



**China's Implementation of its World Trade Organization Commitments
An Assessment by the US-China Business Council
for the Trade Policy Staff Committee**

Docket Number USTR-2019-0010

September 18, 2019

Eighteen years after China joined the World Trade Organization (WTO), the global economy has changed significantly. As part of its accession agreement, China has lowered its overall tariff rate, dropping its applied import tariffs from a weighted average of 14.7 percent in 2000 to 4.8 percent in 2017. However, due to bilateral trade tensions, China has selectively raised the weighted average tariff rate on US goods to 20.1 percent, up from 8 percent in 2018. China agreed to open some, though not all, of its economy to foreign participation—these commitments have largely been implemented. The accession agreement also changed the way most American companies were able to do business in China, such as by allowing companies to distribute and service their own products in the market.

As the Office of the US Trade Representative (USTR) has noted in previous annual reports, while China has fulfilled most of the specific obligations of its accession agreement, several commitments fall short of full implementation. The “positive list” approach used in the accession agreement only opened listed sectors. It also meant that new areas of the economy not envisioned at the time of the accession negotiations were not covered by the agreement, including cloud computing, electronic commerce, and other technology services. And while some additional sectors have been opened to foreign participation in the decade since the “roadmap” of obligations expired, the sectors that remain closed are ones that would benefit from liberalization, from both the perspective of foreign companies seeking market access and from those hoping to strengthen the competitiveness of the Chinese economy as a whole.

There is a logical question that should be considered in the assessment of China's WTO implementation: is the world economy, and in particular, the US economy, better off since China's entry into the WTO 18 years ago? There are several ways to arrive at an answer.

In 2000, the year prior to China's accession, China's gross domestic product (GDP) was approximately \$1.2 trillion, ranking it as the fifth-largest economy in the world. China's GDP was roughly \$13.61 trillion last year, making it second only to the United States' economy which grew from 10.28 trillion to 20.49 trillion. The United States remained the largest economy in the world throughout this time, even when taking into account the global recession in 2009.

China also lifted more than 800 million people out of poverty as a result of its market reforms. Its thriving middle class is now larger than the entire population of the United States and still growing, making it a major driver of global demand for goods and services, which the growth and global success of many US companies is directly tied to. By the US-China Business Council's (USCBC) calculation, China was a less than \$50 billion market for US companies in 2000, adding up US exports and sales by US affiliates in China and eliminating overlaps. It is now approximately a \$550 billion market for US goods and services, placing it just behind Canada and Mexico as America's third-largest market.

The bilateral trade deficit has also grown from \$83 billion to \$378.6 billion since China's accession to the WTO. However, focusing solely on the bilateral trade balance misses an important change in the pattern of trade. After China entered the WTO, suppliers from Japan, Korea, Taiwan, Hong Kong, and other economies moved their export manufacturing to China, shifting the United States' long-standing bilateral trade deficits with those economies to China. China's proportion of the US global trade deficit has increased, while the rest of East Asia's proportion has decreased. But the region's overall share of the US global trade deficit has remained about the same since China's WTO entry with China simply accounting for a larger piece of the region's overall share.

China's accession also made it subject to the WTO's dispute settlement process. This important aspect of WTO membership has introduced a de-politicized mechanism for resolving trade disputes. The United States has a positive track record in cases involving China—as of April 2019, of the 15 completed cases the United States has filed against China, 10 cases were won by the United States and five were settled before a ruling was made. None were lost.

Given the strength of the US economy, on balance, China's WTO entry has been positive for the United States and the world. Notably, China has taken some steps to further open its markets in the last couple of years, particularly in financial services, the approvals process for foreign investments, and other areas to address concerns raised by the US government and industry, China's progress on these fronts is discussed in further detail in this assessment.

At the same time, however, numerous Chinese policies implemented since its WTO accession appear to have been put in place purely to protect or promote domestic industry at the expense of foreign companies.

Implementation of the “Letter” of Existing WTO Commitments

USCBC noted in its 2002 submission for the first Trade Policy Staff Committee (TPSC) hearing on China's compliance with its WTO commitments that:

“WTO-relevant issues involving entrenched PRC bureaucratic and domestic commercial interests will likely require particular vigilance by the US government and the American private sector, in the interest of effective encouragement of China to reach the fullest

possible realization of [its] WTO commitments.”

That vigilance is still needed. While China has implemented most of its sector-specific accession commitments, it has fallen short in implementing or adhering to some of the broader WTO principles. In particular, national treatment remains challenging, as does consistent protection of intellectual property rights (IPR). These challenges are reflected in US companies’ experiences with China’s procurement policies and pressures to transfer technology.

National Treatment

The WTO’s requirement that member countries to treat domestic and foreign companies on an equal basis, also known as national treatment, is an essential principle for all companies doing business globally. However, USCBC’s annual member survey showed again in 2019 that American companies continue to experience problems with discriminatory treatment, primarily in the form of regulatory challenges and preferential treatment for domestic companies. Regulatory and competition challenges are not new for US companies, but they still a real effect on companies’ ability to do business and are among the issues that companies perennially cite as primary restraints on their profitability in China.

China’s policymakers should move toward eliminating terminology in laws and regulations that distinguishes between domestic and foreign-owned companies, such as the term “foreign-invested enterprises.” Continued use of this term invites discriminatory treatment of various types of domestic legal entities, based solely on ownership. A better approach would be to treat all companies legally established under China’s *Company Law* equally, regardless of ownership or nationality. China’s nationwide negative list makes progress toward this end by increasing transparency on all market access requirements—it applies to both domestic and foreign investors.

Many Chinese companies thrive because they produce competitive, high-quality goods and services. However, several Chinese policies and practices continue to provide advantages to both state-owned and private domestic companies over foreign ones, an issue that 66 percent of the respondents to USCBC’s 2019 member survey say affects their companies. This includes direct benefits and support from various levels of the government, as well as favorable licensing decisions, restrictions on foreign investment, and preferential treatment in enforcement actions—all issues identified among companies’ top 10 concerns in 2019 as well as in previous years. Policies to level the playing field for foreign companies should ensure equal treatment of foreign companies regardless of their ownership form.

National Security and Innovation Policies

Companies remain concerned about China’s use of measures imposed under the banner of national security, but seemingly aimed more at promoting domestic industry. Recent examples include China’s *Cybersecurity Law* (as well as draft implementing measures that could mandate data localization), measures targeting foreign technology procurement, and provisions in the *Foreign Investment Law* that require national security reviews of virtually all foreign investments. These policies do little to strengthen China’s national security and contradict the spirit of China’s WTO commitments.

Discrimination is also a feature of China’s innovation policies. Although most of China’s innovation measures are taken to promote high-tech industries, their negative impact extends beyond technology companies. Policies favoring the use of domestic technology appear in rules that affect technology users in industries ranging from financial services to healthcare and ecommerce.

Regulations in the areas of technology and innovation must be based solely on commercial and technical factors. Innovation thrives under such conditions but is stifled when a government seeks to limit how and where it occurs, or seeks to dictate technology choices. To create a fairer legal environment for all companies invested in the market, China—and all governments—should refrain from using national security as a means to discriminate against foreign companies. Measures to protect national security should be narrowly tailored and necessary for the protection of genuine security goals.

Licensing & Approvals

Over the past decade, licensing has consistently ranked among USCBC member companies’ top 10 concerns. In 2019, about half of Member Survey respondents indicated their companies had experienced challenges with Chinese licensing and approval processes.

Certain regulations require expert panels to be convened for inspection, testing, and quarantine of equipment, facilities, products, and articles that directly concern public security, health, and safety of life and property. There are three major concerns about expert panel reviews among US companies.

First, the government has the authority and tendency to nominate panelists who work for the applicant’s Chinese competitors. Second, applicants are often required to report detailed information about confidential and proprietary operations, which many companies consider to be trade secrets, to review panels. Providing such information to anyone outside the company—including government officials, and especially competitors—exposes companies to the risk of losing their competitive advantages, profits, and sensitive technologies. Third, experts have unlimited authority to request information from companies, even when the information requested has little or no relation to the panel’s decision-making.

Because licensing approvals are made more on an ad-hoc basis rather than systemic and transparent rules, they pose as a significant market access barrier. US companies often face more challenges in obtaining licenses than their domestic competitors. Depending on the industry sector, companies may need dozens of licenses to do business, and many of these licenses require frequent renewal. The inconsistency of licensing procedures across provinces and government agencies also complicates company operations.

Intellectual Property Rights

China is slowly making progress in IPR protection, but it remains an issue that US companies have consistently raised over the years—91 percent of survey respondents are concerned about IPR protection.

For the last decade, the majority of our members reported no change in China’s IP protection environment. This trend reversed in our most recent survey: 58 percent saw improvement, 42 percent saw no change, and no companies reported a deterioration in IP protection. Companies attribute these improvements to the Chinese government’s increased emphasis on IPR protection, a variety of new laws and regulations that aim to enhance protections, and US government efforts to elevate the protection of IP in bilateral trade negotiations.

One positive development in recent years that merits attention is the improvement in companies’ ability to use China’s various IPR enforcement channels. Those channels include administrative agencies, civil courts, criminal courts, special IP courts, and China’s recently-created Supreme People’s Court IP appeals mechanism. Other positive developments are the amendments China made in April to its *Trademark Law*, *Anti-Unfair Competition Law*, and *Administrative Law* to improve intellectual property protection. These actions reflect some of the “early harvest” outcomes that bilateral negotiations had begun to reap, but they fall short of effective deterrent measures against bad faith trademark applications and comprehensive reforms on trade secret protection.

Most of the progress has been made in IPR protection policy, but not in IPR enforcement, which still falls short of expectations. Unequal IPR adjudication was reported by 91 percent of companies in the 2019 survey. In particular, significant trade secret cases can languish in court for years, even when there are clear cut cases of Chinese violations of the IP rights of foreign companies. Chinese courts often stall recognition and enforcement proceedings for international arbitration awards obtained by foreign companies against Chinese companies. The delay or denial of prompt and credible enforcement of IPR violations erodes US, international, and, ultimately, Chinese interests in protecting IP and establishing the precedent to prevent further trade secret misappropriation. Further reforms, with follow-through in enforcement, would also help to reduce tensions between China and its major trading partners—something that industry would welcome.

Additionally, China’s evidence-collection requirements make it cumbersome to collect and preserve evidence, impacting companies’ ability to cost-effectively challenge infringers. Tools that many companies use in the United States and other markets to protect their IP, such as non-compete or other contractual agreements, are largely untested in China, leading to uncertainty about how such provisions would be interpreted by China’s courts. Further, China has some policies that could place foreign-owned companies at a competitive disadvantage, such as subsidies offered to Chinese companies for patent prosecution.

One step that China should take to improve IP protection is to adopt a tougher deterrent against piracy. In China’s current system, infringers exploit the system, in which violators are subject to a fine rather than criminal sanctions, which would serve as a stronger deterrent. The *Foreign Investment Law*, passed in March 2019, stipulates that government officials must not reveal sensitive information or trade secrets that they have gained access to in the course of their work. It also requires that public officials of administrative organizations can be criminally prosecuted for illegally providing others with trade secrets they learned while performing their duties. While this is a step in the right direction, the veracity of these changes on IP enforcement will be tested when the law goes into effect on January 1, 2020.

Broadening the use of higher penalties, holding both government and commercial infringers criminally liable for IP infringement—including by adopting WTO-consistent deterrents of criminal penalties in cases of commercial-scale infringement—and creating stronger deterrents in both civil and criminal cases against all types of IP infringement would benefit everyone doing business in China.

Technology Transfer

When China joined the WTO, it agreed that it would not require foreign companies to transfer technology in order to invest or sell products in China. Tech transfer would be allowable only in situations where a foreign and Chinese company agreed to such a transfer as part of a normal business negotiation. The accession’s *Working Party Report* stipulated that “the terms and conditions of technology transfer, production processes or other proprietary knowledge, particularly in the context of an investment, would only require agreement between the parties to the investment.” China’s accession protocol also specifies that the right to import or invest in China will not be conditioned on “performance requirements of any kind, such as local content [or] the transfer of technology.” Despite these commitments, as part of China’s drive to become more innovative, foreign companies have been “encouraged” and, in some cases, pressured to transfer technology to their China subsidiaries or Chinese companies.

Only 5 percent of respondents to USCBC’s member survey report that they have been explicitly asked to transfer technology to China as a requirement for gaining an investment, project, product, or market entry approval, down from 20 percent in our 2017 survey. While fewer of our member companies report technology transfer as an issue affecting their business in China, it is an acute issue for affected companies, putting them in the position of making difficult choices about managing the tradeoffs between technology sharing and market access.

Recent actions China has taken to address some of US companies’ concerns about its technology transfer practices include the changes that the State Council made in March to its Technology Import and Export Regulations (TIER) and Implementing Regulations for the Chinese-Foreign Equity Joint Ventures (JV Regulations). Article 22 of the *Foreign Investment Law* prohibits forced technology transfer. These regulatory changes address some of the top concerns raised in USTR’s Section 301 report on restrictions that reduce the ability of foreign companies to negotiate fair, market-based terms for the transfer of their technology into China.

Structural Issues Encourage Tech Transfer

While the above regulatory changes are in the right direction, they do not address the structural issues—China’s JV requirements and foreign equity restrictions in certain industries—that are the root of technology transfer issues in China.

