative office).
- R&D costs of local rivals are lower since machines are copied.
- Different cost calculation (local competitors don't calculate cost of capital etc., therefore foreign companies have competitive disadvantage against local partially or state-owned firms)
- Unfair competition practices of local firms
- Payment delays

Many companies in the service sector mentioned some further problems:

- Litigation in different courts of competition law and IP law
- In the industry of inspection, testing and certification services, foreign invested companies can't enjoy national treatment and face restrictions in setting up new branches, extending services scope. Only selected state owned companies and labs might be nominated to conduct compulsory inspections, testing and certification.
- Legal services – international arbitration problems (as conforming with WTO practices)
- Opening to the tourist-industry too slow
- Beijing branch disadvantaged by having to comply with certain regulatory requirements that do not apply to offshore companies.

One company pointed out that China needs to improve the following three areas:

- "Public procurement regulatory framework: Streamline the provisions and applicability of the Government Procurement Law (GPL) and of the Bidding Law (BL) in line with the principle of "market economy"; Ensure uniform regulatory framework nationwide in the enforcement of the legislation."
- "Market access: Eliminate discrimination against "non-Chinese" domestic products and companies; Consider all companies legally established in China as domestic companies regardless of the origin of their capital. Ensure level playing field and equal treatment for wholly Chinese-owned enterprises and foreign invested enterprises (FIEs); Define domestic goods in accordance with their respective rules of origin; Give equal treatment to European companies in China as Chinese companies enjoy for public procurement in the European Union."
- "WTO Government Procurement Agreement (GPA)".

Over 55% of all surveyed companies, 52% of production, 43% of pharmaceutical and chemical, and 73% of service firms answered that **the global assessment of business climate in China** was positive. Among the pharmaceutical and chemical sector responses the comments "good, but facing uncertain future" and "very active, exciting, and challenging environment" were given. Service firms assessed the situation as good and expected plenty of business opportunities for those committed and willing to station in this country. According to some, the market is becoming more transparent, there is a trend towards an opening of the market and, thanks to a lack of experience and knowledge of local competitors, the service sector in logistics and freight forwarding experience a certain competitive advantage. The production sector complained about: complicated and challenging regulatory environment, extremely competitive business environment, still too many regulations, and lack of concern for quality, corruption and low standards, and increasing of production costs. However China is also seen as an important and growing market which is highly investment friendly and offers good opportunities; the environment is fast at learning and improving; and the country has the advantage of low labour costs.

To the question "**have you noticed any improvement in lifting barriers on trade and investment over the past year?**" over 40% of production, over 50% of pharmaceutical and chemical, and over 45% of service companies answered yes. Companies noted that positive developments have been made, but further improvements are still needed. A production company complained about an increase of protection of local industries. Other companies in the same sector noted that abolishment of import restrictions, liberalisation of import rights, important import duties have gone down in some areas, and quota policy on importation of certain products was cancelled. Companies from the tourism industry pointed out an improvement of outbound travel industry in China thanks to the ADS[2] signed between China and the EU, and China and Switzerland.

Almost 50% of the production and over 40% pharmaceutical and chemical companies saw strong growth potentials of **the East - and South-east Asia region (ESER) as a market for goods produced in China and/or imported via China**. Some companies in the production sector were more critical and pointed out that "ESER might increase trading restrictions for goods made in China in the future". Therefore China might not function as a hub.

Some main recommendation for a Swiss small and medium sized enterprise (SME) considering to enter into the Chinese market:

Production sector

- Adapt to local conditions; learn and respect Chinese culture
- What value can you provide to China
- Early market entry : Study and understand the market well before entry; be conservative on business planning (results expectations)
- Choosing the right location (e.g. in an international industrial zone)
- Go solo, no partnership (only WFOE)
- Expect the unexpected; don't expect miracles; modest set up in the beginning; growth should be controlled and stable
- Commitment from headquarters : Sufficient finance support and long-term investment
- Clear objective and long term outlook; prepared for a very different and challenging environment
- Gradual build up of an operation and own experiences you need to have patience and a long term approach; stamina is required
- Don't waste time by doing everything locally; don't only transfer old machinery
- Have a clear strategy to protect know-how
- Hire consultants; be careful with local consultants
- Take the time to find loyal and qualified staff; employ best available local talents
- Start with the necessary specialists
- Not to work w/o ex-pat and no naivety

2 ADS – Approved Destination Status

Pharmaceutical and chemical sector

- Understand cultural differences; good understanding of local policy
- Establish presence; gain experience
- Work closely with local partner; look for strong reputable partners
- Support by appropriate local agents; find the right consultant; employ the right people
- See for yourself; patience & hard work
- Not to expect a quick return, unless a leader in field w/unique (luxury) products or technology; intricate business environment where help and experience from consultants needed; risk-averse companies should be aware that there are some involved
- Appropriate products

