THE US-CHINA BUSINESS COUNCIL
美中贸易全国委员会

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

September 28, 2018

Seventeen years after China joined the World Trade Organization (WTO), the global economy has changed significantly. As part of its accession agreement, China has lowered many tariffs, dropping its applied import tariffs from a weighted average of 14.7 percent in 2000 to 3.5 percent in 2016. China agreed to open some, though not all, of its economy to foreign participation -- commitments that 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 China.

As the Office of the US Trade Representative (USTR) has noted in previous annual reports, China has fulfilled most of the specific obligations of its accession agreement, but it has not yet implemented several important commitments. The "positive list" approach used in the accession agreement opened only 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 electronic commerce and other technology services. And while some additional sectors have been opened to foreign participation in the decade since the accession agreement "roadmap" of obligations ran out, the sectors that remain closed are ones that would benefit from liberalization, from both the perspective of foreign companies seeking market access and strengthening the competitiveness of the Chinese economy as a whole. At this time, China's record of applying the spirit or principles of the WTO's tenets of national treatment remains problematic.

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 American economy, better off since China's entry into the WTO 17 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 was approximately $1.2 trillion, ranking it as the fifth-largest economy in the world. China's GDP was roughly $12.2 trillion last year, making it second only to the United States. The US economy has also grown during that time, from $10.28 trillion in 2000 to $18.57 trillion in 2016; and the US economy has also remained the largest economy in the world throughout this time, even when taking into account the global recession in 2009.

China has lifted more than 800 million people out of poverty as a result of its market reforms; and its thriving middle class not only benefits from the job creation facilitated through new investment, but also drives global demand for goods and services. The growth and success of many American companies is directly tied to China's demand for goods and services. By the US-China Business Council's (USCBC) calculations, China was a less than $50 billion market for American 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 since China's accession to the WTO, from $83 billion in 2000 to $375 billion last year. However, focusing solely on the bilateral trade balance misses an important change in the pattern of trade. Including China, East Asia's share of the US global trade deficit was 56 percent in 2017; it was roughly the same 20 years ago, before China's WTO entry. After China entered the WTO, suppliers from Japan, Korea, Taiwan, Hong Kong, and other economies moved their export manufacturing to China, and shifted the United States' long standing bilateral trade deficits with those economies to China as well. 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 over time, 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 September 2018 of the 15 completed cases the United States has filed against China, 10 cases were won by the United States and 5 were settled satisfactorily before a ruling was made. None were lost.

Given these facts, on balance, China's WTO entry has been positive for the United States and for the world. Notably, China has taken some steps to further open its markets in the last couple of years. In October 2016, China replaced the original approval process for foreign investments not subject to restrictions on its negative list with a simpler and more abbreviated record filing process, allowing companies in many sectors to simply notify authorities of their investments rather than awaiting approval to proceed. There have also been meaningful liberalizations in long-difficult-to-access sectors like financial services.

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

Implementation of the "Letter" of Existing WTO Commitments

In its 2002 submission for the first Trade Policy Staff Committee (TPSC) hearing on China's compliance with its WTO commitments, USCBC noted 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, even though USCBC's surveys continue to show slow but steady improvement in this area. These challenges are also reflected in US companies' experiences with China's procurement policies and pressures to transfer technology.

National Treatment

The WTO's rules require member countries to treat domestic and foreign companies on an equal basis, a requirement known as national treatment and an essential principle for all companies doing business globally. However, USCBC's annual member survey showed again in 2018 that American companies continue to experience problems with discriminatory treatment, primarily in the form of regulatory challenges and preferential treatment for domestic companies, creating an uneven playing field. Regulatory and competition challenges are not new for US companies, but they have a real effect on companies' ability to do business and are among the issues that companies cite as primary restraints on their profitability in China.

China's policymakers should move toward eliminating terminology in laws and regulations--such as the term "foreign-invested enterprises"--that distinguishes between domestic and foreign-owned companies. Continued use of this term invites discriminatory treatment of various types of domestic legal entities, based solely on ownership. The better approach would be to treat equally all companies legally established under China's Company Law, regardless of ownership nationality. China's nationwide negative list, which applies to all investors--domestic and foreign--would make progress toward this end, but despite announcements that this list would be implemented in January of 2018, China has continued to drag out the timeline.

Some Chinese companies thrive because they produce competitive, high-quality goods and services, but many Chinese policies and practices continue to provide advantages to domestic companies over foreign ones. That 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 the top 10 concerns in USCBC's member survey in 2018, as well as in previous years. 57 percent of respondents in USCBC's latest member survey say they have been negatively impacted by preferential treatment extended to China's domestic companies. Since these benefits are given both to domestic SOEs and private Chinese companies, policies to level the playing field for foreign companies should ensure equal treatment of foreign companies vis-a-vis all forms of domestic Chinese companies, regardless of ownership.

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 than protecting national security interests. Recent examples of this include China's Cybersecurity Law, measures targeting foreign technology procurement, and provisions in the draft 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. 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.

Discrimination also figures in China's innovation policies. Although most of China's innovation promotion measures are tied to the high-tech industry, their negative impact increasingly extends beyond technology companies. Policies favoring the use of domestic technology are popping up in rules that affect technology users, ranging from financial services institutions to healthcare providers and businesses engaged in ecommerce. Despite repeated assurances by Chinese officials that policies promoting innovation are open to both domestic and foreign companies, policies such as Made in China 2025 (MIC2025) remain concerning to USCBC members. The majority of USCBC members have not yet been impacted by MIC2025; however, 20 percent report that their sales and operations in China have been negatively impacted, and only 6 percent report a positive impact.

Technology and innovation play a critical role in creating stronger commercial environments that are capable of meeting the needs of 21st century economies. As a consequence, regulations in these areas must be based solely on sound commercial and technical factors. To that end, China should embrace the transformational power that a truly open economy creates. Innovation, a top priority for China's government, thrives under such conditions, but is stifled when a government seeks to limit how and where it occurs, or seeks to dictate technology choices.

Licensing & Approvals
USCBC members regularly cite licensing as a top challenge to conducting business in China. Over the past decade, the issue has consistently ranked among the top 10 priority concerns in USCBC's annual member survey. In the 2018 survey, licensing ranked third, with slightly more than half of respondents indicating that their companies had experienced challenges with Chinese licensing and approval processes.

License approvals are necessary for every company operating in China, just as they are in other markets. However, in China, licensing approvals can become significant market access barriers. American companies often face challenges obtaining licenses that their domestic competitors do not. 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 frustrates company operations.

Intellectual Property Rights

Over the dozen years that USCBC has conducted its annual member survey, companies have consistently expressed concern over the protection of intellectual property rights (IPR) in China. While companies generally report slow improvement in IP protection, the issue remains a top concern 17 years after China's accession to the WTO. 88 percent of respondents in USCBC's most recent survey express some level of concern about protecting intellectual property.

It should be noted that USCBC's membership as a whole views China's IP protection regime as slowly improving. For the last decade, a slight majority of our members have reported no change in the IP enforcement environment in China, but a significant minority has reported seeing improvement, while only a fraction of members have reported deterioration. The 2018 survey results were consistent with this trend: 56 percent saw no change, 43 percent saw improvement, and one percent saw deterioration.

One positive development in recent years is the improvement in companies' ability to use China's various IPR enforcement channels. Those channels include administrative agencies, civil courts, criminal courts and China's recently-created special IP courts. Even with this progress, there are specific problems that our members note China needs to address. Unequal adjudication is among the signs of protectionism that companies reported in the 2018 survey, and this perception likely contributes to companies' decisions to pursue or forego pursuing cases. China's evidence collection requirements make it cumbersome to collect and preserve evidence, impacting companies' ability to cost-effectively challenge infringers. In addition, 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 adoption of a tougher deterrent against piracy. Currently, China maintains a system of thresholds that determine whether an IP violator will be subject to a fine versus the stronger deterrent of criminal sanctions. IP violators exploit these thresholds to avoid criminal sanctions. For those who get caught, paying a fine merely represents a cost of doing business and does little to deter piracy. China should adopt the stronger, WTO-consistent deterrent of criminal penalties in cases of commercial-scale infringement. Broadening the use of higher penalties and stronger deterrents in both civil and criminal cases against all types of IP infringement--including patent, copyright, trademark, and trade secrets violations--will 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 13 percent of USCBC member companies report that they have been directly 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. The issue is acute for affected companies, however, putting them in the position of making difficult choices about managing the tradeoffs of technology sharing and market access.