In sectors where 100 percent foreign ownership is allowed in China, foreign companies are generally not compelled to transfer their technologies to their competitors, since any technology used in their China operations remains in their own hands. In various industries, China imposes equity caps or other restrictions that require foreign companies to not only partner with a domestic company to access the market but also to allow the domestic company to control the

technologies and processes—aspects of operations that many foreign companies consider to be trade secrets.

While many requests for technology transfer might technically be part of a “normal” business negotiation, in reality, China’s joint venture requirements and foreign equity restrictions create unbalanced negotiations—Chinese companies have an inherently stronger position over their foreign counterparts because of joint venture requirements or equity restrictions as stipulations for market entry. As a consequence, a request for technology transfer made by a Chinese party in a business negotiation can reasonably be interpreted by the foreign party as a requirement for the deal to be successfully concluded.

In order for China to uphold its WTO accession responsibilities, China should eliminate all joint venture requirements and foreign equity limitations, and regulate all companies in the market under China’s *Company Law*. This would provide meaningful improvements in affected sectors and bring China in line with its commitments.

Procurement

China has a variety of procurement-related policies that act as de facto IP or technology transfer requirements. For instance, China’s *Cybersecurity Law* and measures related to the law’s implementation include requirements for the use of “secure and controllable” technology in certain industries, which in effect mandates the purchase of such technologies by government or state-owned entities. Qualification for participation in such procurement processes requires sharing source code or other proprietary information. Some provincial and local procurement policies continue to include preferences for products using “indigenous” innovation, frequently interpreted as meaning products made by Chinese companies. This problem is exacerbated by a lack of clear domestic content regulations, leading some tendering agencies to interpret a country of origin without considering products manufactured in China by foreign-invested firms.

Foreign companies often cannot participate in various procurement processes if they do not comply with technology transfer, encryption, or other requirements that leave their trade secrets and intellectual property vulnerable. The system also lacks a functioning appeals framework which limits bidders from reviewing detailed records of how a tendering decision is made.

To address these concerns, it is critical that China’s regulations comply with its WTO commitments on nondiscrimination and national treatment. The Chinese government should also continue to actively ensure that its commitments to treat IP owned and developed in other countries on par with intellectual property owned or developed in China are being honored at both the central and local levels. This includes ensuring the procurement process appropriately values investment in innovation, and that government procurement policies and decisions are transparent, predictable, and consistent across the central and local levels.

Lastly, China should join the WTO’s Government Procurement Agreement (GPA) and ensure that goods and services provided by all legal entities in China are treated equally during procurement processes, regardless of ownership. In advance of joining the GPA, China should immediately designate a formula of “substantial transformation” similar to those used by the

United States to determine a product's national origin, rather than the approach included in draft Chinese regulations.

Transparency

China has made incremental progress in its commitment to increase transparency. The Chinese government's move to generally require draft regulatory documents to be open for a 30-day public review and comment period, as per China's bilateral commitments, is a welcome step. USCBC continues to recommend that China go further by permitting a longer comment period of 60 or 90 days to ensure high-quality comment contributions. It should also expand the scope of regulatory documents subject to the public comment process.

Beyond the rule-making process, however, transparency challenges remain pervasive and a top source of concern among US companies in China. As noted above, companies face challenges obtaining accurate information on the status of their licensing and patent applications, as well as in participating in the standard-setting process and providing input on government regulatory developments. Obscure allocation of government resources and regulatory scrutiny is often equated with unfair competition and preferential treatment for Chinese firms, a concern among over three-quarters of companies who responded to USCBC's 2019 member survey.

Another emerging area of concern is the development of China's corporate social credit system (SCS). Lack of clarity about how the vast amounts of company data collected are shared between different government entities, as well as how the utilization of a blacklist system as a compliance and enforcement tool, are raising concern that the SCS could provide Chinese government officials significant discretion to apply pressure on companies in an opaque and non-fact-based manner. The growing web of frameworks supporting a social credit system leaves too much room for interpretation and should be narrowly applied transparently and introduce safeguards that guarantee due process for all entities subject to the systems' ratings.

Greater transparency is essential if China is to meet its own goal of developing a market-based, competitive economy. As China completes the government restructuring process, USCBC recommends the Chinese government ensure the process is fully transparent to help reduce operational uncertainty. It is important for businesses to clearly understand new and revised responsibilities, authorities, and relationships of relevant government departments in order to operate efficiently. It is also essential that recently created or regionalized departments exercise new duties faithfully.

Anti-dumping & countervailing duties (AD/CVD)

China's politicization of the anti-dumping/countervailing duty regime is a significant violation of WTO commitments and core values such as procedural fairness. China has deliberately targeted key imports of countries when disputes arise in order to bring pressure and damage to foreign industry as well as to support China's domestic industrial development goals. The process is non-transparent, unnecessarily burdensome, and designed to ensure negative outcomes that establish maximum political and commercial leverage rather than following the rationale and nature of the AD/CVD process.

Ensuring a transparent and WTO-compliant AD/CVD process is critical for a well-functioning trade regime. The Chinese government should make determinations based on the law and articulated facts and establish transparent standard procedures.

State of the Trading Relationship

US trade tensions are hardly limited to China. Within the last twenty-four months, the United States has been the subject of 26 requests for consultation and dispute settlement—some of them initiated by China—but complaints have also been filed by Canada, Mexico, Korea, the European Union, Vietnam, India, Norway, Russia, Switzerland and Turkey. In at least two separate instances this year, 40 WTO members jointly voiced objections to US tariff plans at the WTO Council on Trade in Goods. In March, trading partners complained that US measures imposing tariffs on steel and aluminum were not WTO compliant, and in July, they objected to US measures imposing additional duties on imported autos and parts. These formal and informal complaints represent an exponential increase in our global trading partners’ perceptions that we, ourselves, are not acting in accordance with our commitments or following WTO rules.

The United States is losing credibility as a leader of the global trading system, and by extension, risks validating controversial Chinese approaches that have used similar justifications. Neither China nor the United States should implement policies that parse WTO commitments into simply the letter of the rules. We must push ourselves and encourage our trading partners to implement policies that reflect the spirit of those commitments as well. If existing rules fall short, we should not abandon them, but instead should take the lead to improve them.

While the WTO’s dispute settlement body is not without fault, it remains a central component of the global, rules-based trading system from which the United States benefits. Restoring the body to its full capacity and working with partners to enact reforms to the functioning of the appellate body will serve the long-term interests of the United States and its companies, and is the only means of ensuring that the WTO continues to provide an active and meaningful mechanism for resolving disputes over China’s trade practices. If the appellate body ceases to function, dispute settlement decisions at the WTO will not be enforceable.

Multilateral Cooperation

Constructively working with like-minded partners has proven to be an effective method to alter adverse Chinese policies. The United States’ dispute settlement case filed in March 2018 identifying Chinese laws and regulations that raise tech transfer and IP protection concerns is a good example of how the United States should seek those types of outcomes. USTR’s request for consultation to address China’s discriminatory technology licensing requirements, based on evidence detailed in the Section 301 investigation report, has been joined by five WTO members, an encouraging sign.

The recent trilateral with the EU and Japan aimed at addressing “non-market-oriented policies and practices” provides another example of constructively working with like-minded partners to address inappropriate Chinese practices. The three countries have held a series of meetings to develop stricter rules governing subsidies and state-owned enterprises, with a longer-term goal of similarly upgrading the WTO’s existing rules. This offers a clear indication that like-minded

global trading partners are eager to work with the United States in ways consistent with international agreements to address common concerns regarding China's trade and investment policies. USCBC encourages the United States to undertake more actions that include this kind of cooperation.

Written Testimony Attachments

USCBC 2019 Member Survey Report

How China's Social Credit System Will Impact Companies

Member Survey

US-China Business Council | 2019



Member Survey

US-China Business Council

August 2019



In the 19th consecutive year of the US-China Business Council's annual member company survey, and more than a year since tariffs have been imposed, three major themes dominated 2019 member survey outcomes. First, US-China trade friction is negatively impacting US companies operating in China. Second, an unlevel playing field favoring domestic companies over foreign ones is making it increasingly difficult for US companies to compete. Third, while China continues to be a priority market for most of the companies surveyed, market optimism is moderating. All three of these trends are forcing companies to reevaluate company strategies and supply chains. American companies also remain concerned about recent developments in intellectual property rights (IPR), technology transfer, and data flow and cybersecurity policy.

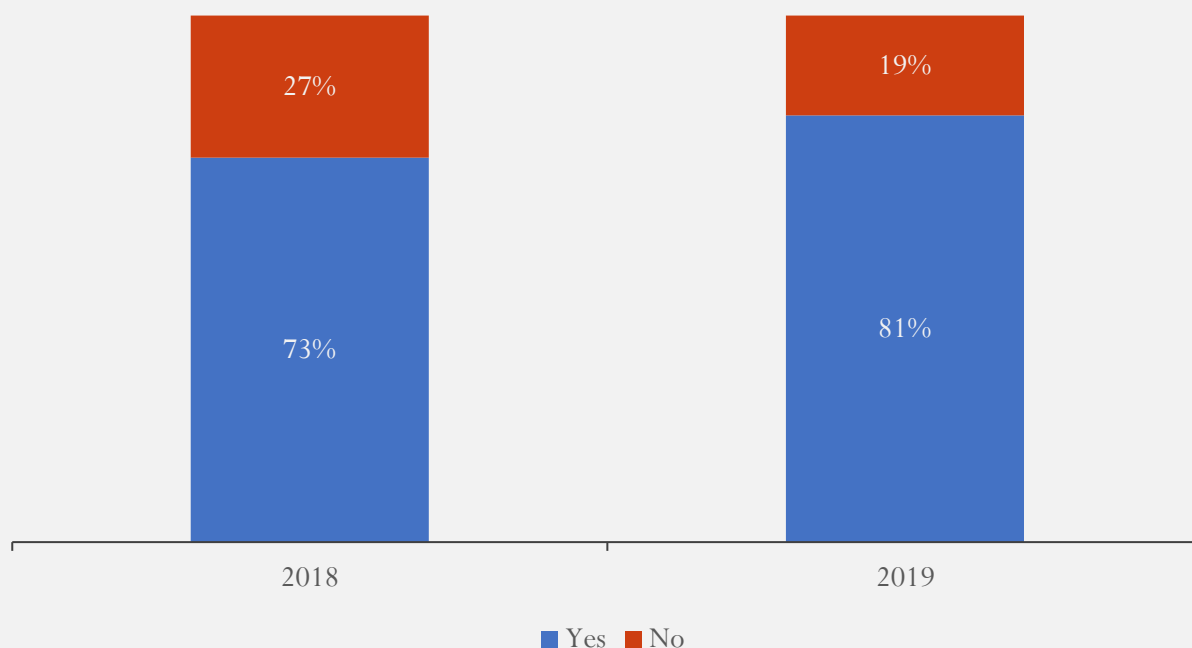
Top 10 Challenges

1. US-China relations
2. Competition with Chinese companies
3. Licenses and approvals
4. Cost increases
5. Data flows
6. IPR enforcement
7. Uneven enforcement
8. Human resources
9. Innovation policies
10. Investment restrictions on foreign companies

US-China Relations

The relationship between the United States and China—particularly, bilateral trade tensions—is overwhelmingly the top concern of American companies operating in China in 2019. Last year, bilateral trade tensions prompted anxiety over how punitive tariffs contribute to an unpredictable business environment. While uncertainty still pervades the 2019 data, companies report that trade tensions are having a measurable impact on US company competitiveness in the Chinese market, especially their competitiveness vis-à-vis domestic Chinese companies. Over 80 percent of American companies report that trade tensions have affected their business operations in China, an 8 percent increase from the year before.

Has your company's business with China been affected by US-China trade tensions?



