

CHINA'S SOCIAL CREDIT SYSTEMS

Getting ready for China's self-regulated marketplace



Confederation of Danish Industry

CHINA'S SOCIAL CREDIT SYSTEMS

Getting ready for China's self-regulated marketplace

Context

China's corporate social system has been a hot topic for media all over the world. Often, it has been presented as a futuristic, AI-powered and Orwellian system that has been created to monitor and control the society by assigning a score to each individual. In reality, China's social credit system is more like an effort to centralize already collected data from different governmental agencies in order to promote trust and strengthen the marketplace by regulating corporate behavior in the Chinese market and enforcing existing regulations.

Where does the idea come from?

The creation of a Social Credit System can be traced back to the end of the 1990s when the Chinese sociologist from the Chinese Academy of Social Sciences Liu Junyue came back from Penn State and published a paper on the need to restore trust between people and the State. This lack of trust was impacting policy implementation, and in turn, was seen as an obstacle to the growth of the socialist market economy. He suggested to build a data collection framework inspired by the West but adapted to the Chinese context. The platform will collect financial and behavioral data on firms and citizens and will be underpinned by a rewards and punishment mechanism to enforce accountability.

The idea was that markets are made of individuals and that individual's willingness to fulfill their personal obligations cannot be separated from their willingness to fulfill their legal and financial obligations. Basically, untrustworthy individuals and societies result in unstable and corrupt markets, governments and institutions. Hence, the need to establish one holistic system.

What is China's Social Credit System all about?

The first thing to mention is that there is **no national centralized Social Credit System**. China is working on and testing different systems and there is no unified system (yet). Therefore, it is more correct to talk about social credit systems.

The second important thing is to **distinguish between the SCS for individuals and for the corporate sector**. At the individual level, the SCS is comprised of individual records and does not evaluate citizens with individual scores. Some cities are running local programs and testing various scoring systems, but the government has not announced a plan to run a centralized scoring system for citizens. For the corporate sector, the government is working

on gathering data records from dozens of government agencies, to produce a score that can serve as a basis for trustworthiness. This system concerns ALL firms operating in China, including foreign firms.

Last, in the Chinese context, the term 'credit' goes beyond the financial sphere. It should be understood as one's ability to repay debts and one's trustworthiness/sense of civic responsibility.

Both systems need to be understood separately but in practice, they work together.

What's in the SCS?

There are three elements in the SCS:

- The National Credit Information Sharing Platform,
- a blacklisting system,
- Rewards & punishments

1. The National Credit Information Sharing Platform (a.k.a. Master Database)

As we have explained above, in order to satisfy its plans for market regulation, the government is working on gathering data from various government agencies. The government needs tons of data to establish its system and already has data on financial records, tax records, safety inspection records, traffic violations, court records, etc. ... but the problem is that the data is spread across hundreds of databases. And those databases do not communicate. This means that for example the Customs Department knows that firm Y has a record of multiple import violations and the Ministry of Ecology and Environment has identified the same firm as big polluters, but the city of Kunming does not know this and ends up selecting this same firm for a big local infrastructure project. Therefore, for the government, the first step is to gather all this data in one central location and allow access to the information to anyone who needs it. This central place is called the National Credit Information Sharing Platform and gathers data on organizations and individuals.

What's in the National Credit Information Sharing Platform?

a. Data on companies

80 % of the total data is related to companies, and 75% is open to the public to look at. This will include data on both domestic corporations, and foreign companies doing business in China. **Here's what is in the database:**

- ✓ Basic company registration data
- ✓ Equity structure (shareholders, legal representative, stock info)

- ✓ Branches/subsidiaries
- ✓ Executive-level personnel
- ✓ Annual reports
- ✓ Tax information (taxes paid and owed, tax rate, tax period, etc.)
- ✓ Social insurance payment history
- ✓ Provident fund deposit history
- ✓ Administrative licenses
- ✓ Administrative penalties received
- ✓ Inspection records
- ✓ Awards and honors
- ✓ Utility payment history
- ✓ Red and blacklist records

b. Data on individuals

Credit records on individuals include:

- ✓ Basic identity information
- ✓ Employment information
- ✓ Financial information
- ✓ Legal history
- ✓ Political data
- ✓ Regulatory and legal violations
- ✓ Civic behavior
- ✓ Outstanding achievement records

How will this data be used?

The central government provides different levels of access to different public and private sector entities, to conduct different types of credit assessments. Some examples:

- *State agencies* will use the data to assess the compliance of individuals, organizations in their jurisdiction.
- *The central government* will use the database to assess how well the local governments are complying with national directives and how well they are serving local citizens.
- *Local governments* use the data to assess the legal, civic and professional conduct of citizens and corporations in their areas.
- *Financial institutions* use the data to evaluate potential lending risk.

Besides acting as a punishment tool, there are also hopes that the data can be used as a risk prediction tool and prevent safety incidents to happen (like another milk scandal...).

The short version:

- The data comes from administrative activities, inspection records and self-submitted records.
- The data is not new. Records come from data already generated from the course of daily operations of the government.
- The data is not high-tech. In fact, the objective of a high-tech system is still far from being reached. There are some pilot projects being carried out in some sectors, but the reality is closer to human beings manually inputting data in the system.

2. The Blacklisting System

The second component of China's SCS is the blacklisting system. As the name suggests, there is not one master blacklist. Instead, there are hundreds of different lists authorities use to penalize those who are in violation of various regulations. The minority of those lists are targeted at individuals and include individual lists for tax evaders, people that default on court-ordered judgments or phone scammers, for example. The majority of those lists are targeted at companies and organizations. Several hundred of lists exist and identify companies that fail to pay wages, those that disseminate banned content online or commit social insurance fraud, etc.