In sectors where 100 percent foreign ownership is allowed in China, foreign companies are generally not compelled to transfer their technology to a competitor, since any technology used in their China operations remains in the possession of the foreign company. 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 stipulate that the domestic company 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 an unbalanced negotiation for foreign companies seeking to enter the Chinese market. Chinese companies have an inherently stronger position over their foreign counterparts since a Chinese company's participation is required to form a joint venture or to provide the remaining equity in restricted sectors. As a consequence, a request for technology transfer made by a Chinese party in a business negotiation can reasonably be interpreted by foreign parties as a requirement for the deal to be successfully concluded.

The solution to address these concerns is obvious: China should eliminate joint venture requirements and foreign equity limitations. This would provide meaningful improvements for the affected sectors and bring China in line with its technology transfer-related 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 include requirements for the use of "secure and controllable" technology, which in effect mandates the purchase of such technologies by government or state-owned entities. Qualification requires sharing source code or other proprietary information. In addition, some provincial and local procurement policies continue to include preferences for products using “indigenous” innovation, frequently interpreted as meaning products made by Chinese companies. 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.

To address these concerns, it is critical that China’s cybersecurity regulations comply with its WTO commitments on nondiscrimination and national treatment. China’s central government should also continue to actively ensure that its commitments to treat IP owned and developed in other countries on an equal basis with IP owned or developed in China are being honored at both the central and local levels.

More generally, China should join the WTO’s Government Procurement Agreement and ensure that good and services provided by all legal entities in China are treated equally during procurement processes, regardless of ownership.

Transparency

China has made incremental progress towards increasing its commitment to transparency. The Chinese government’s move to require draft regulatory documents 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 take 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 in their ability to get accurate information on the status of licensing and patent applications, as well as their ability to participate in the standard-setting process, and to provide 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 according to USCBC’s 2018 member survey.

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

<u>State of the Trading Relationship</u>

Political risk associated with the bilateral relationship ranked number one in this year's survey for the first time, jumping up from its ranking of eighth in 2017. This is a significant change in view among US companies, as competition with Chinese counterparts has ranked as their top challenge since 2014. 73percent of companies report that their business operations have been affected by tensions between the US and Chinese governments.

US trade tensions are hardly limited to China. Within the last twelve months, the United States has been the subject of 21 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 have jointly voiced objections to US tariff plans at the WTO Council on Trade in Goods. In March, trading partners complained that the 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 the United States nor its trading partners should implement policies that parse WTO commitments into simply the letter of the rules, which could be outdated. 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.

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 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 the evidence detailed in the Section 301 investigation report, has been joined by five WTO members.

The recent initiative 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. We encourage the United States to undertake more actions that include this kind of cooperation.

Written Testimony Attachments

USCBC 2018 Member Survey Report

US-CHINA BUSINESS COUNCIL

2018 Member Survey

Executive Summary

Despite positive commercial gains in the last year, American companies have strong concerns about the increasingly rocky US-China relationship and implications for the business environment in China. American companies are less optimistic about China's policy direction and the trajectory of the bilateral relationship. They remain concerned about discriminatory industrial policies and the advantages enjoyed by Chinese companies. These issues raise questions about American companies' future competitiveness in the China market.

In this context, three major themes dominated the US-China Business Council's 2018 member survey outcomes:

US-China trade tensions are affecting American companies.

• 73 percent of companies report their business has been affected by current bilateral trade tensions.

• Companies report increased scrutiny from regulators and loss of sales due to both US and Chinese tariffs and uncertainty about supply chains.

Regulatory issues in China continue to be a significant challenge for foreign companies.

• Since 2009, when USCBC began asking about signs of protectionism in China, companies have regularly reported that they see favoritism for Chinese companies in China's licensing and regulatory processes. In 2018, almost 60 percent of respondents cite protectionism in licensing.

• While companies are generally still optimistic, China's policy and regulatory environment affect American companies' five-year business outlook for China.

• 88 percent of companies are concerned about China's preferential policies for domestic companies.

Despite these challenges, China remains an important market for American companies.

• Most American companies invest in China to access and compete for Chinese customers.

• China remains among the top priority markets for 90 percent of US companies, and most plan to maintain or accelerate their resource commitment to China in the coming year.

• China's government should not take that commitment for granted, however: China is no longer consistently outperforming other markets.

• If trade tensions begin to affect market access for American companies, or if alternative supply chains become a more effective way for companies to meet their business targets, investment may begin to shift to other markets that face fewer challenges.

Top 10 Challenges

1. US-China Relations
2. Competition with Chinese Companies in China
3. Licenses and Approvals
4. Data Flows
5. Human Resources
6. Uneven Enforcement
7. Innovation Policies
8. Cost Increases
9. Cybersecurity
10. IPR Enforcement

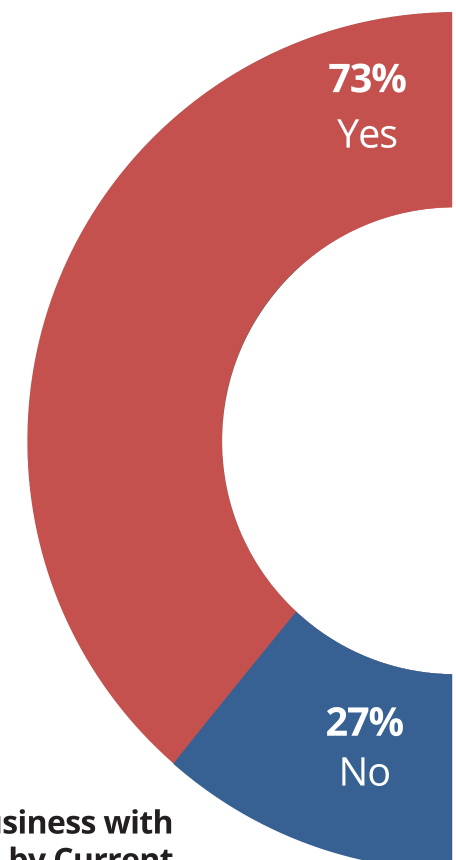
US-China Trade Tensions are Affecting American Companies

THE RELATIONSHIP BETWEEN THE US AND CHINESE GOVERNMENTS IS THE TOP CONCERN FOR A MAJORITY OF COMPANIES DOING BUSINESS IN CHINA – AND NOT JUST BECAUSE THE ISSUES ARE IN THE NEWS EACH DAY.

Political risk associated with the bilateral relationship ranked number one in this year's survey for the first time, jumping up from its ranking of eighth in 2017. This is a significant change in view among US companies, as competition with Chinese counterparts has ranked as their top challenge since 2014.

With significant tariffs imposed by both the United States and China, and various "qualitative" measures imposed against US industry in China, almost three-quarters of American companies report that trade tensions have affected their business operations in China. Unfortunately, the types of effects they are experiencing are not new, and they are not unique to any sector.

Since 2009, when USCBC began asking about signs of protectionism in China, companies have regularly reported that they see favoritism for Chinese companies in China's licensing and regulatory processes. This year, almost 60 percent of respondents cite protectionism in licensing. Further information on these issues is detailed in the next section of the report.



Has Your Company's Business with China Been Affected by Current US-China Trade Tensions?

Specific to the current bilateral trade tensions:

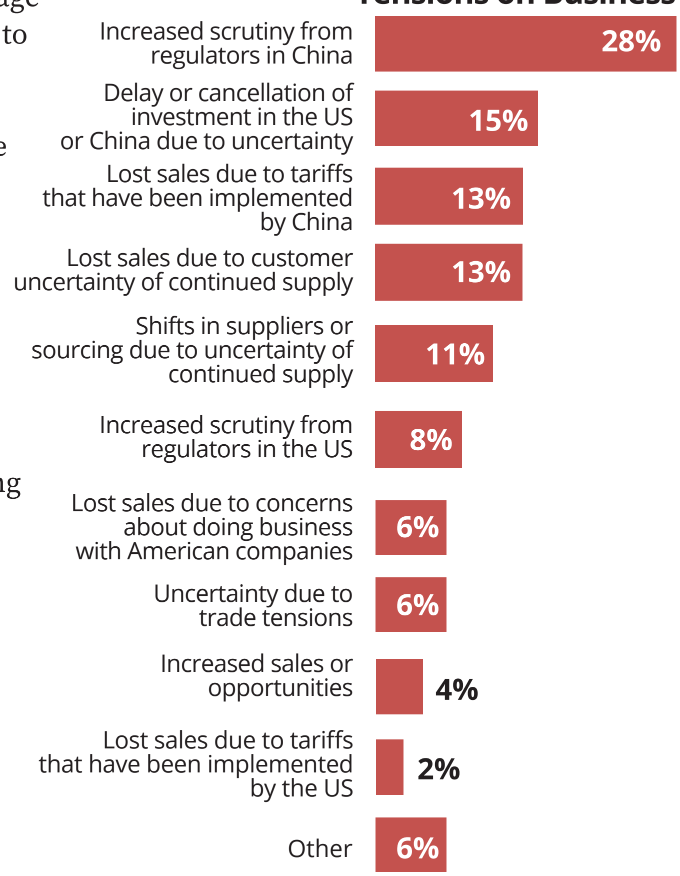
- 28 percent of US companies report that they have been subjected to increased scrutiny from Chinese regulators as a result of bilateral trade tensions; 8 percent report increased scrutiny from US regulators.
- 15 percent report lost sales due to tariffs – either imposed or threatened by the US and China.
- 15 percent note slowed, delayed, or cancelled investment in the United States or China due to the uncertainty from heightened tensions.
- 13 percent report lost sales due to customer concerns about continued supply, which has driven some of their business to other foreign competitors.
- 11 percent report making changes in their suppliers or sourcing due to uncertainties about continued supply.
- 6 percent report lost sales due to concerns among Chinese customers about doing business with American companies.