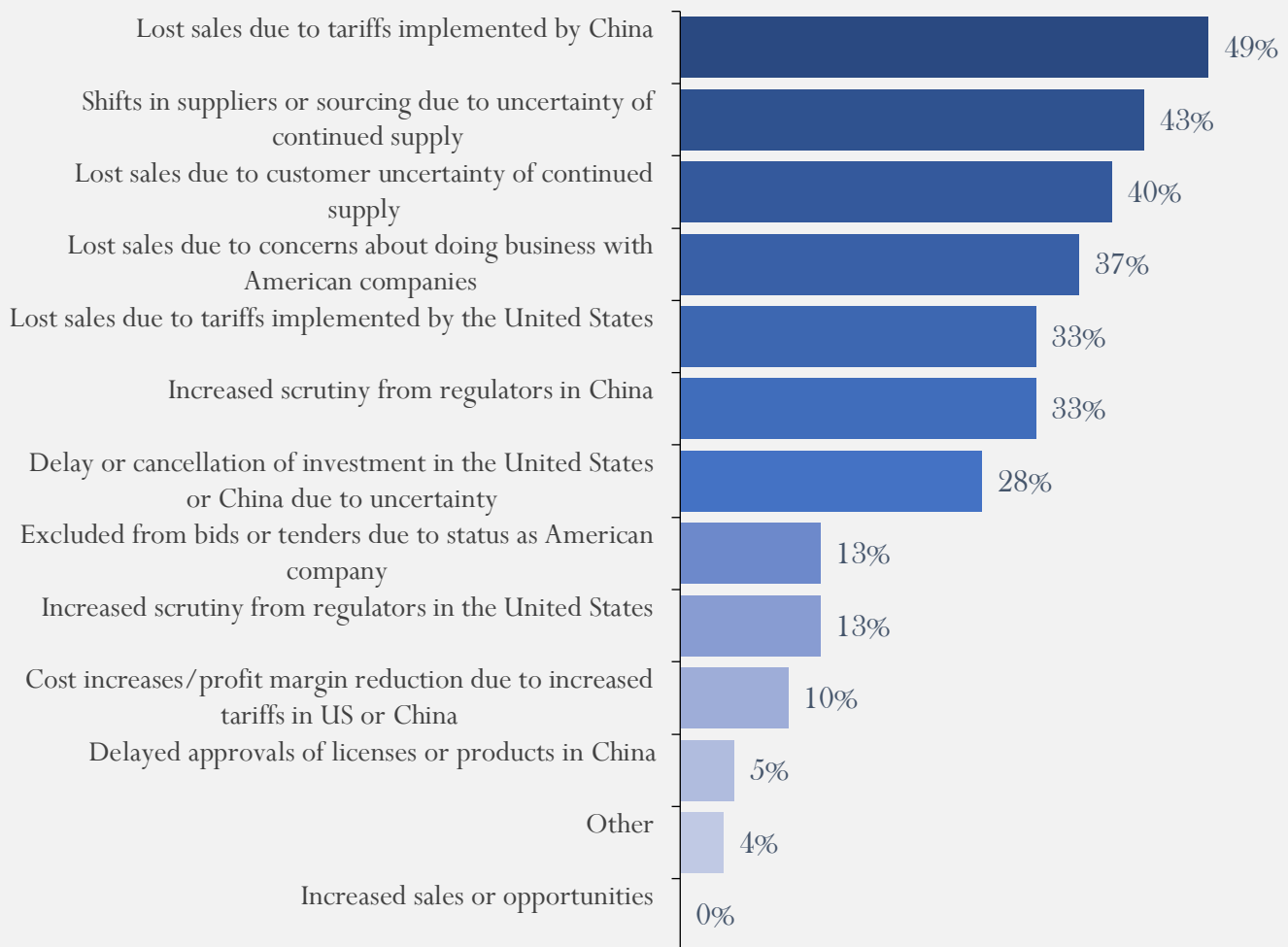
Lost Market Share

Nearly half of respondents report lost sales and ceding market share to foreign competitors. The primary contributor to lost sales is the implementation of both US and Chinese retaliatory tariffs, as evidenced by lost price competitiveness, shifts in supply chains, and uncertainty of continued supply.

Chinese customers are concerned about supply chain links that depend on American companies, which they increasingly view as unreliable business partners as a result of the volatility of the bilateral commercial relationship. In 2019, a staggering 37 percent of respondents indicate lost sales in China due to Chinese partners' concerns about doing business with American companies, a seven-fold increase over 2018.

Similarly, one third of companies report in 2019 that they have been subjected to increased scrutiny from Chinese regulators as a result of bilateral trade tensions.

Impact of US-China Trade Tensions on Business



An Unlevel Playing Field

Responses to survey questions regarding competition with Chinese companies and signs of protectionism convey a distinct trend: unequal treatment between foreign and Chinese companies remains a concern in 2019. The competition issue has made the list of top 10 concerns throughout all previous USCBC surveys, and was the second-ranked challenge for the last two years.

Many Chinese companies excel by producing innovative, high-quality goods. However, Chinese government policies and practices frequently offer competitive advantages to domestic companies that are not offered to foreign companies. Unfair competition is a root concern in several of this year's top 10 challenges: licenses and approvals (#2), data flows (#5), IPR protection (#6), uneven enforcement of rules and regulations (#7), innovation policies (#9), and investment restrictions on foreign companies (#10). Beyond the top 10 challenges, companies also note that domestic preferences in Chinese government procurement, as well as domestic advantages in standard setting and preferential financing, contribute to an anti-competitive operating environment.

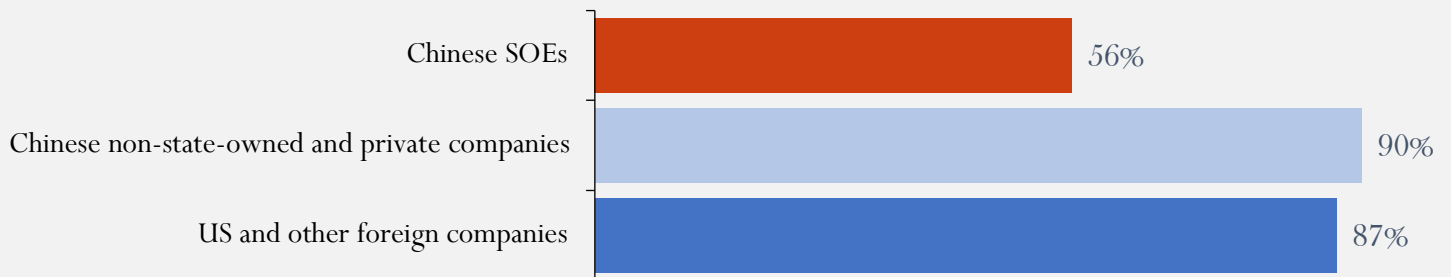
Signs of Protectionism in China



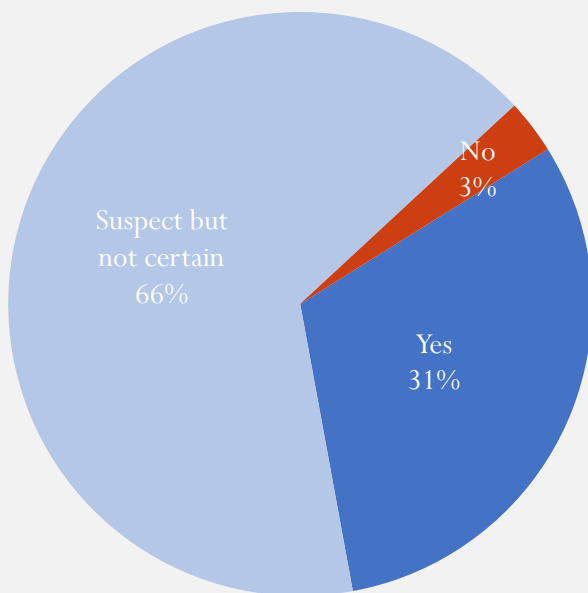
Preference for Domestic Companies

Most American companies are concerned about the preferences that China provides to domestic companies through innovation and manufacturing policies. These benefits, in tax policies, financial subsidies, and licensing and approvals, are given to both state-owned enterprises (SOEs) and private companies.

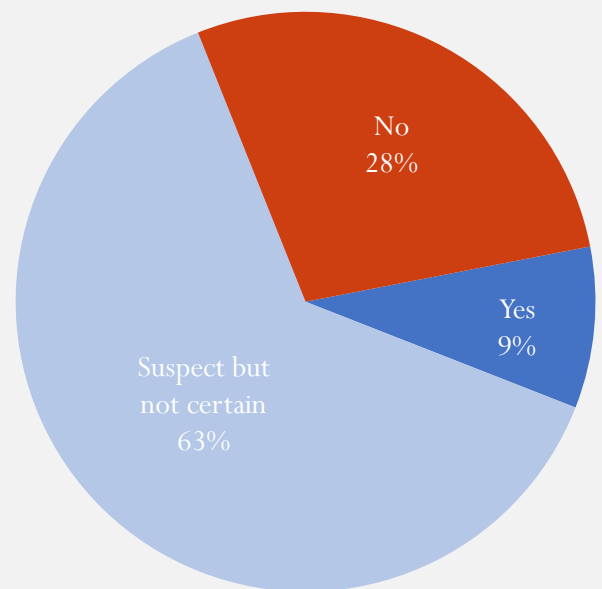
Who are your competitors in China?



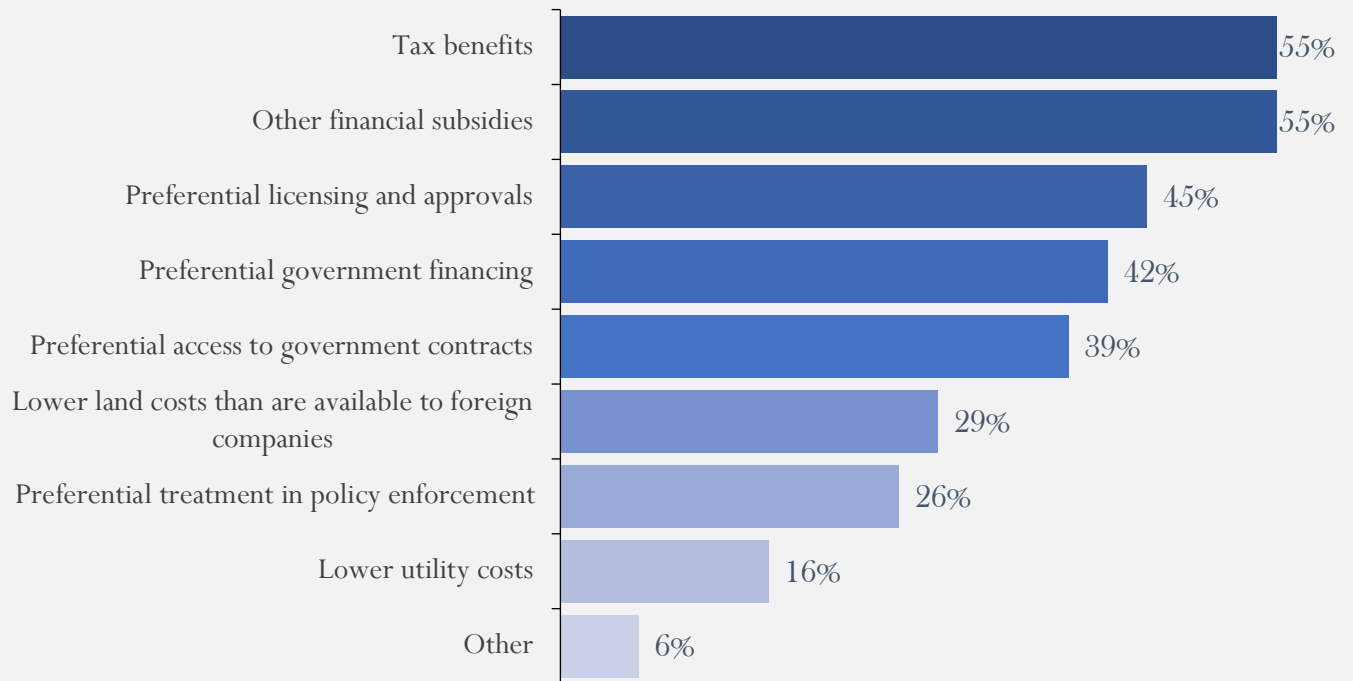
Are state-owned competitors receiving tangible benefits?



Are non-SOE Chinese competitors receiving the same benefits?

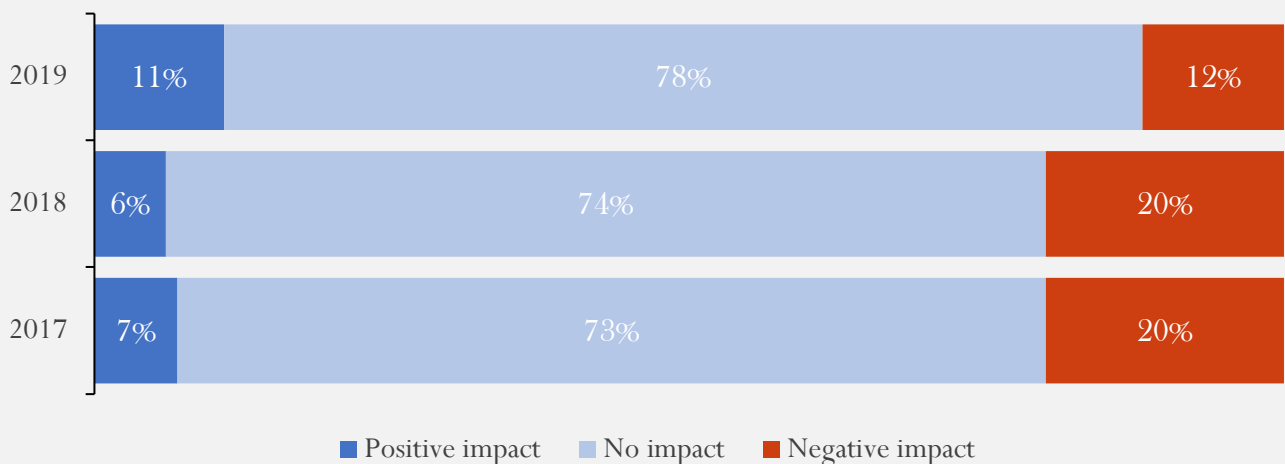


What kind of benefits do SOE competitors receive?



However, one of China’s most high-profile and controversial industrial policies, Made in China 2025 (MIC 2025), has reportedly had limited impact on the majority of American companies surveyed. In a shift of sentiment, the number of companies indicating that MIC 2025 offered positive opportunities for their business in 2019 has nearly doubled since 2018. This shift may indicate that some of China’s efforts to offer foreign companies increased access to industrial policies are beginning to take root.