One important thing to mention is that the blacklisting system does not create new offenses, it is mainly to report the companies that do not comply with existing rules and regulations. In other words, it adds an extra layer of enforcement to the rules already in place.

How (not) to get on a blacklist

Companies get blacklisted for different reasons including:

- Not honoring legal obligations
- Failing to pay employees
- Fraudulent financial activity
- Tax evasion
- Import-export offenses
- Endangering public health and safety

New reasons for getting blacklisted are on the way:

- Excess energy consumption

- Pollution
- Operating with the right licenses
- Safety violations and accidents
- Counterfeiting, fraud and IP violations
- Poor production quality
- Etc.

For individuals, blacklisting happens due to the following reasons:

- Failure to pay court-ordered fines or carry out court-ordered judgments
- Bad behavior on trains and airplanes
- Tax evasion
- Engaging in scamming

Important to know: personal and company credit records are linked. This means that if a company gets blacklisted, its legal representative might get blacklisted as well. This can result in lifelong career setbacks such as being held back from leadership positions at other companies operating in the same industry.

Does blacklisting result from a score dropping below a certain level? Not really. Generally, blacklisting happens after having failed to honor one's obligations. For example, Company X does not follow-up on court-ordered judgments, and it directly results in blacklisting, not a deduction of points that might lead to getting placed on a blacklist.

How to know if my corporation is on a blacklist? Herein lies one of the biggest problems of the system. In most cases, people find out that their corporation has been blacklisted when they face the negative consequences of blacklisting. In other words, it is up to corporations to keep informed on their own status.

How to get off a blacklist? The government is currently working on clarifying the rectification procedures. What we know is that getting off a blacklist is easier said than done. The time corporations stay on a blacklist depends on the severity of the violation and the efforts put into getting off that list. In some cases, blacklisting can last from 6 months to a year, in some other cases it is 5 years and for severe violations blacklisting can be permanent.

How to rectify my credit? In general (and not for extremely serious uncreditworthy behavior), rectifying one's credit starts by proving that the violation has been corrected. For corporations, proof that the key personnel have completed creditworthiness training courses and promising not to offend again will be requested.

The Redlisting System

Companies with excellent credit records can get added on a redlist. Here are the behaviors that can get corporations on redlists:

- ✓ Maintain 'harmonious' labor relations
- ✓ Having good social insurance payment records
- ✓ Having good financial credit
- ✓ Being good at product or service innovation
- ✓ Actively participating in social charities
- ✓ Taking part in protecting the environment and resource conservation

3. Unified Rewards and Punishments Framework

What happens if a corporation gets redlisted or blacklisted?

The framework works as a series of legal agreements between government agencies with the promise to enforce each other's blacklists and redlists.

In practice, government agencies sign Memorandums of Agreement with each other to honor each other blacklists and redlists; then, when one agency is listing one company a record is made in the target's social credit file; this file is then available to other government agencies in the National Credit Information Sharing Platform. The result is that the black/redlisted corporation is punished/rewarded by all the government agencies.

In Xi Jinping's words "everything is convenient for the trustworthy, and the untrustworthy are unable to move a single step." Put simply, this means that if one corporation gets in trouble with one agency, it gets in trouble with all agencies.

How does the SCS work in practice for companies operating in China

There are 5 important elements to understand and learn to navigate.

1. The National Credit Information Sharing Platform

Details have been provided in the first section of the report. Please refer to section 1 to get an overview of what is available on the platform. It is a key resource for companies to keep track of their records and for corporate due diligence. Most importantly, the platform can/should be used by companies to actively upload company data and annual reports.

2. Unified social credit number

Each company has an 18-digit credit number that is composed of its business license number, tax registration number and organizational code.

3. Corporate grading systems

In order to determine how corporations should be treated based on their credit records, there are four different types of grades.

- [Comprehensive Public Credit Rating](#)

The rating will be based on the data from the National Enterprise Credit Information Publicity System and will score companies based on judicial complaints, breaches of contract, regulatory violations, rewards and honors, and corporate social responsibility. Companies can be assigned 4 grades: **Excellent, Good, Medium and Poor**

If companies are assigned Excellent and Good, they will be told to keep up the good work. For companies with a Medium score, government will organize training sessions to sensitize companies on the importance of credit management. For companies with a Poor score, interviews will be conducted and recorded into the National Credit Information Sharing Platform.

- [Operational grades](#)

State agencies assign grades from **A-D** to assess the corporation's level of regulatory compliance in various areas. For example, if a corporation always pays its taxes in time, the Tax bureau might assign a grade A taxpayer status.

- [Industry Association grades](#)

Industry associations and chambers of commerce also play an important role in the Chinese market and state agencies often collaborate with the government on policy updates. Mostly, they will gather data via voluntary submissions by member companies and the National Enterprise Credit Information Publicity System.

- [Financial scores](#)

Around 150 agencies have been approved to issue credit scores to enterprises.

4. The “Double Random, One Open” inspection system

Since 2015, Chinese regulators have implemented a new inspection system where both the company to be inspected and the inspector are randomly selected and the inspection results are openly published on the National Enterprise Credit Information Publicity System in a company's social credit file.

5. Credit commitment letters

Since July 2019, corporations are being encouraged to sign standardized letters promising to operate in good faith and to honor social credit regulations. The letters are openly published on the National Enterprise Credit Information Publicity System. One perk of signing the letters is that companies with good credit records can be pre- approved to various bureaucratic applications.

Conclusion

- The Social Credit System is still a work in progress. At the moment, there is still a lot of uncertainty and policy gaps that need to be addressed. Corporations are invited to stay updated on changes and policy updates and understand how the system is going to impact their operations.
- Now is the time to get the credit records in good shape. Companies should not focus on credit scores because the scores are based on credit records. Corporations should focus on keeping healthy credit records.