Even before the 2018 survey was conducted, USCBC called on the US and Chinese governments not to engage in retaliation, but instead to do the hard work needed to address these problems.

USCBC has also regularly called for China to eliminate the designation of Foreign Invested Enterprises (FIE) in China – a designation that invites discriminatory treatment in the market. In addition, changes are needed to China's regulatory process, which gives arbitrary authority toregulators that frequently lead to preferences for Chinese companies over foreign ones. That arbitrary authority can include regulators not "accepting" license applications when they are initially filed by foreign companies and instead seeking changes before the review process begins.

Addressing these issues will mitigate some of the problems that foreign companies face in China, and will also benefit Chinese companies and the overall Chinese economy.

Impact of US-China Trade Tensions on Business



Multiple responses allowed.

Regulatory Issues in China Continue to Be a Significant Challenge

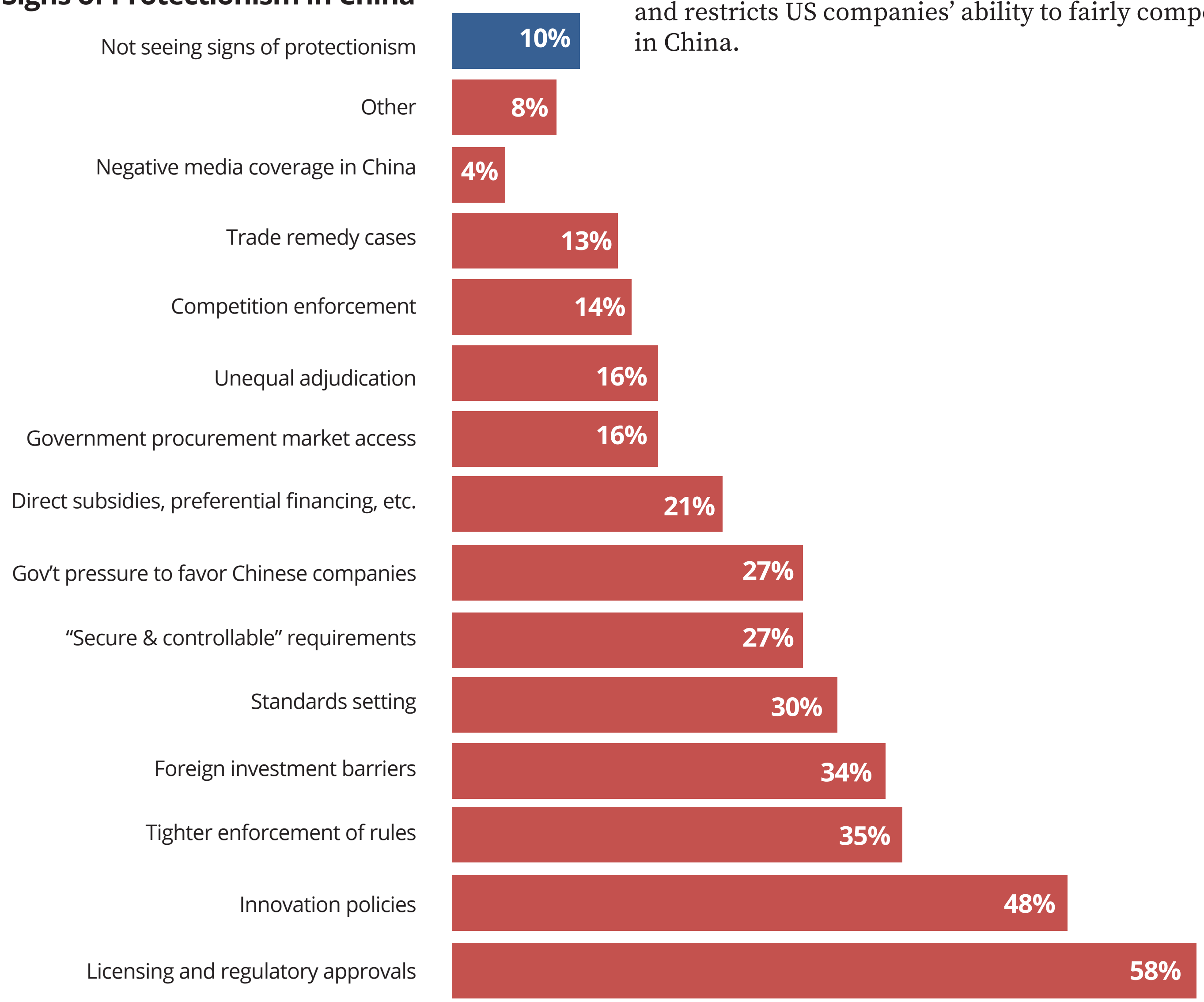
AMERICAN COMPANIES CONTINUE TO CITE REGULATORY ISSUES AMONG THEIR TOP CHALLENGES IN CHINA.

Of the top 10 issues identified in this year's survey, many involve circumstances in which American companies report that they are treated differently from their Chinese counterparts regarding licenses and approvals, regulatory enforcement, innovation policies, cybersecurity, and intellectual property rights enforcement.

Competition with Chinese companies ranked second in the survey, an issue that US companies regularly cite in USCBC's annual survey as including inherent discrimination in favor of domestic companies.

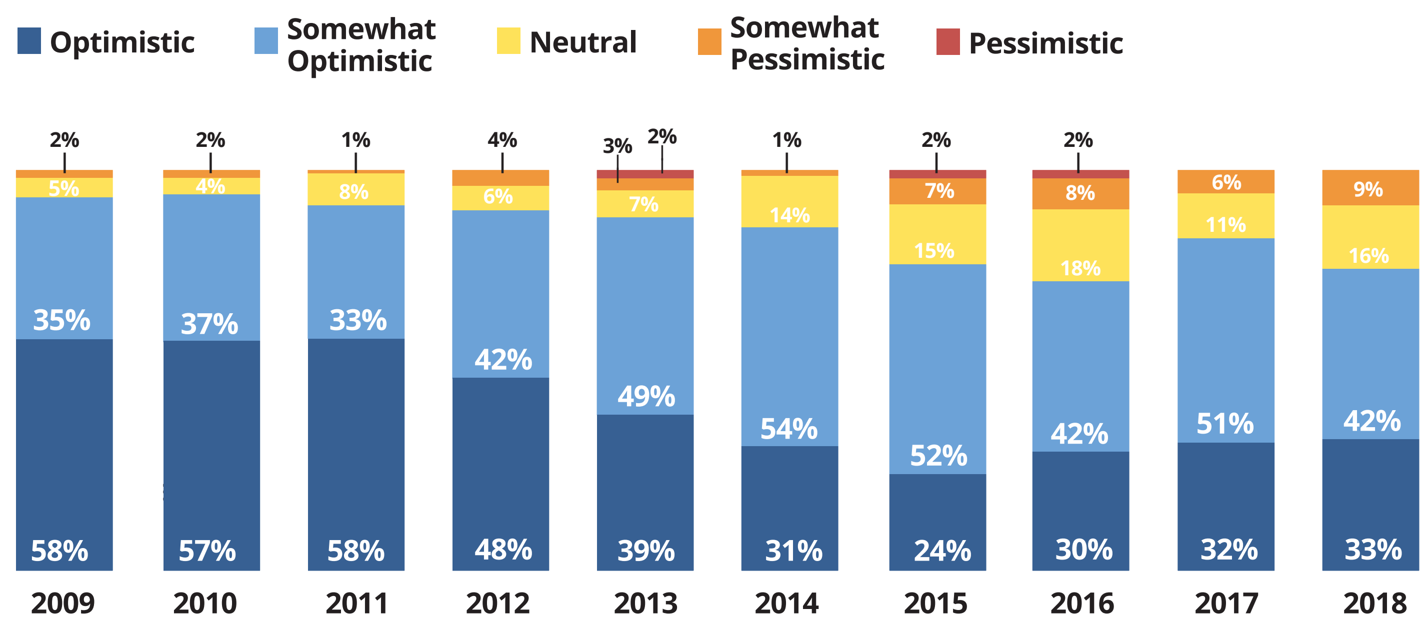
These issues are often rooted in protectionism. Many companies report that various actions and policies in China are calibrated in an effort to promote domestic companies at the expense of foreign ones. Increased regulatory scrutiny of American companies is yet another lever that can be used for protectionist purposes and restricts US companies' ability to fairly compete in China.