Has Made in China 2025 impacted your company’s operations?

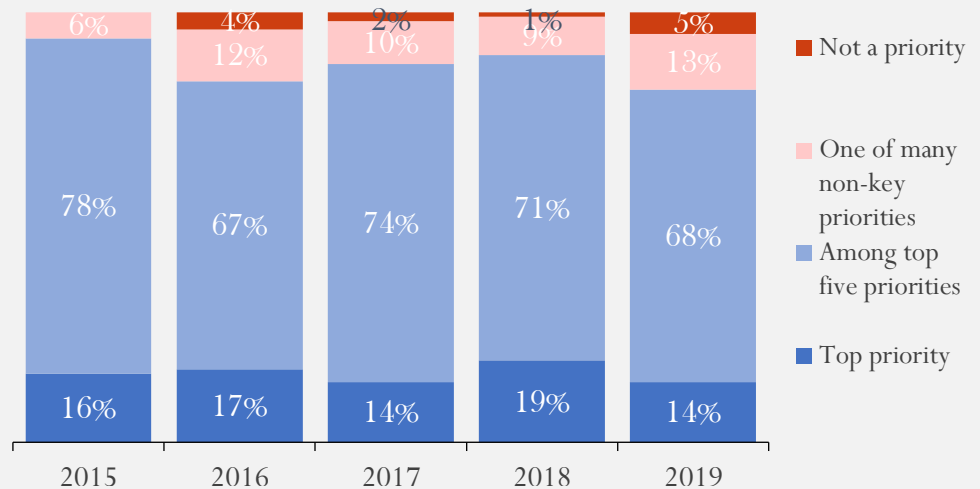


China Remains an Important Market, but Optimism Dipped in 2019

China’s importance as a market for American companies should not be underestimated. China continues to be among the top five global markets for American companies.

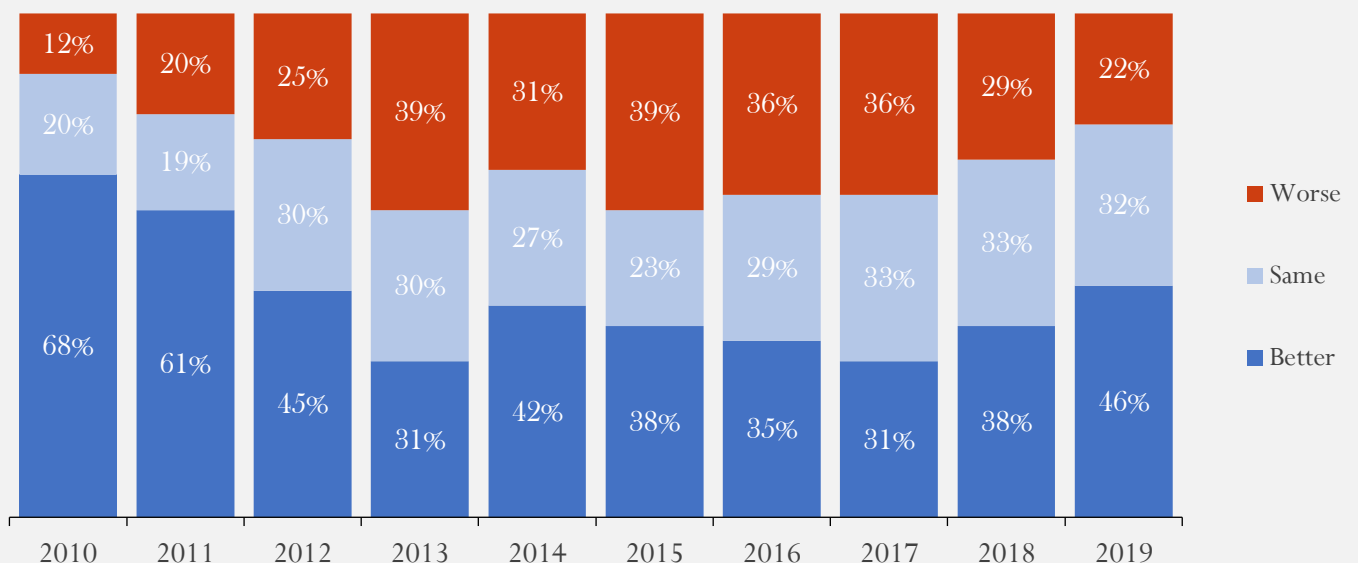
The China market is a priority over other markets due to its comparative significance as a driver of revenue growth. The vast majority of companies report that their China operations are profitable—so much so, that the number of respondents reporting a profit margin rate for their China operations that is higher than that of their overall operations jumped from 38 to 46 percent in 2019. Similarly, the majority

China’s prominence in overall company strategy

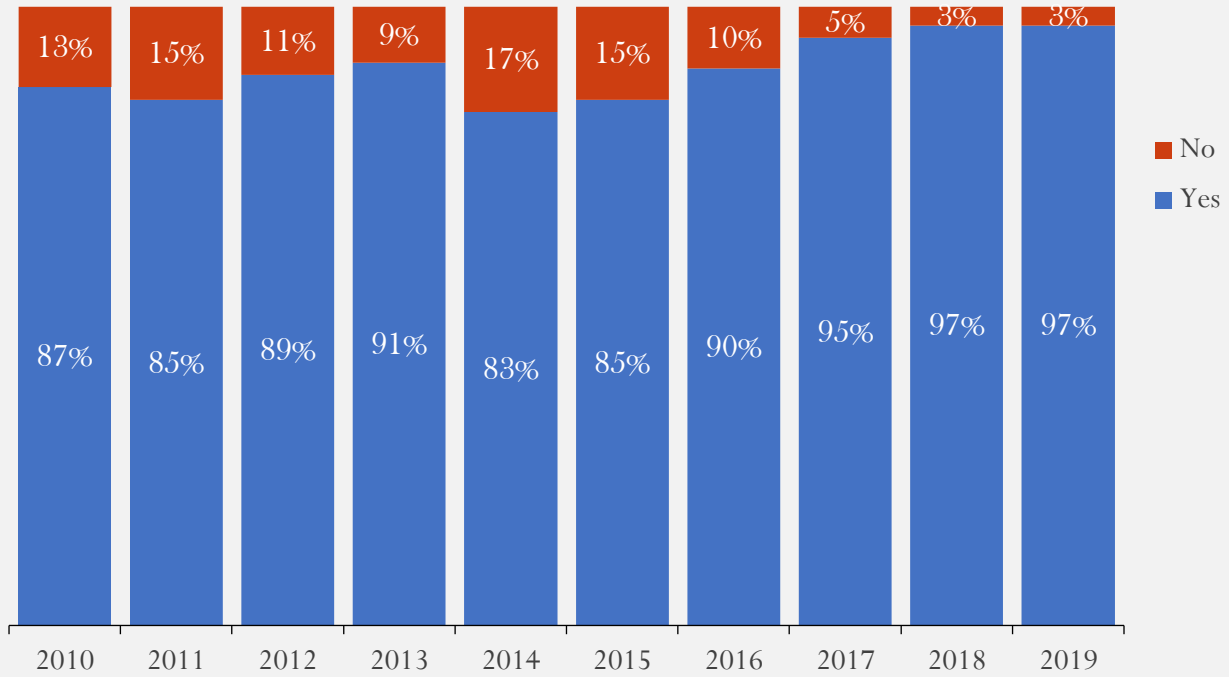


of companies consistently report that revenue from their China businesses has increased in the previous year. However, only a slight majority anticipate that revenue will increase in 2020, down 26 percent from last year, showing that tariff uncertainty, the trade conflict, and a deteriorating market environment are negatively affecting the business outlook for American companies.

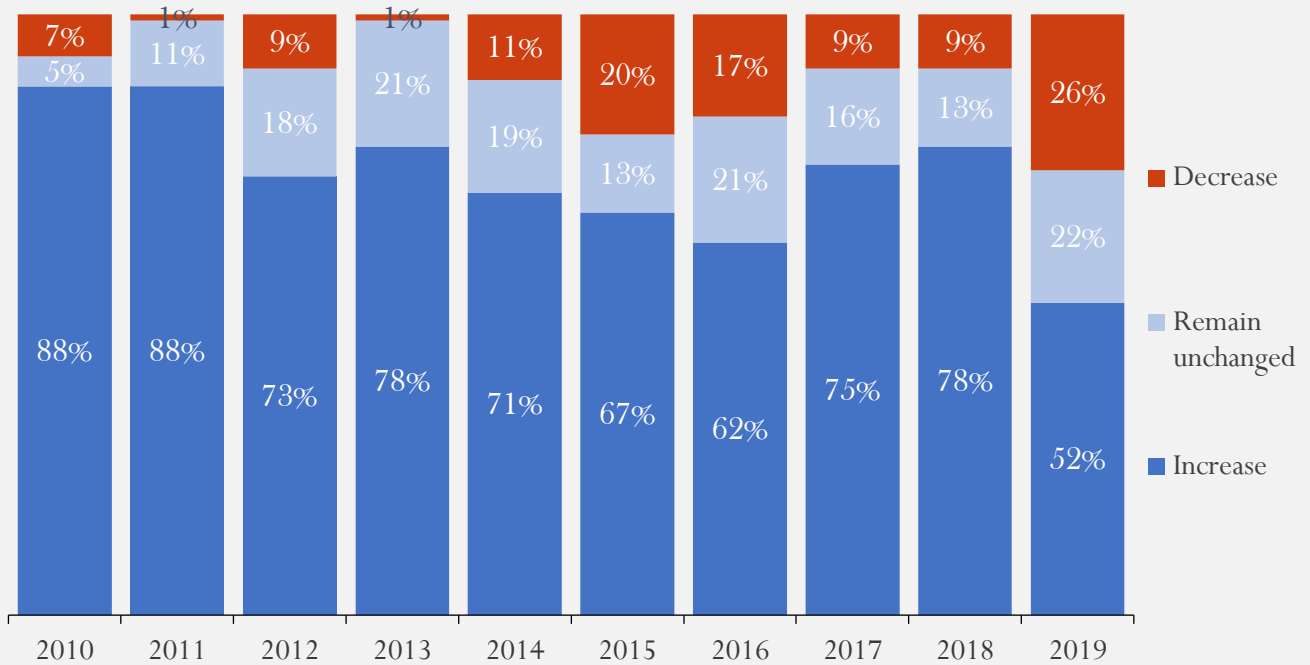
Profit margin rate of China-based operations compared to overall operations



Are your China operations profitable?



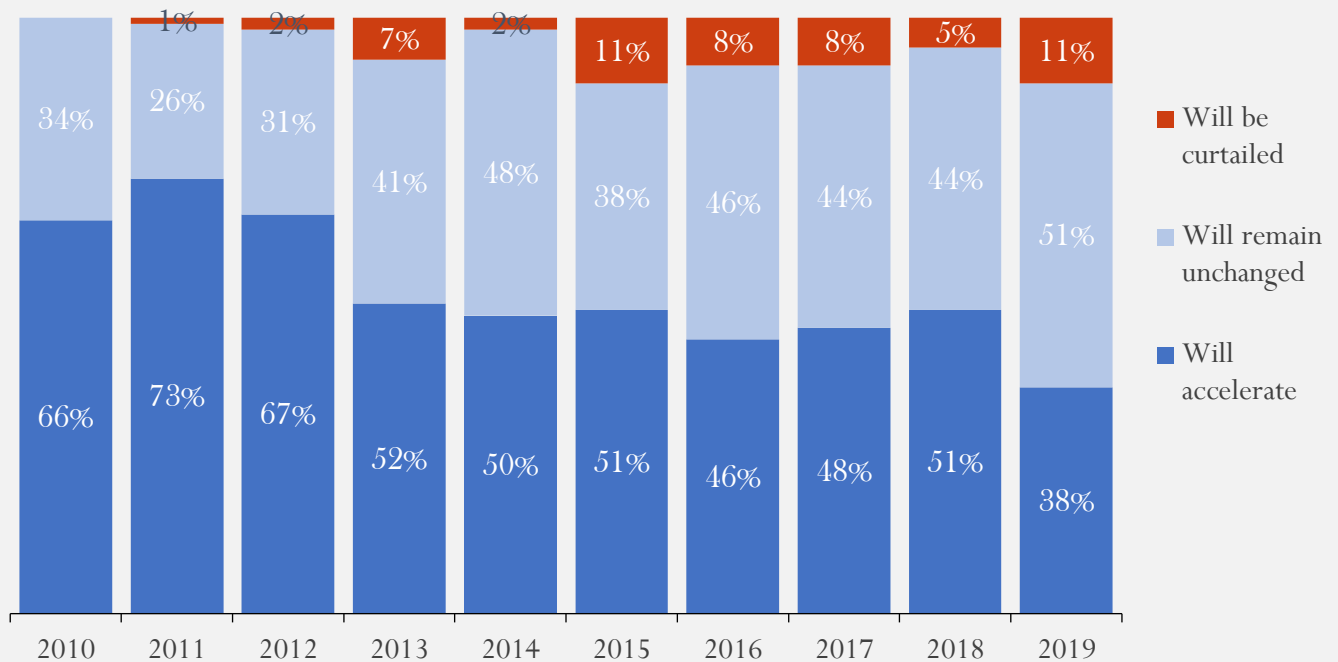
Current year revenue from China projection