Service sector

- Risk analysis; due diligence; possible exit strategy
- Consider professional help
- South China maybe has better investment environment than the North
- Be versatile to Chinese changes to understand it
- Stick to Swiss originality and try not to compete on price with other rivals in China. Treat the first 3-5 years as marketing period; real profit and customer base will come from 4^{th}-5^{th} year only
- Not to listen to others too much, find out alone and not be shy on spending costs at the beginning
- Not to expect miracles in the first 1-3years (patience)
- For **tourism**: for resorts, it is right to do promotion in China, but travel agencies (land operators) aren't allowed to do business in China at present so should keep an eye on the market and get ready for future business

Five most important issues to overcome in order to stimulate investment and trade between Switzerland and China:

- Improve IPR law enforcement
- Increase standards of quality
- Tackle corruption;
- Reduce bureaucracy
- Simplify licensing for business/ efficient admin approval procedure

<u>Finance</u>

- Flexibility of the financial system (Improve finance requirements and accessibility to alternative finance)
- Free money transfers abroad
- Transparent laws& regulations/ clear information

<u>Market economy</u>

- Open access to local market
- Streamline the provisions and applicability of the Government Procurement Law and Bidding Law (market economy principles) and ensure uniform regulatory framework nationwide in the enforcement of the legislation
- Eliminate discrimination against non-Chinese domestic products and firms and consider all companies legally established firms in China as domestic regardless of the

origin of capital; define domestic goods in accordance with their respective rules of origin.

- Full trading rights for foreign owned companies
- Safety, accountability and predictability in property rights
- Sharing of experiences and results in China for foreign companies

<u>Taxes</u>

- Abolish import tax
- Improve import/export process
- Unified national tax/social contributions rates
- Eliminate business tax on royalties and technical assistance
- Reduce income tax rates

<u>Sino-Swiss issues</u>

- Establish Chinese - Swiss FTA
- Direct flight Switzerland - China

Over 80% of the production, over 70% of the pharmaceutical and chemical, and over 85% of the service sectors planned to **expand activities in the near future in China**. Reasons for production and service companies to invest more in China were the domestic and East and South-east Asia market potential, near to customers, growing exports demands, and increase market share in China in order to survive in Swiss or/and EU facilities. Pharmaceutical and chemical firms were motivated by the strategic crossroad for leadership and development worldwide, opportunities for resource deployment, and provide better healthcare products to Chinese consumers.

Over 40% of all surveyed companies (48% of the production, over 70% of the pharmaceutical and chemical, and over 35% of the service sectors) were familiar with one of **the trade promotion instruments of Switzerland.**

11. Conclusion

According to the findings of this survey, more than half of the surveyed Swiss companies doing business in China perceived the **business climate in China as challenging but overall positive.** The Chinese market is important, growing and becoming more and more attractive as there are steady improvements in the business environment, particularly in the service industry. However, the climate remains extremely competitive and mainly suitable for solid companies with high quality products. There are still many restrictions, the regulatory environment is complicated and lacks transparency, and costs are expected to increase in the future. Some companies find that their **problems are not being taken seriously by the Chinese authorities**, in particular in IPR protection. **The overall macroeconomic environment remains therefore difficult** and important structural weaknesses remain, challenging foreign exporters and investors alike, as was pointed out throughout this analysis. On the other hand, in some economic zones Swiss companies are very satisfied with the management combined with easy access and excellent service mentality of local authorities.

The Swiss Embassy in Beijing and the Consulates General in Hong Kong, Shanghai and Guangzhou (official opening scheduled for end of 2006) contribute to the deepening of Sino-Swiss economic relations and the **improvement of the conditions for Swiss businesses in China on the macro- and sector-levels as well as for individual companies** (advocating with Chinese authorities through individual company memoranda and diplomatic interventions). This field of activities includes the preparation and follow up of high-level bilateral visits (such as the economic mission of Federal Councilor Joseph Deiss, accompanied by a mixed economic delegation in July 2005), regular bilateral economic dialogues (the bi-annual meetings of the Mixed Economic Commission) and specialized sector/ horizontal dialogues with Chinese authorities and Swiss companies and associations, and continuous work on the network of contacts at the central and provincial level.

A combination of structural, institutional and legislative changes are required to further improve the economic framework conditions for doing successful business in China. Based on data obtained from the sources cited in the introductory section, which will be completed with the answers received from Swiss companies through this survey, Seco is currently developing a strategy on future action to improve bilateral economic and trade framework conditions for Swiss companies doing business with and in China. In consultation with the Embassy of Switzerland, it will come up with proposals for concrete measures to improve the contractual framework of bilateral relations and further support Swiss companies active in China.

Edgar Doerig / Heng Lim / Isabelle Dérobert

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