Signs of Protectionism in China



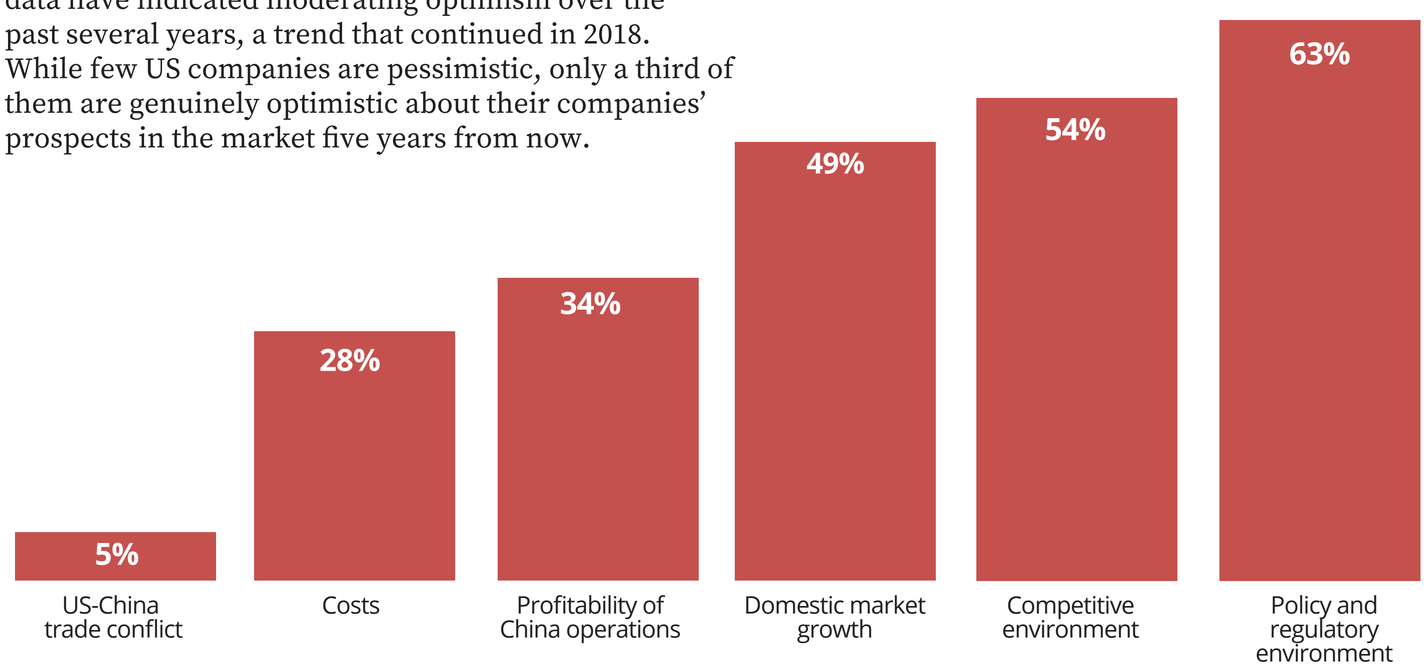
Multiple responses allowed.

View of the Business Climate in China Over 10 Years



Regulatory and competition challenges are not new for US companies, but they have a real effect on companies' ability to do business. These challenges are among the issues that companies cite as primary restraints on their profitability in China. Companies also frequently cite these issues as affecting their five-year outlook for business in China. USCBC survey data have indicated moderating optimism over the past several years, a trend that continued in 2018. While few US companies are pessimistic, only a third of them are genuinely optimistic about their companies' prospects in the market five years from now.

Issues Impacting Five-Year Outlook

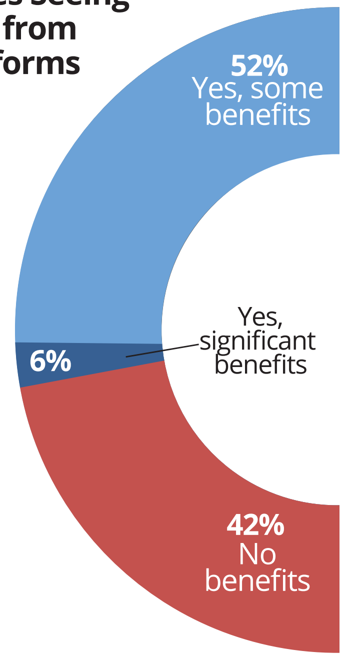


However, decreasing optimism is neither inevitable nor unsolvable. USCBC has regularly called for China to speed up implementation of its economic reforms, fully implement its pledges to improve IP protection, ensure equal treatment of foreign companies, and allow the market to play a stronger role in the economy. USCBC's survey again finds that most companies have seen only a few benefits from reform efforts to date.

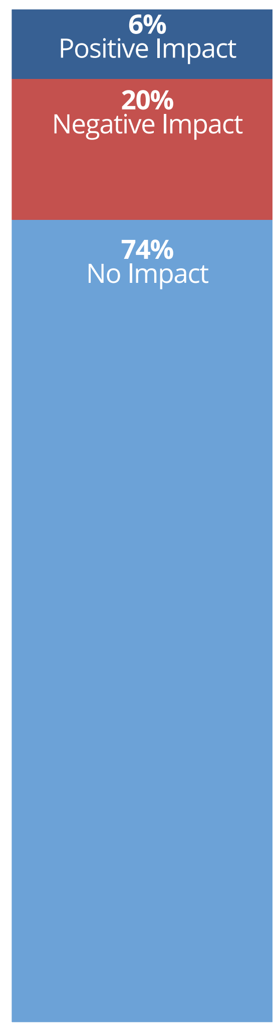
Implementing reforms that equalize treatment between foreign and domestic firms, improve IP protection, and address market-distorting factors that lead to unfair competition would be welcomed by foreign companies doing business in China and by China's trading partners. Such reforms would also provide a solid response to critics by demonstrating that China has embraced its position as the second largest – and soon to be largest – economy in the world. China's leadership also has regularly acknowledged that such steps are in its own economic interests.

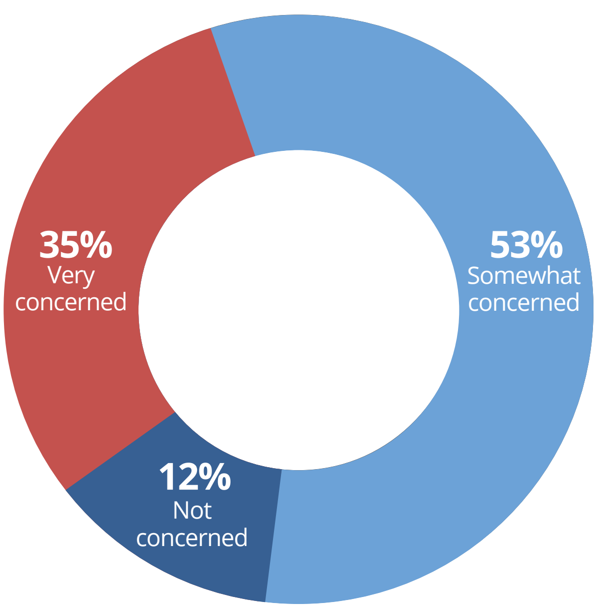
Most American companies are concerned about the preferences that China provides to domestic companies through innovation and manufacturing policies, though most have yet to see an impact specifically from Made in China 2025 (MIC2025). Those that do report being affected by MIC2025 describe more limited access to the sectors outlined in the plan and increased competition from Chinese companies that were not previously competitors.