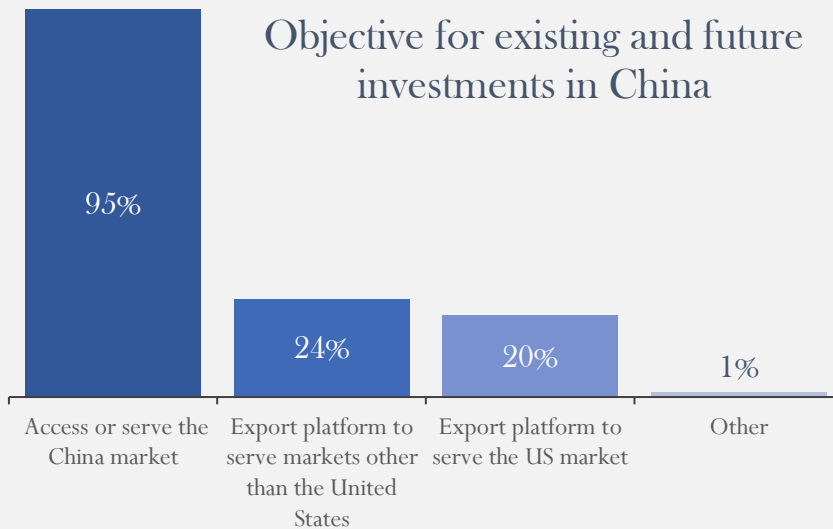
Rising Costs

The majority of American companies surveyed remain committed to the China market and few are currently divesting existing operations. However, responses allude to a cautious evaluation of their supply chains in China. Rising costs in China—a long-time trend appearing in this survey—is a significant impetus for this review, but the impacts of deteriorating US-China relations are also a contributing factor. The political uncertainty may be causing companies to delay or cancel planned investment decisions; this year marked the lowest percentage of respondents reporting that they will accelerate investments in the China market. Nearly 30 percent of respondents report slowed, delayed, or cancelled investment in the United States or China due to the uncertainty from heightened tensions—twice the number reported in 2018.

Resource commitment to China for the next year

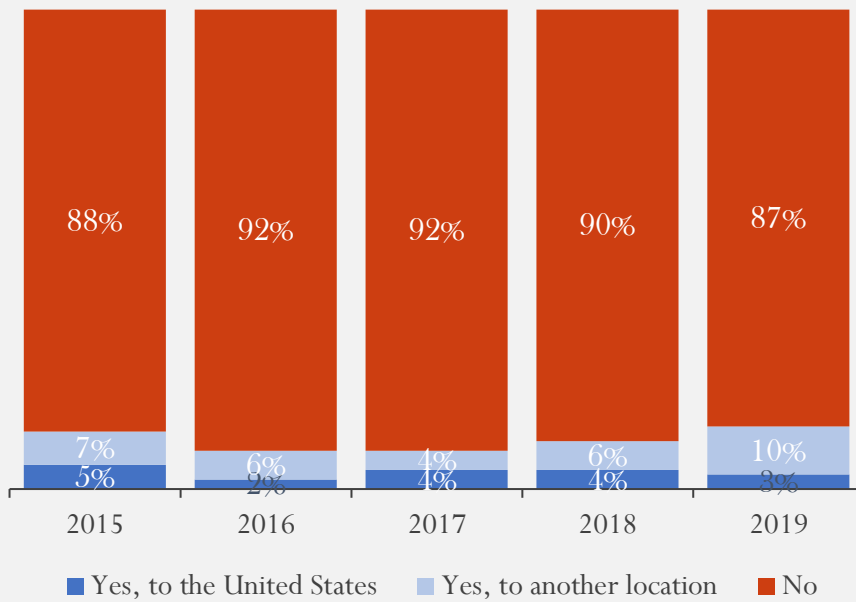


Objective for existing and future investments in China



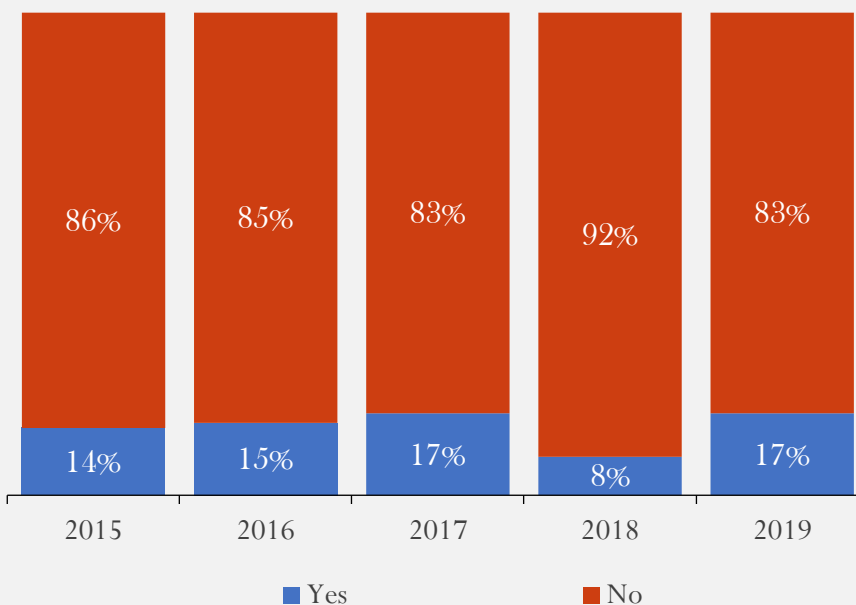
Company investment objectives in China are crucial to understanding the shifting resource commitments reported in survey responses. The overwhelming majority of USCBC member companies—95 percent—invest in China to access the domestic market. Less than a quarter of companies invest in China to export regionally or to the United States.

Has your company moved or does it plan to move any operations out of China?



As a result, there is a bifurcation of investment and operational strategies beginning to take place. Companies will continue to invest in China to access Chinese consumers, but at the same time, rising production costs will push more companies to divest export-focused operations from China. The bifurcation is taking place both between and within companies. The pace of divestitures is unlikely to see a major shift in the coming years, as a sharp uptick would make it difficult for companies to maintain the investment levels required to remain cost competitive in China.

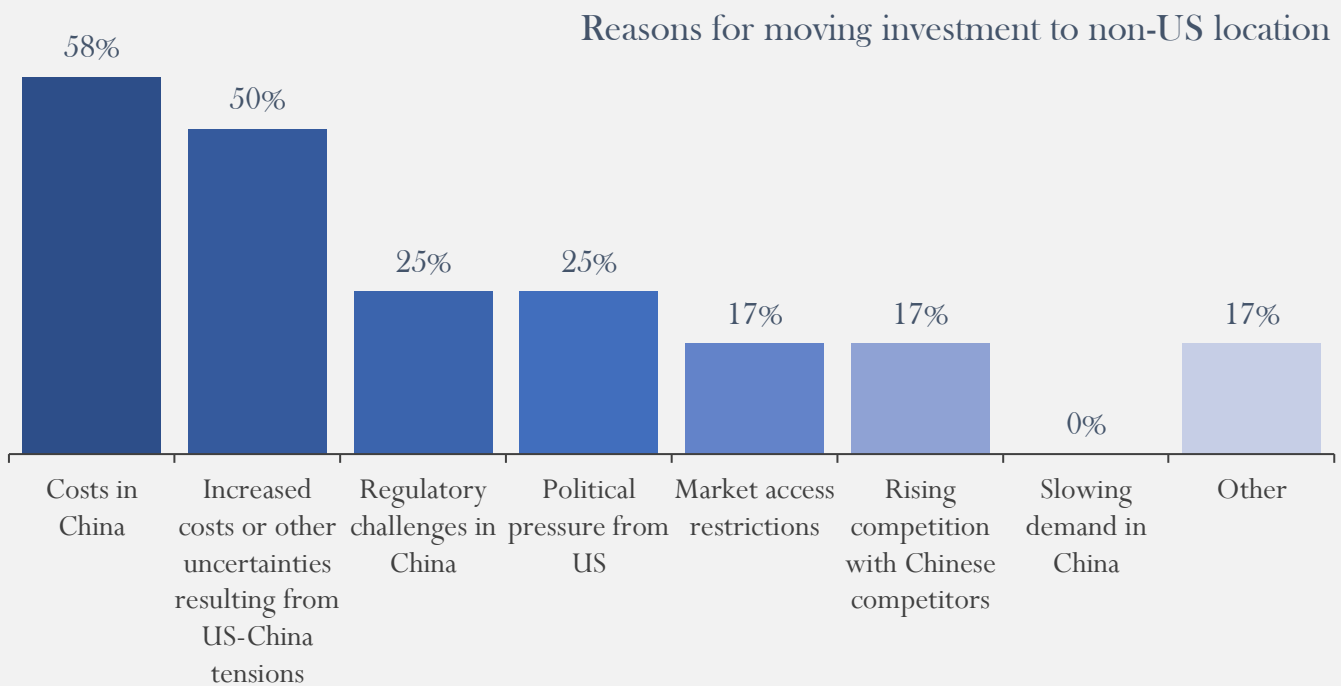
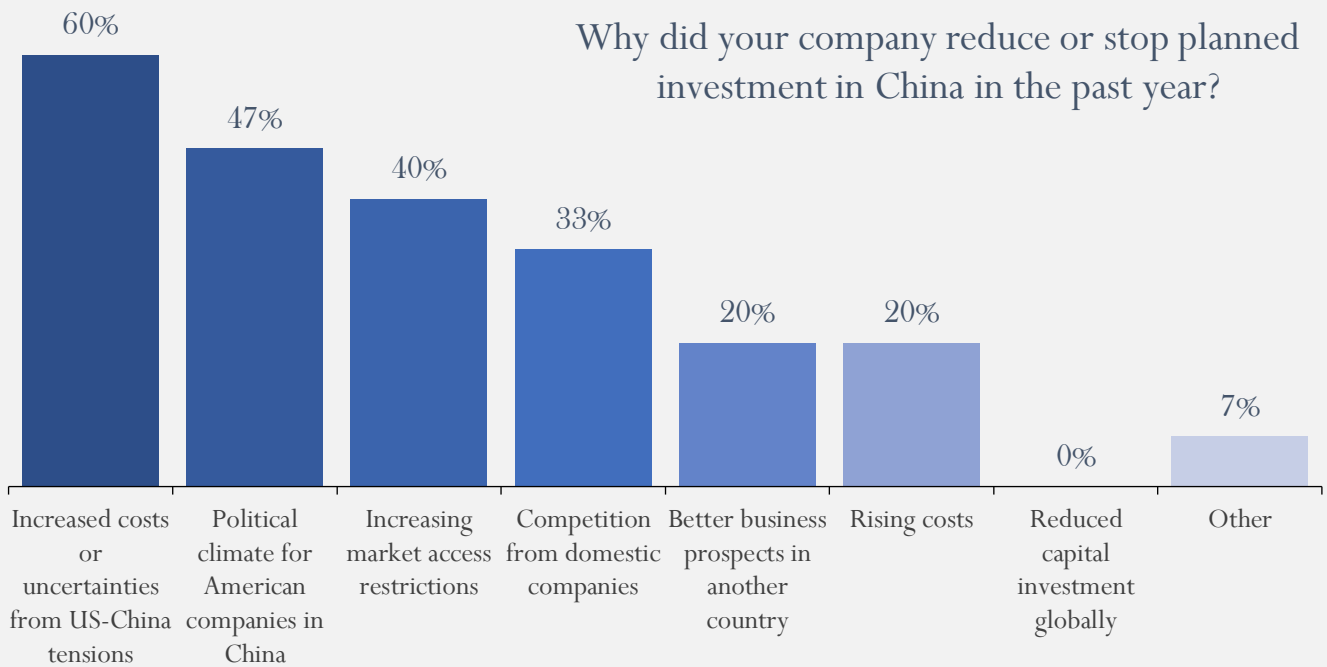
Did your company reduce or stop planned investment in China in the past year?



For companies with upstream inputs impacted by Chinese retaliatory tariffs, or those that export to the United States, tariffs are increasingly impacting bottom lines, as evidenced by half of respondents emphasizing increased costs from US-China relations as contributing to their decision to shift investments to another location.

More telling is the uptick in companies which decided to stop or reduce new investments. Though 17 percent is largely in-line with historic trends, the rationale for this reduction points to

new company pressures in the local market as a result of US-China tensions. Sixty percent of respondents cited increased costs or uncertainties from US-China trade tensions. Forty-seven percent cited the political climate for American companies in China as the top reason for reducing or stopping planned investment in 2019. This reason was not cited in the past two years' survey data, despite being included as an option.



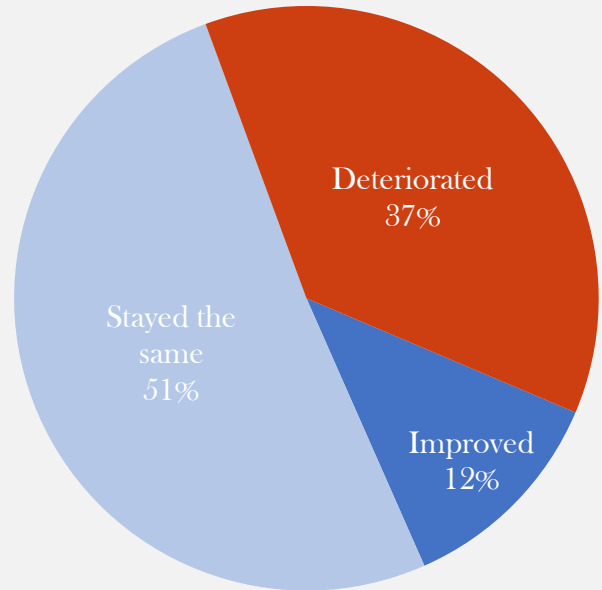
Declining Optimism

Still, US company commitment to the China market should not be a foregone conclusion. Though revenue from China operations increased last year, and profit margins compared to overall operations ticked up slightly, the view that China’s market environment deteriorated in 2019 was held by 37 percent, up from 21 percent in 2018, of those businesses surveyed. In fact, USCBC survey data indicate moderating optimism over the past several years, a trend that continued in 2019. Companies with positive outlooks cite domestic market growth and profitability of China operations as key determinants. Conversely, a pessimistic outlook is the result of an uncertain policy and regulatory environment, unlevel competitive environment, and rising costs.

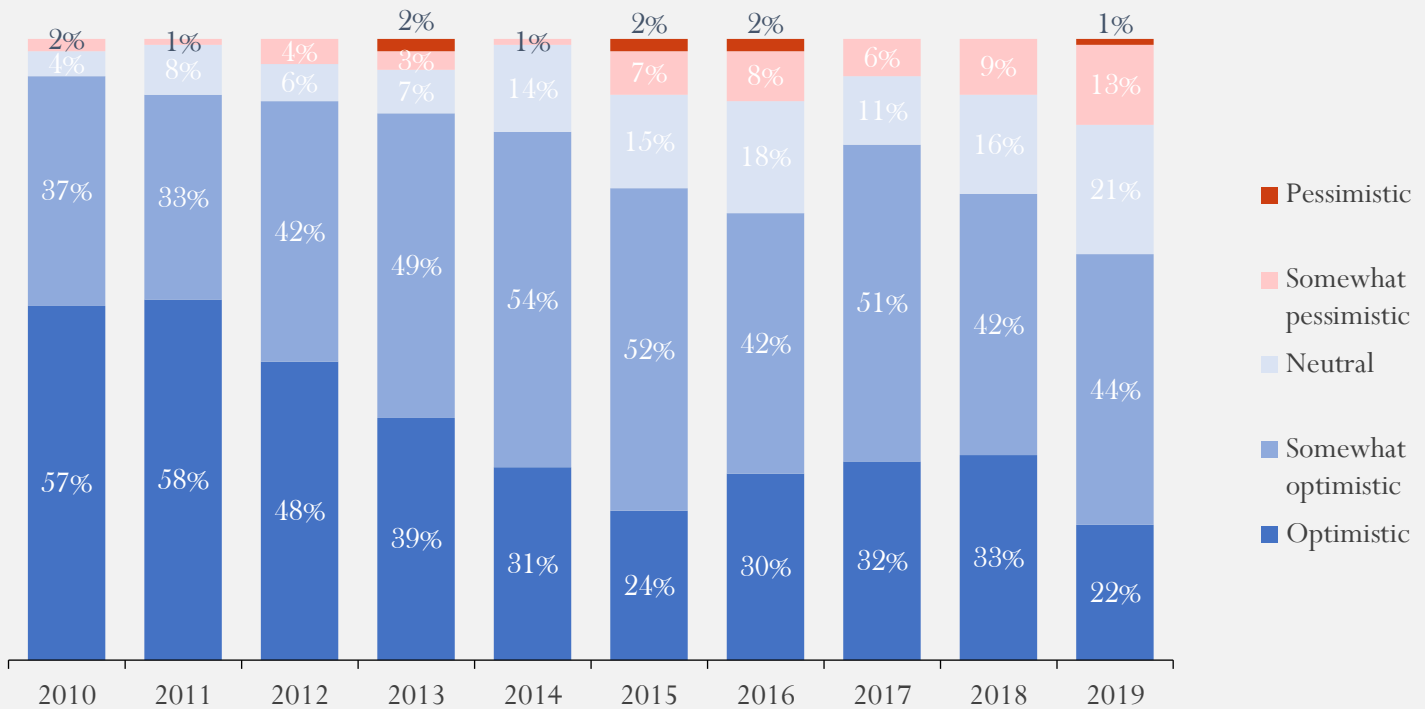
While few companies are pessimistic, respondent optimism about China market prospects five years from now is at a historic low. While the trade conflict is a pressing reason for this sentiment in the short term, survey data shows that China’s policy and regulatory environment is a significantly larger contributor to companies’ deteriorating outlook in the long term.

This trend is not lost on China’s leadership. Recent calls for improving the business environment recognize the positive impacts of reform for domestic economic interests.

China market environment over last 12 months

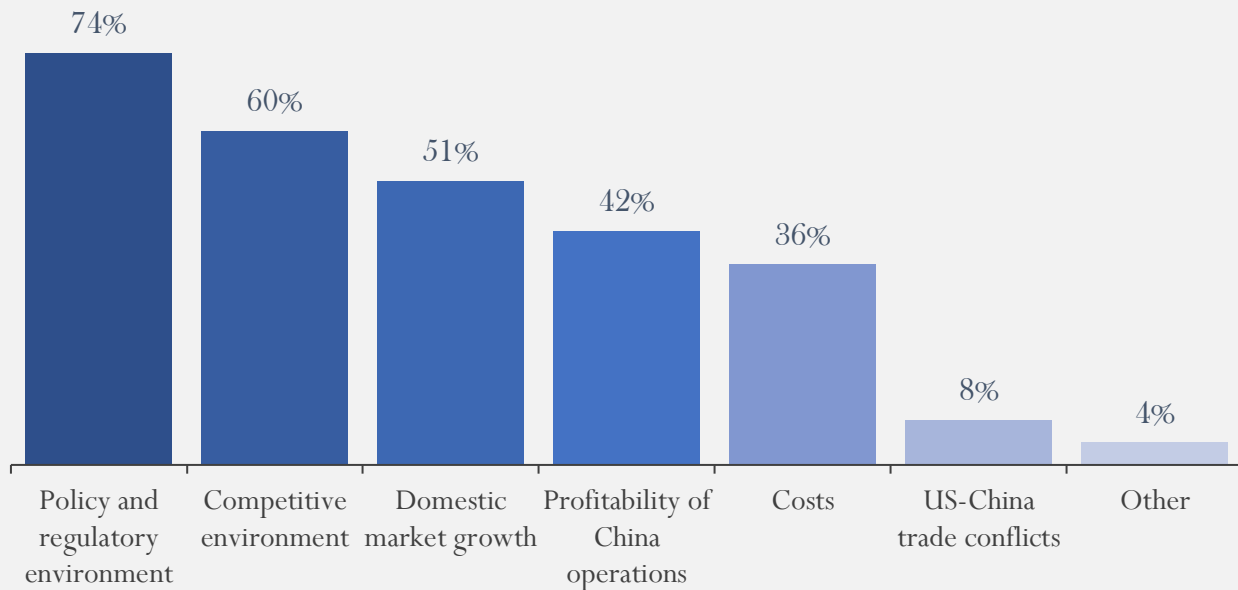


Five-year outlook for business in China



However, based on the 74 percent of respondents who cited the policy and regulatory environment as the top contributor to their five-year outlook, it appears that the pace of implementation has not been satisfactory. Implementing reforms that equalize treatment between foreign and domestic firms, improve IPR protection, and address market-distorting factors that lead to unfair competition would reverse these trends and demonstrate to critics that China has embraced its position as the second largest—and soon to be largest—economy in the world.

Issues impacting five-year outlook

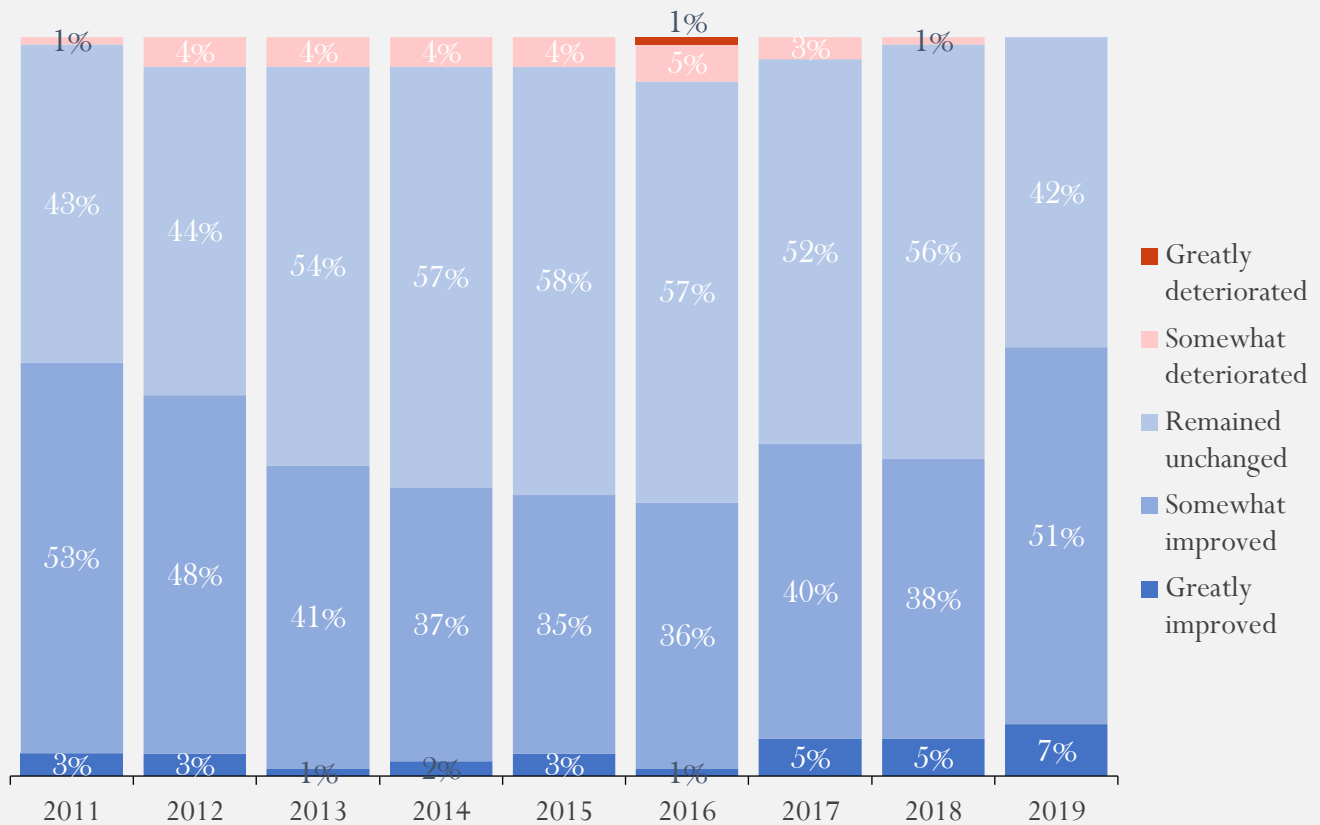


Areas for Improvement

Intellectual Property

IPR protection is a core issue in bilateral trade tensions and commands a significant portion of attention from both governments. Notably, nearly 60 percent of respondents this year report improved IPR protection in the China market, the highest level in any USCBC member survey. American companies attribute these improvements to the Chinese government’s increased emphasis on IPR protection, as well as a variety of new laws and regulations that aim to enhance protections.