Foreign Companies Seeing Tangible Benefits from PRC Economic Reforms



Has *Made in China 2025* Impacted Your Company's Operations?

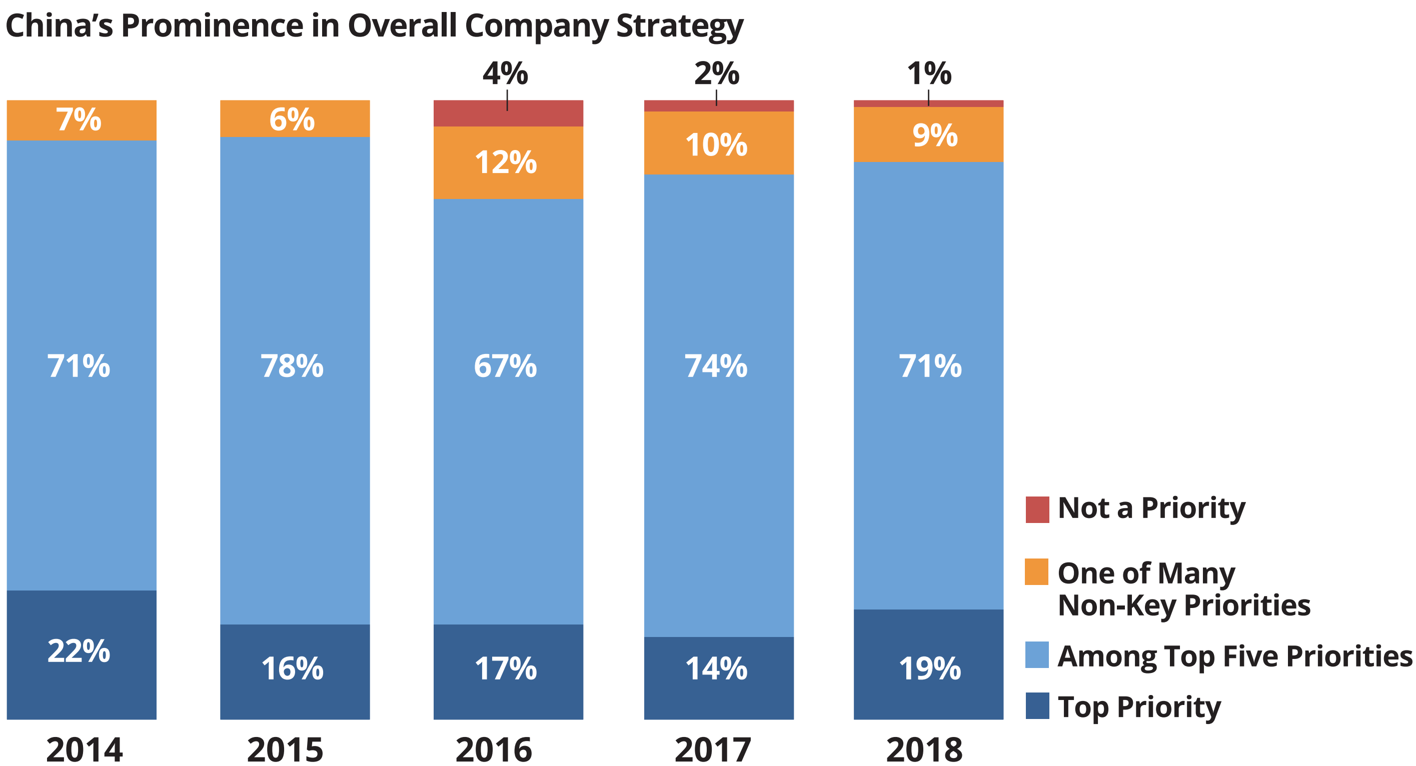




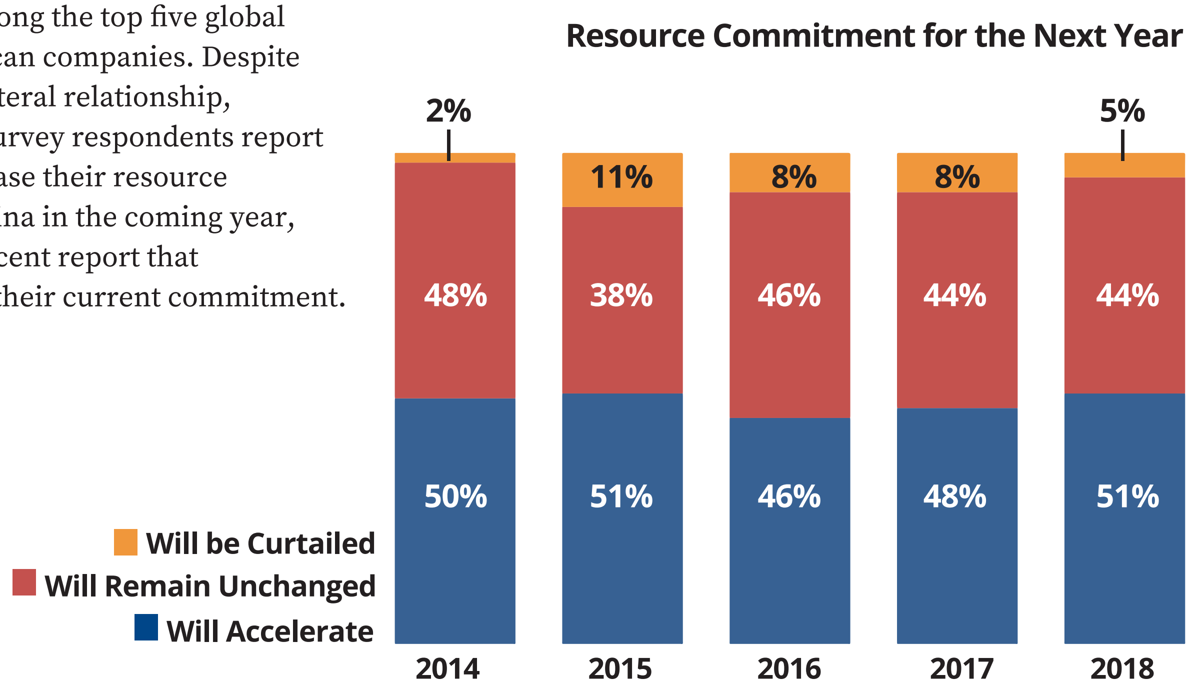
Level of Concern About China's Preferences for Domestic Companies

China Remains an Important Market for US Companies

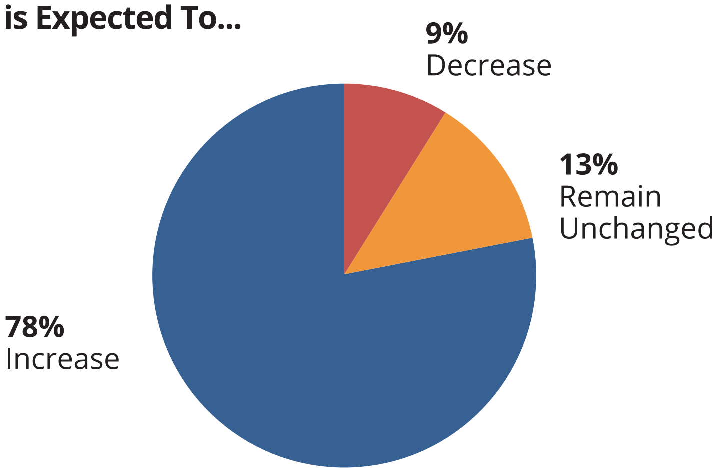
CHINA'S IMPORTANCE AS A MARKET FOR AMERICAN COMPANIES SHOULD NOT BE UNDERESTIMATED.