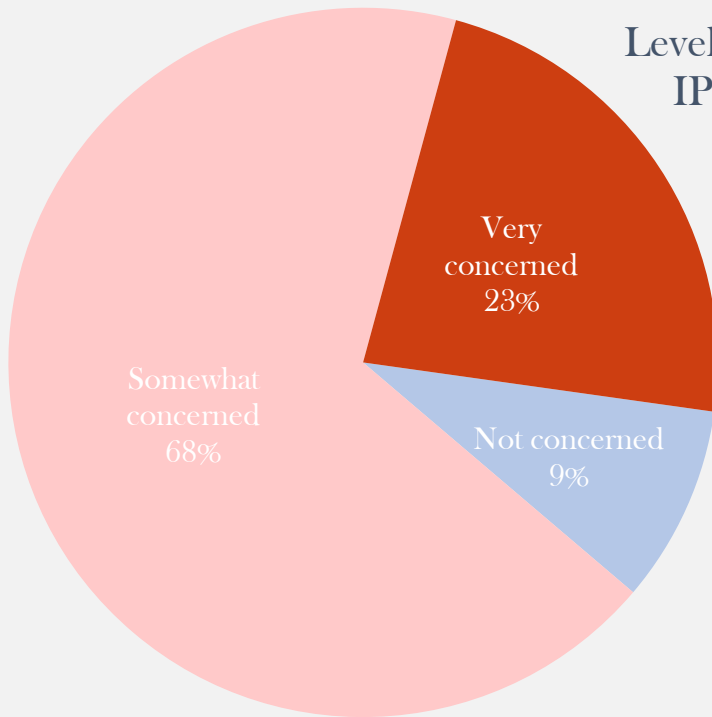
Over the past year, China’s protection of IPR has:



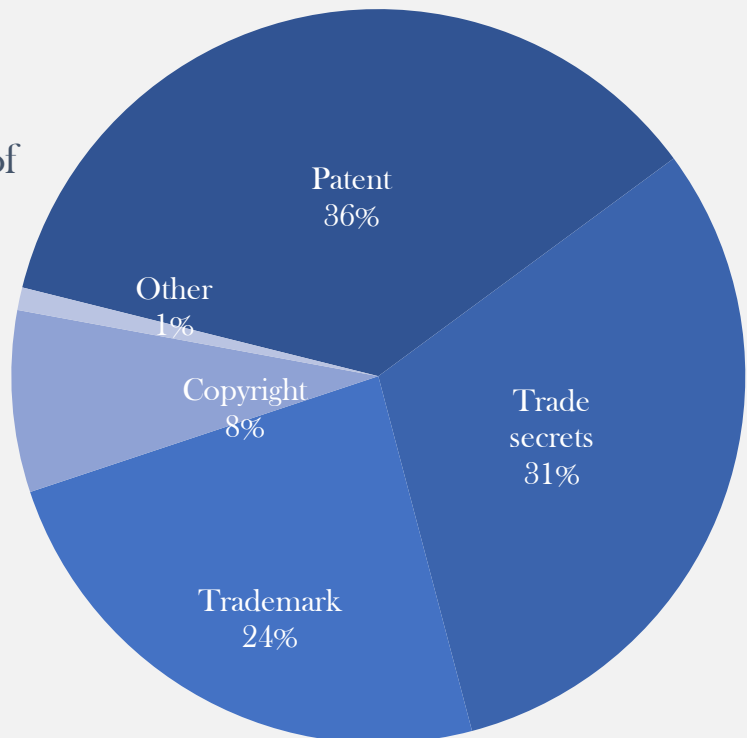
While these improvements are welcome, companies distinguish between IPR protection—which has seen marked improvement—and IPR enforcement, which still falls short of expectations. In 2019, 91 percent of companies expressed concern over China’s enforcement of IPR protections.

As in previous years, most companies report that their IPR concerns curtail what they are willing to do in the market. This is yet another lost opportunity for China's economic growth. Further reforms, with follow-through in enforcement, would also help to reduce tensions between China and its major trading partners—something that industry would welcome.

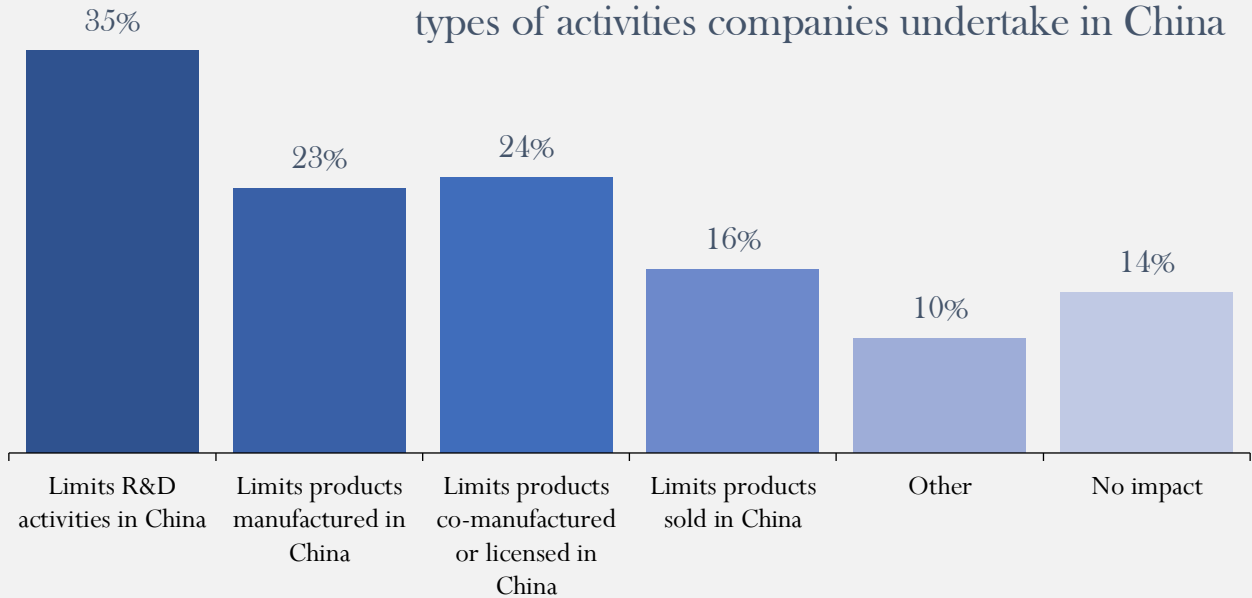
Level of concern about IPR enforcement



IP infringement of greatest concern



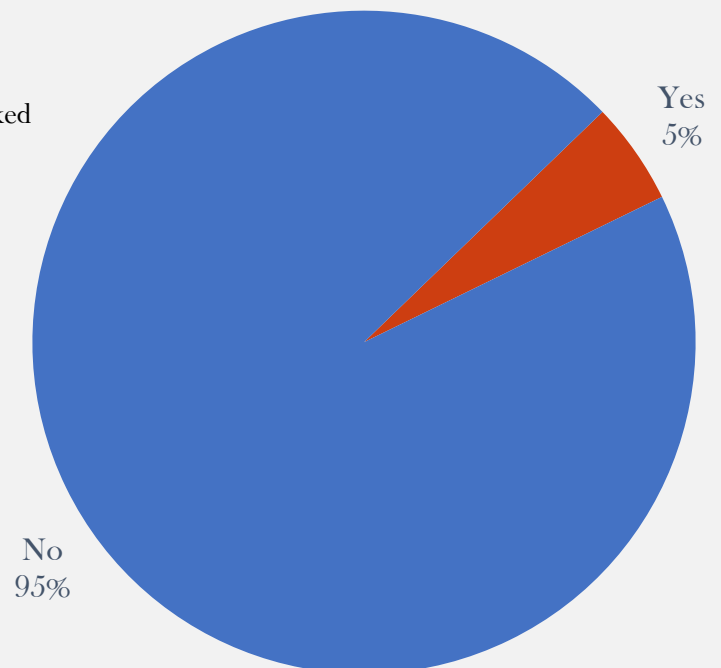
Impact of China's level of IPR enforcement on types of activities companies undertake in China



Technology Transfers

Technology transfers remain a key sticking point in US-China tensions, yet this concern ranked 24 out of the 27 possible top challenges companies face in the China market. While only 5 percent of survey respondents report being asked to transfer technology in the past three years, the issue is an acute concern of affected companies in key sectors. The companies that are asked to transfer technology must make high-consequence decisions and manage the tradeoff of technology sharing and market access. Industry would welcome continued reform to current JV and administrative licensing requirements that increase the vulnerability of trade secrets.

Has your company been asked to transfer technology to China?



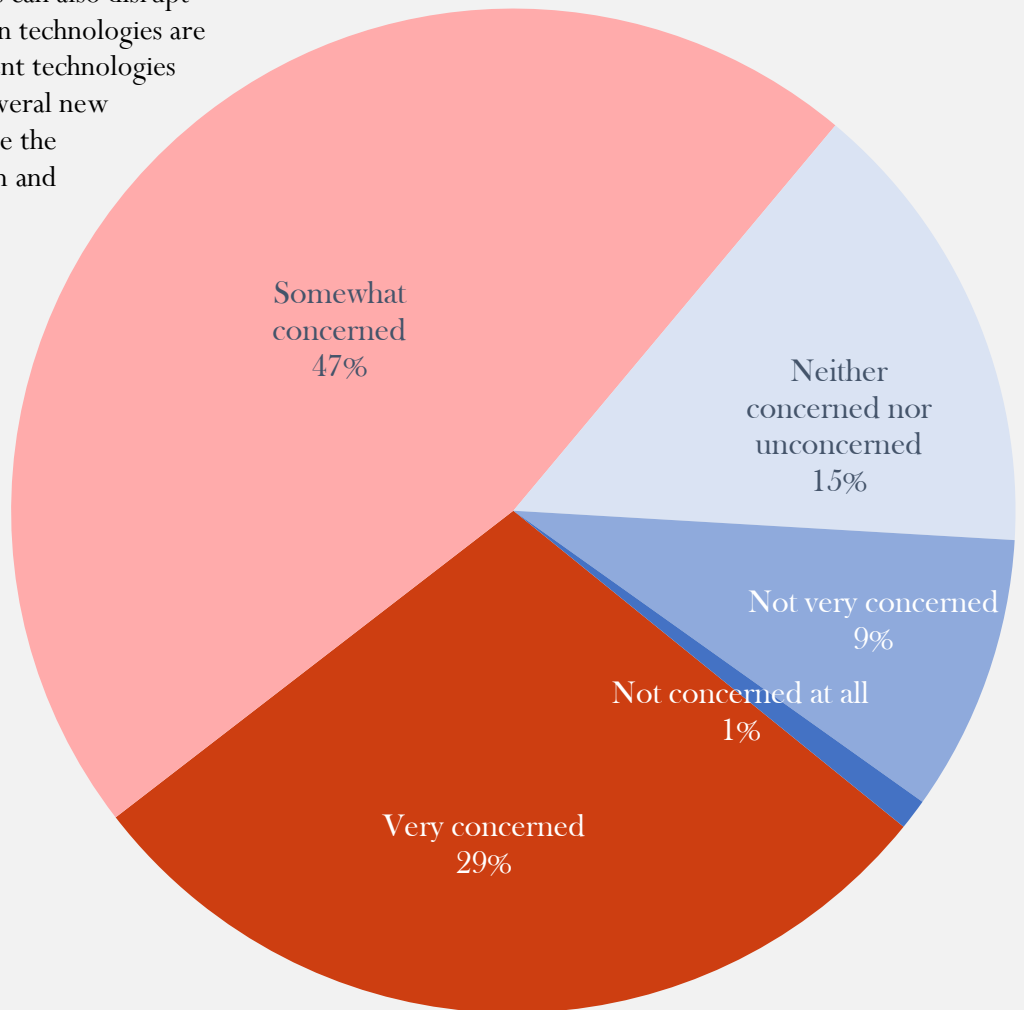
Data Flows and Cybersecurity

Data flow and cybersecurity issues impact almost all companies in China, and are not exclusively a concern of technology firms. As a consequence, it is not surprising that data flows has appeared consistently in the top 10 issues since 2015, the first time the issue was included in this survey.

A majority of companies, 76 percent, have some level of concern about China’s policies on data flows and technology security. A recurring theme this year, 64 percent of respondents report US-China political tensions as their top cyber-related concern. The next two most prominent concerns are more operational, with concerns around restrictions on cross-border data flows and data localization requirements.

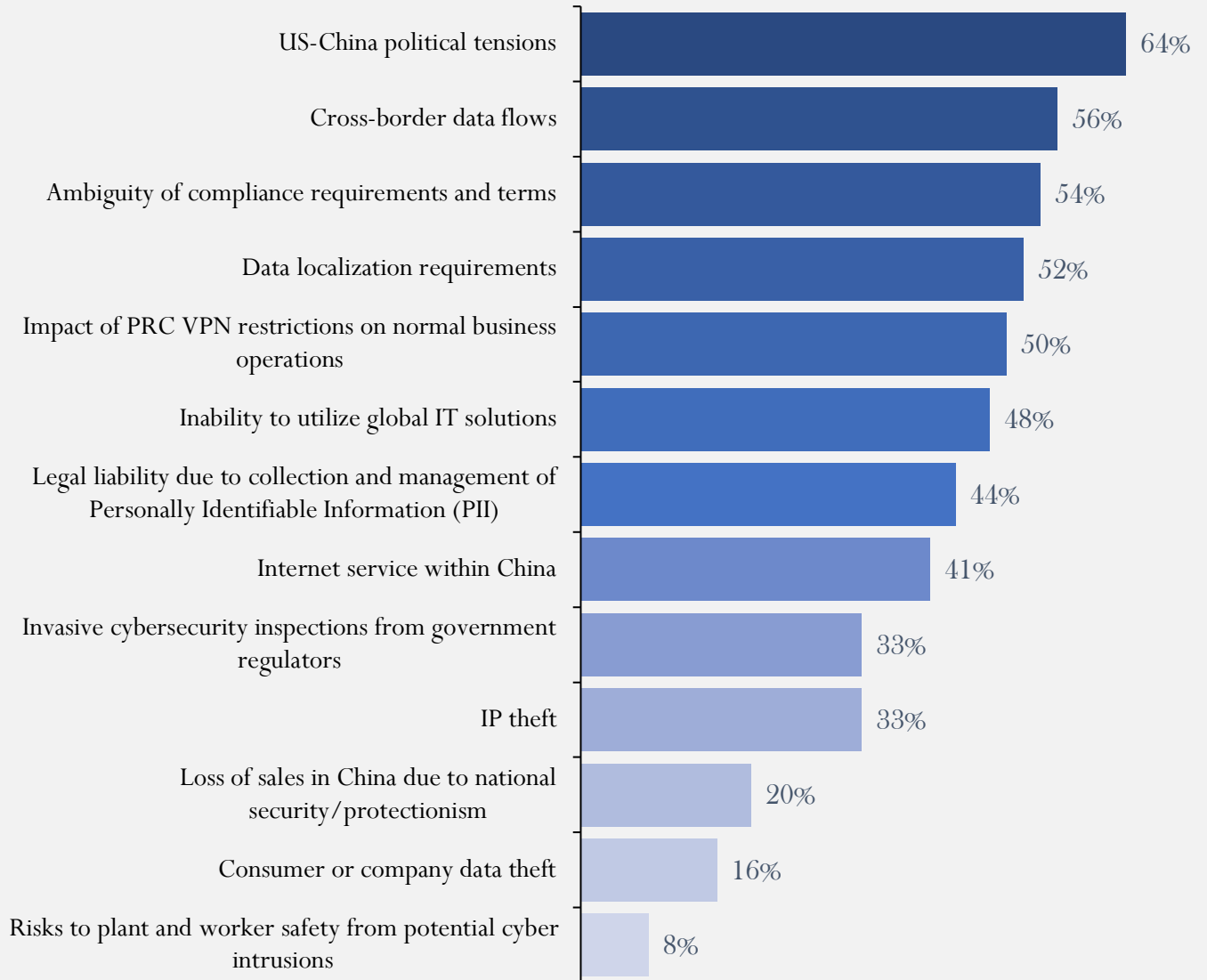
China’s updated data regime may have adverse consequences. American companies report that, in addition to increasing infrastructure and local vendor costs, these restrictions can also disrupt network security. Many foreign technologies are still the most secure and resilient technologies available commercially, and several new requirements would undermine the security that global information and communications technology companies build into their products. These types of policies create more widespread vulnerabilities in Chinese networks, which could undermine China’s broader economic security and development goals.

Concern about China’s information flow and technology security policies



As regular bilateral engagement has abated, so too have the opportunities for industry to engage with regulators on their data and cybersecurity priorities. It is essential that the United States and China find ways to discuss these issues regularly and identify areas of mutual agreement to reduce cyber-related tensions.

Concerns regarding cyber-related issues





THE US-CHINA BUSINESS COUNCIL

美中贸易全国委员会

How China's Social Credit System Will Impact Companies

July 24th, 2019

By Hanchen Zheng and Angela Deng

- *Certain features of the system, such as platforms for sharing company data and publicizing company records online, have already been put in place.*
- *Major details are still being sorted out at the local government level through pilot systems and trial measures.*
- *Industry regulators have issued broad guidelines on how companies in their sectors will be evaluated and rated, and a few local governments have fleshed out thorough credit rating systems for specific industries.*

China is still far from completing its ambitious goal of building a [social credit system](#) for companies by 2020. The system will encompass individuals, companies, social organizations, and government departments to “promote trust, sincerity, and traditional values.” A broad framework has been established for rating companies, as well as for collecting, aggregating, and publishing relevant records on companies. However, many industry regulators have released only vague guidelines on how to develop sectoral social credit systems, leaving specific details to be decided by local governments. Policymakers are still in the process of defining the standards for codifying and rating companies’ actions and behaviors, and it is unclear what direction will be taken.

How has China's social credit system evolved?

In 2014, the State Council released its [Planning Outline](#) describing its goals for the construction of a national social credit system (SCS), though local governments had already begun rolling out SCS pilots in the early 2000s. Since the publication of the [primary documents](#) laying out the key goals and tasks for building out a national SCS in 2014, sixty-one municipal governments and four provinces have started rolling out SCS pilots. Commercial development of the SCS has been initiated, but none of the commercially developed social credit systems have been officially endorsed by the central government. How the social credit system works for companies

In China's corporate sector, the social credit system is primarily used for regulatory enforcement. China has so far created a system for measuring, tracking, and enforcing companies' compliance with industry regulations. Under the current system, companies are identified by their unique 18-digit codes called the “[uniform social credit code](#).” So far, China has [built credit profiles](#) for 25.91 million enterprises and organizations.

The social credit system applies to both domestic and foreign companies in China. Specifically, the [Foreign Investment Law](#) passed by the National People's Congress in March states that foreign-invested enterprises (FIEs) will be investigated and that misconduct by FIEs will be recorded in the credit information system. According to USCBC sources, foreign companies are already being incorporated into China's social credit system.

A company that violates industry regulations or fails to comply with the [Interim Regulation on Enterprise Information Disclosure](#)—specific criteria that companies must meet on disclosure of corporate information—would land on the List of “Irregular Businesses” which is managed by the State Administration of Market Regulation (SAMR). Companies who prove compliance with the interim regulation within three years can apply for removal from the list. Companies that stay on the List of “Irregular Businesses” for three or more years or have committed more serious industry violations are put on the official blacklist, the List of Enterprises with Serious Illegal and Dishonest Acts, also managed by SAMR. To be removed from this list, companies must not have any repeat violations for five years. Specific industry regulators determine the types of punishments companies receive for being placed on the List of Enterprises for Serious Illegal and Dishonest Acts. Typically, no company is punished for being placed on the List of “Irregular Businesses.” All memorandums delineating industry-specific punishments to date can be found [here](#). China’s Cyberspace Affairs Commission on July 24 published a set of [new punishments](#) companies and individuals can receive for violations of internet content laws and dissemination of harmful information online.

Enforcement under SCS: great rewards, severe punishments

The SCS is meant to enforce good behavior through a joint system of punishment for untrustworthy behavior and positive incentives for trustworthy behavior. To implement the joint system, China has compiled so far a total of 51 [blacklists](#) for non-compliance with laws and regulations. Conversely, companies can be recognized on a [redlist](#) by showing exceptional behavior, but ministries and local governments appear to have put more emphasis on building blacklists.

Companies that are blacklisted will face disproportionate punishments, covering both administrative and market restrictions. Blacklists are shared among industries and ministries so that punishments for breaking of trust in one area or sector would apply across the board. Punishments for having bad credit include increased inspections, reduced access to loans and tax incentives, and restrictions on stock issuance, bidding for government projects, and luxury consumption. Rewards for being added to a redlist also vary and range from fast track approvals for administrative processes, priority consideration for preferential government policies, to market benefits such as easier access to lending and debt issuance. Benefits from having good credit are similar to those of being added to a redlist.

To improve bad credit, companies first have to correct their unwanted behavior within the prescribed time limits and then go through a series of additional steps, such as submitting “credit promise” notes, going through special training, or participating in charitable activities. Removal from a blacklist depends on specific conditions set by the regulator in charge of managing the specific blacklist. Companies can also appeal negative credit or designation by a government entity, but the burden of proof is high.

A long way to go before the social credit system is complete

A key aspect of the SCS is to create a unified system for integrating and sharing data collected across different industries, levels of government, and various government departments. However, bureaucratic infighting has made this task difficult. According to a source familiar with the People’s Bank of China (PBOC), the PBOC has resisted the National Development and Reform Commission’s ideas (NDRC) on the types of non-financial data being collected and the mission for SCS. PBOC has been building a separate financial credit system, the [Financial Credit Information Database](#), and appears to be unwilling to share its data with NDRC. Commercial developers of social credit systems also seem reluctant to share their data with PBOC.

Despite these challenges, China has made some progress in collecting and sharing data among all stakeholders. China created a National Credit Information Sharing Platform, which has pulled together over 400 datasets from ministries and other government agencies. Most of the data collected on companies are publicly available on the [National Enterprise Credit Information Publicity System](#), which shows whether companies are on the List of “Irregular Businesses” or the List of Enterprises for Serious Illegal and Dishonest Acts. Central ministries use the data in the National Enterprise Credit Information Publicity System as well as those collected by the Chinese central bank in their administrative approval

and bidding processes. A parallel platform, [Credit China](#), includes information on good and bad credit for both companies and individuals.

Unanswered questions and concerns about SCS

What specific criteria will companies be evaluated on?

While the system of blacklists and redlists has been rolled out for specific industries, China still has not begun systematically calculating and assigning credit scores to companies across all industries, something that the Planning Outline did not explicitly require. So far, only a few central government agencies and some provincial governments, have set up detailed systems for rating companies based on records of their regulatory compliance for specific industries.

Will the SCS adversely impact on companies?

As companies' credit scores will impact access to credit and markets, companies may feel pressured to change their business priorities so that they align with the party's political and strategic aims. The SCS also leaves space for abuse by local regulators given some of the vague provisions governing the blacklist system and introduces concerns about fair competition, as credit information provided by one business may influence the credit score of another. Data privacy could also be in jeopardy, as SCS relies on the collection of massive amounts of data. The SCS could provide legal justification for the Chinese government to request access to proprietary company data.

How the social credit system impacts specific industries

China has been focusing on applying the social credit system primarily to issues that affect people's safety and property, such as those relating to food, medicine, environment, engineering quality, work safety, elderly care, and urban safety. So far, blacklists have been rolled out or contemplated for fourteen industries, and China strives to apply the blacklist system to all industries in the future after 2020. USCBC's has compiled policy [documents on sectoral SCS](#) published by central ministries and local governments' rating systems for specific industries.

Industry / Relevant Regulations	Targeted behaviors	Possible punishments
<p>E-commerce:</p> <p>Plan on Joint Disciplinary Actions on Untrustworthy Subjects in E-commerce and Sharing Economy Administrative Measures for the List of Enterprises for Seriously Illegal and Dishonest Acts (Revised Draft for Comments)</p>	<p>“Hyped credibility,” meaning promotion of one’s credibility through publication of self-praise and fictitious transactions and deletion of unfavorable evaluations and comments.</p> <p>For business owners:</p> <p>Fake reviews</p> <p>Malicious or false tarnishing of competitors’ reputation</p> <p>For e-commerce platforms:</p> <p>Failure to implement mechanisms to enforce laws</p>	<p>Restrictions on creation of new accounts</p> <p>Blocking or deletion of existing accounts</p> <p>Restrictions on release of goods and services</p> <p>Restrictions on participation in various marketing or promotional activities</p> <p>Flagged as risky in search results</p>

	<p>and regulations (e.g. E-commerce Law)</p> <p>Abuse of contracts, transactions, or technologies</p> <p>Failure to conduct due diligence on businesses or consumers hosted on the platform that may have violated rules or regulations</p>	
<p>Energy:</p> <p>Memorandum of Understanding on the Implementation of Joint Disciplinary Measures Against Serious and Untrustworthy Subjects in the Oil and Gas Industry</p>	<p>Those in the oil and gas industry that have violated relevant laws and regulations or are on the List of Enterprises for Serious Illegal and Dishonest Acts are punished.</p>	<p>Restrictions on market access and licensing, such as orders to stop operations and suspensions of license applications</p> <p>Increase in frequency of supervision and inspection</p> <p>Suspension of standardized review of work safety</p> <p>Revoking of certificates for work safety</p>
<p>Environment:</p> <p>Trial Measures for Enterprise Environmental Credit Assessment</p> <p>Guiding Opinions on Strengthening the Establishment of an Enterprise Environmental Credit System</p>	<p>Enterprises with records of high pollution</p> <p>Enterprises with environmental violations, such as construction without approval, concealing of emissions with malicious intent, and environmental crimes</p>	<p>Orders to publicly announce plans or commitments to improve environmental behaviors and to submit reports on rectification of problems identified in environmental credit evaluations</p> <p>Increase in frequency of law enforcement inspections</p> <p>Suspension of various special funds for environmental protection</p> <p>Increase in the rate of environmental pollution liability insurance premiums</p>
<p>Food and Drugs:</p> <p>Administrative Measures for the List of Enterprises for Seriously Illegal and</p>	<p>Fake reviews</p> <p>Malicious and/or false tarnishing of competitors' reputation</p> <p>Refusal to cooperate with food sampling</p>	<p>Restrictions or bans on market access</p> <p>Bans on initial public offering</p> <p>Restrictions on participation in bid tenders</p> <p>Denial of government funding</p>

<p>Dishonest Acts (Revised Draft for Comments)</p>	<p>Violation of food safety regulations Submission of false documents on clinical trials Sale of counterfeit or inferior drugs</p>	<p>Denial of tax breaks</p>
<p>Insurance: Memorandum of Understanding on Joint Disciplinary Measures Against Violators and Responsible Subjects in the Insurance Field</p>	<p>Sale of fake insurance policies False Advertising Unfair product pricing and insurance contracts Other market activities that are recognized by the insurance regulator as seriously illegal and dishonest acts</p>	<p>Restrictions on obtaining qualification as a certification body and obtaining a certificate Restrictions on establishment of securities, fund management, futures, financial guarantee, and other types of financial services companies Use of the company’s illegal and untrustworthy records in its application for establishing a commercial bank, branch, or representative office</p>
<p>Transportation: Memorandum of Understanding on Joint Disciplinary Measures Against Untrustworthy Market Entities and Related Personnel with Serious Law Violations in the Transportation and Logistics Industries</p>	<p>Companies on the List of Enterprises for Seriously Illegal and Dishonest Acts</p>	<p>Restrictions on market access (business license, bidding, government procurement, supply of land from the government, certification, etc.) Financial restrictions (issuance of corporate bonds, issuance of stocks, mergers and acquisitions, etc.)</p>