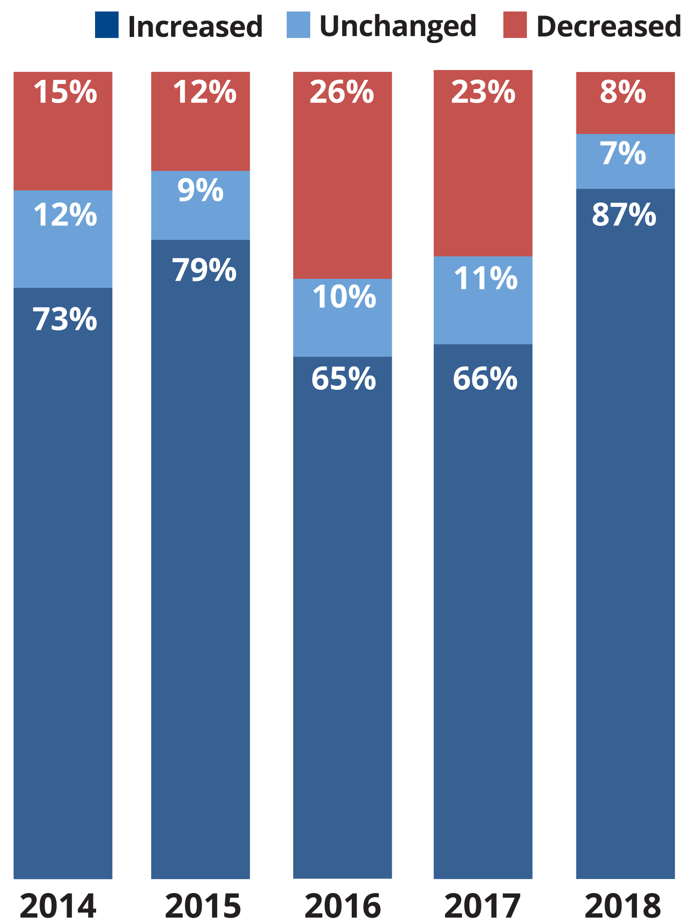
USCBC'S 2018 survey shows, yet again, that China continues to be among the top five global markets for American companies. Despite tensions in the bilateral relationship, half of this year's survey respondents report that they will increase their resource commitment in China in the coming year, and another 44 percent report that they will maintain their current commitment.



2018 Revenue from China is Expected To...



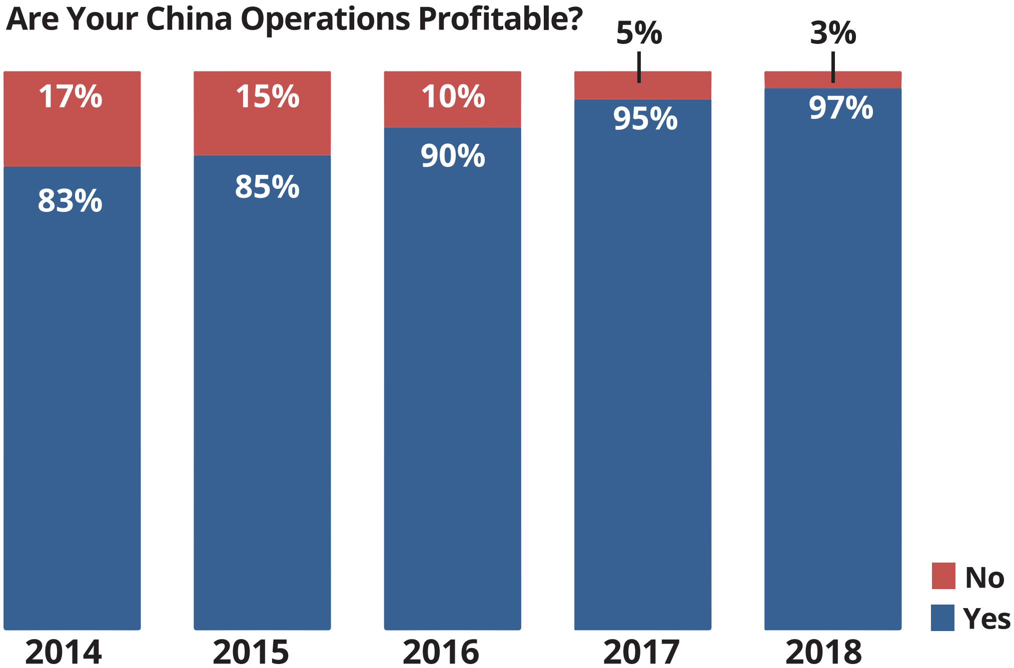
Revenue from China Business in Past Year



The priority that companies place on China versus other markets is due to its consistency as a revenue driver. The overwhelming majority of US companies report that their China operations are profitable.

The majority of companies also consistently report that revenue from their China businesses increased in the previous year, and most anticipate that revenue will increase in 2018, even in the face of trade tensions.

Are Your China Operations Profitable?

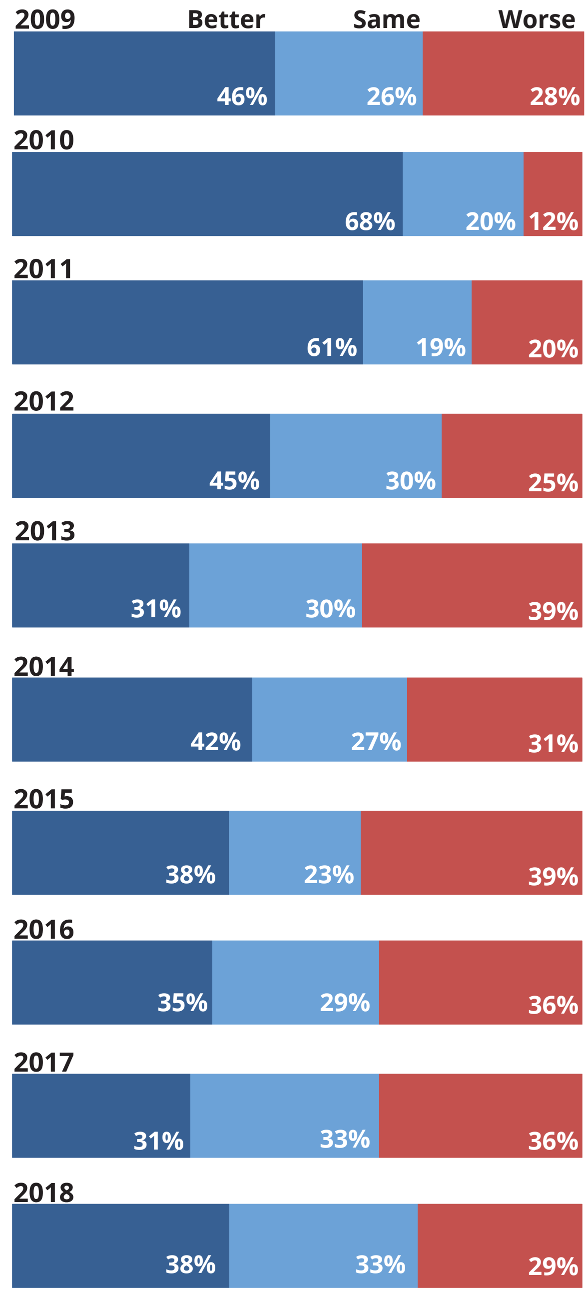


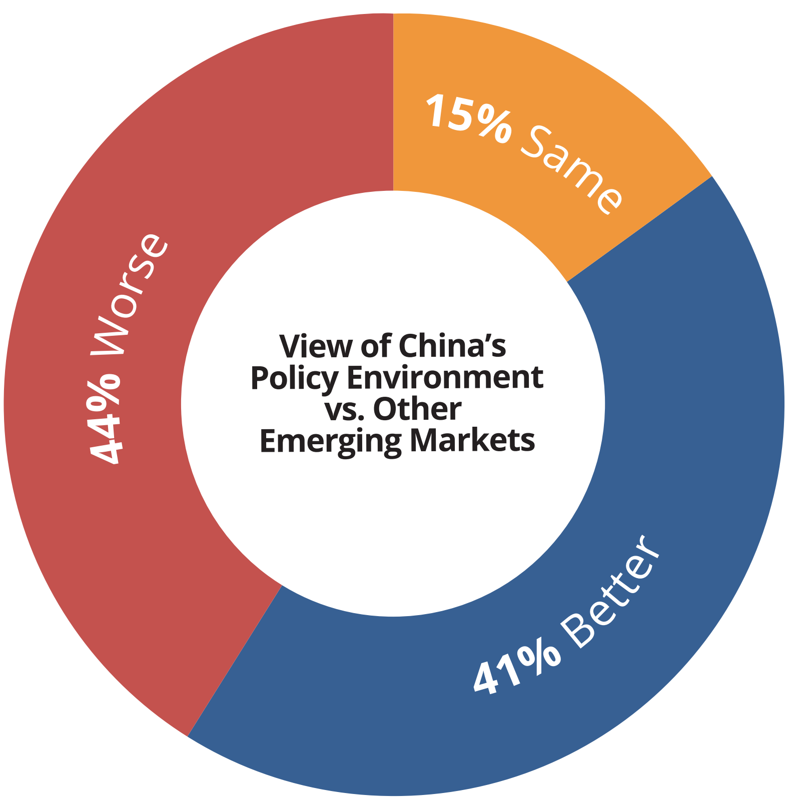
China's government should not take foreign companies' commitment to the market for granted, however. Companies report that revenue from their China businesses increased in the past year, but they also report that profit margins in China no longer consistently outperform overall company operations.

And while less than a quarter of respondents report that China's policy environment has gotten worse in the past year, more than 40 percent view China's policy environment as worse than that of other emerging markets.

If trade tensions begin to affect market access for American companies, or if alternative supply chains become a more effective way for companies to meet their business targets, investments may begin to shift to other markets that face fewer challenges.

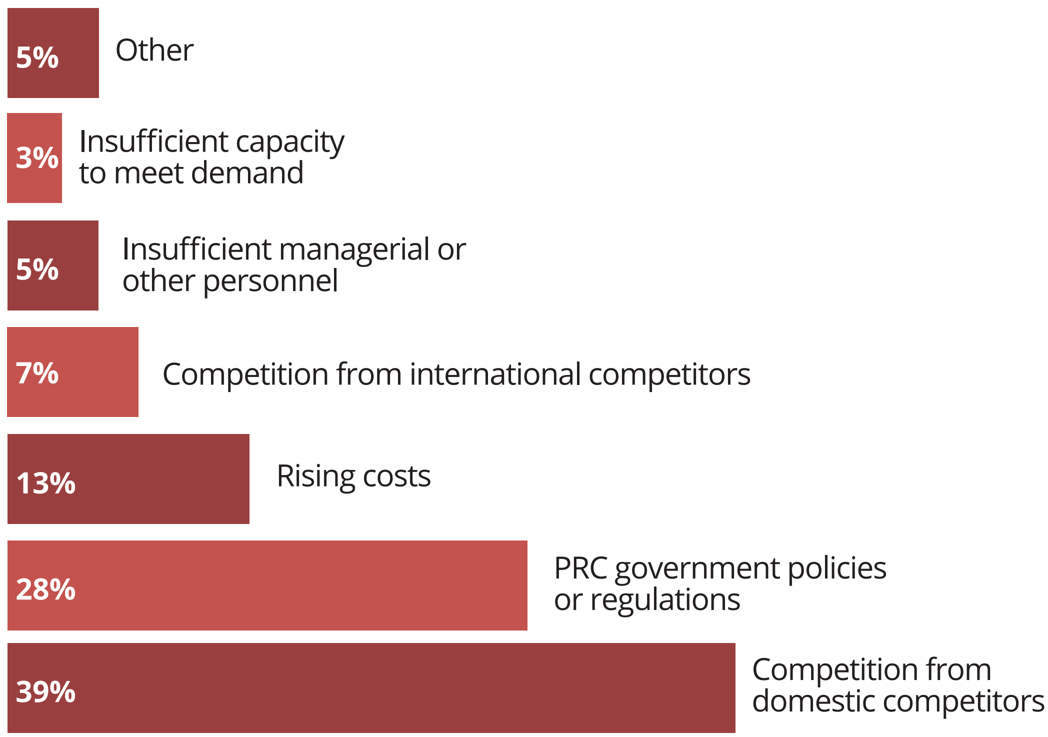
Profit Margin of China-Based Operations Compared to Overall Operations



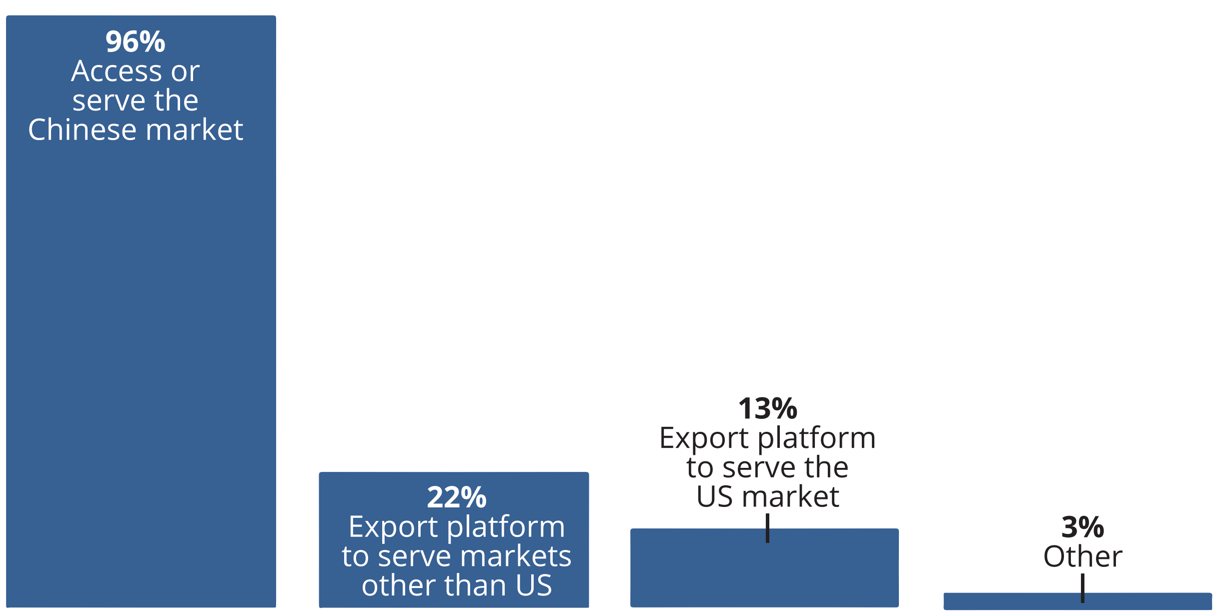


In the meantime, policymakers in both the United States and China should keep in mind why the vast majority of American companies invest in China: to access and compete in China for Chinese customers. Implementation of meaningful economic reforms could help address issues with access and competition, benefiting China's economy and Chinese consumers, and building confidence among companies operating in the market.

Primary Restraint on Increased Profitability



Objectives for Existing and Future Investments in China



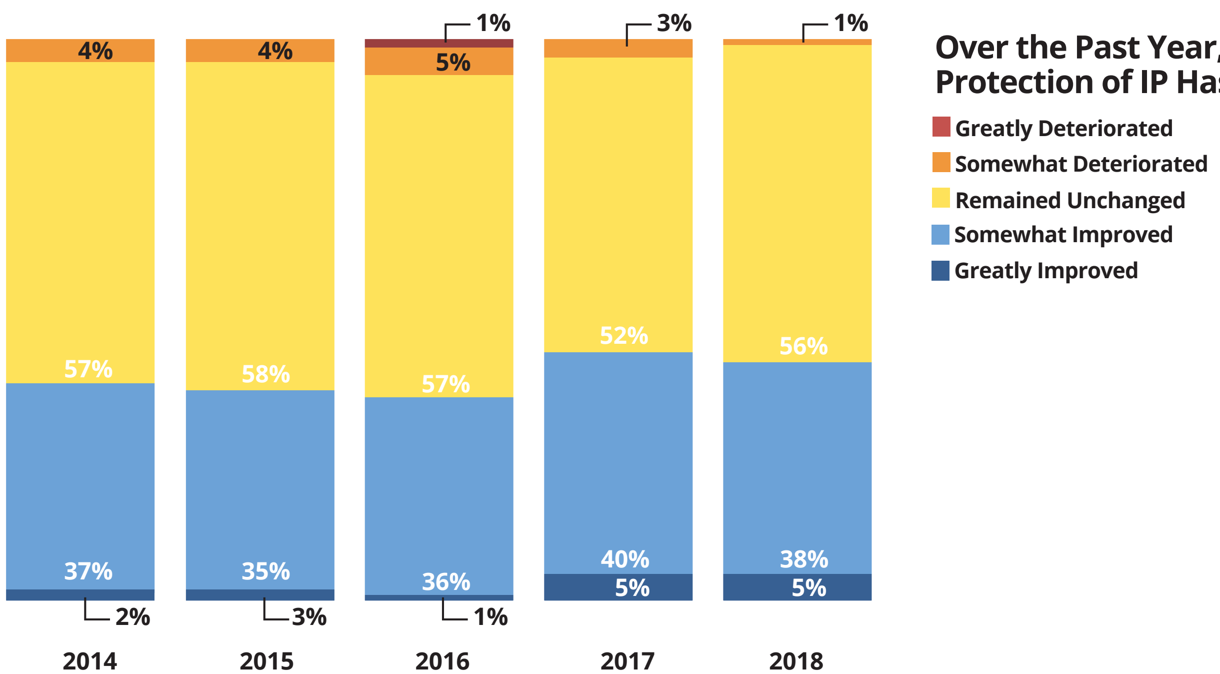
Multiple responses allowed.

Intellectual Property Rights

Intellectual property protection and technology transfer policies have received a great deal of attention in the past year due to the United States' Section 301 investigation.

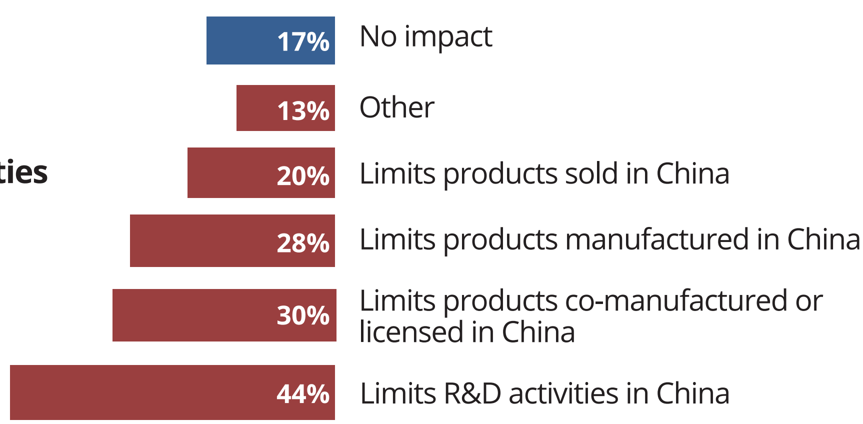
As in previous years, USCBC's 2018 survey finds that most companies report China's IP protection generally remains unchanged from previous years. Enforcement and protection continue to improve, but very slowly, and most companies continue to be concerned about these issues as they consider their operations in China.

Over the Past Year, China's Protection of IP Has...



Most companies report that their IP concerns curtail what they are willing to do in China. This is yet another lost opportunity for market and economic growth that could be addressed if genuine reforms were implemented. Such changes would also help reduce tensions between China and its major trading partners – something that industry would welcome.

Impact of China's Level of IP Enforcement on Types of Activities Companies Undertake in China

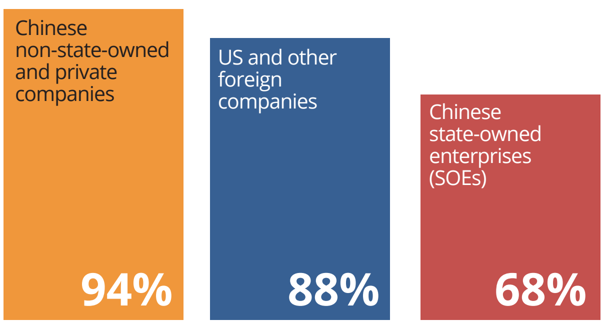


Multiple responses allowed.

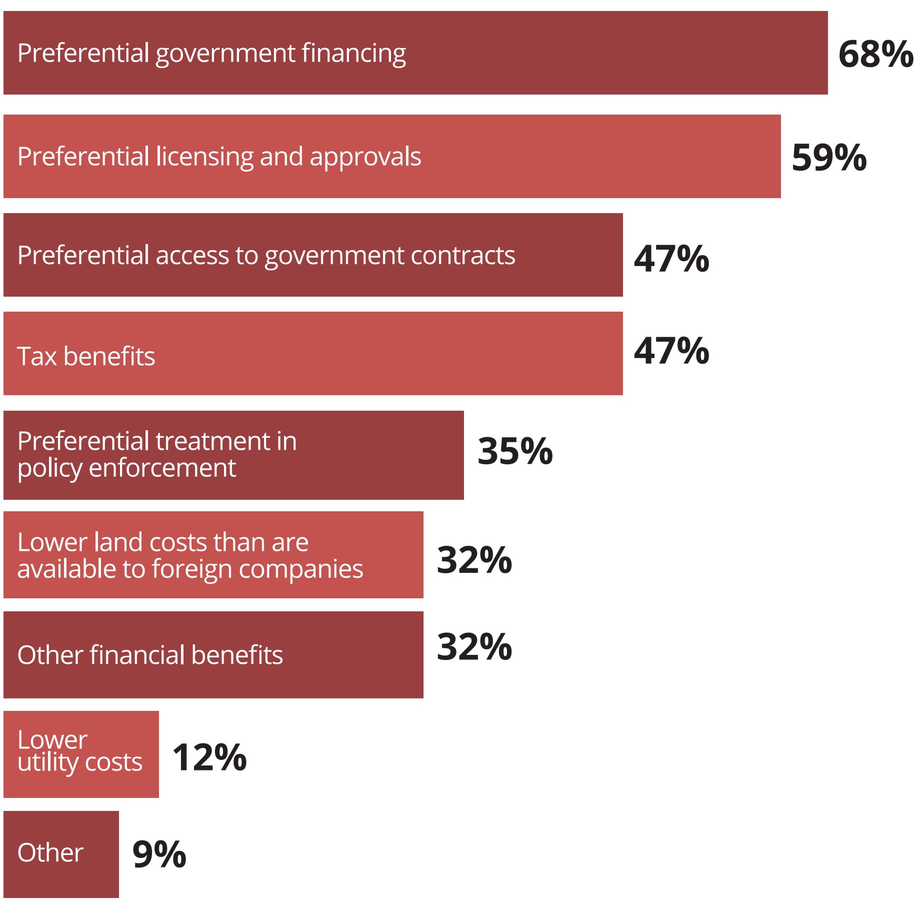
Competition with Chinese Companies

As in previous years, US companies report their top competitors in China are primarily Chinese private companies, followed closely by other foreign companies, though about 70 percent of companies compete with state-owned enterprises (SOEs). Companies report that they suspect or know their SOE competitors are receiving benefits not available to others. Those benefits include preferential access to financing, licensing, and government contracts, as well as tax incentives. Such preferences are not unique to Chinese SOEs, however: almost 70 percent of companies report that their privately owned Chinese competitors get similar benefits unavailable to foreign firms.

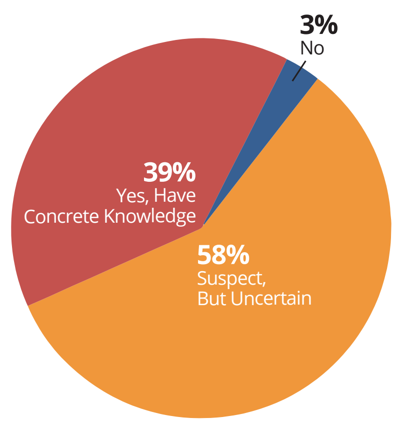
Who Are Your Competitors in China?



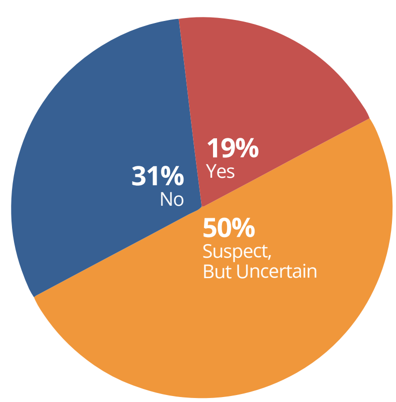
Types of Benefits SOE Competitors Receive



Are State-Owned Competitors Receiving Tangible Benefits?



Are Non-SOE Chinese Competitors Receiving Tangible Benefits?



Methodology

For the last 10 years, USCBC has annually polled its members on their business performance in China and their priority issues. This year's survey was conducted in June 2018 and reflects the input of roughly half of USCBC's 205 member companies. The Top 10 Challenges are calculated on a weighted basis, reflecting rankings by respondents of the most significant issues they deal with as part of doing business in China. The same methodology was used in previous years in order to ensure consistent analysis of the issues.

US- and China-Based Executives

USCBC's annual membership survey incorporates a unique mix of US- and China-based executives. Respondents were roughly equally divided between those based in China with an on-the-ground perspective, and those based in the United States, with a view of the China business environment from a global perspective. The remainder of survey respondents were located elsewhere in Asia. Several companies submitted responses reflecting multiple locations of their operations.

In addition, respondents ranged from CEOs of global corporations to executives based in the field. Survey results as a consequence incorporate both strategic and tactical perspectives.

Cross-Sector Representation

USCBC members who completed the 2018 survey represented a cross-section of US companies doing business in China. Fifty-five percent of respondents represented manufacturing companies, and 63 percent represented service providers. Many respondents' companies are active in both sectors.

Long Experience in China

USCBC member companies have a long history of doing business in China: 73 percent of respondents' companies have been in China for more than 20 years, and 20 percent have been in China for 11 to 20 years.