China's Implementation of its World Trade Organization Commitments

Written Testimony by the US-China Business Council
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Fifteen years after China joined the World Trade Organization (WTO), the global economy is very different. As part of its accession agreement, China's import tariffs were lowered from an average 14 percent to 6.5 percent. China agreed to open some— but not all— of its economy to foreign participation. The agreement also changed the way most American companies were able to do business in China, such as allowing companies to distribute and service their own products in China.

As the Office of the US Trade Representative (USTR) noted in previous annual reports, while China has fulfilled most of the specific obligations of the accession agreement, China has not implemented several important commitments. In addition, the "positive list" approach of the accession agreement only opened listed sectors— many with conditions— and left important sectors blocked from meaningful market access. It also meant that new areas not envisioned at the time of the accession negotiations were not covered by the agreement, such as electronic commerce and other online services. Furthermore, China's record of applying the spirit or principles of the WTO's tenets of national treatment remains problematic, and few additional sectors have been opened to foreign participation in the decade since the accession agreement's "roadmap" of obligations ran out.

There is a logical question that should be considered in this year's assessment of China's WTO implementation: is the world— and in particular, the American— economy better off since China's entry into the WTO 15 years ago? There are a few ways to assess 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. Fifteen years later, China's GDP is roughly $11 trillion, making it second only to the United States. 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.

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 at least a $400 billion market, putting it on par with Mexico as America's second-largest overseas market, behind only Canada. The US economy has also grown dramatically during that period, even when taking into account the global recession in 2009.

The bilateral trade deficit has also grown since China's accession, from $83 billion in 2000 to $366 billion last year. However, focusing on just the bilateral trade balance misses an important change in the pattern of trade. The East Asia (including China) share of the US global trade deficit was 67 percent in 2015; it was about the same— 68 percent— 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 our longstanding 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.

China 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—of the 19 cases filed (the latest was filed earlier this month), 10 cases were won by the United States and 4 were settled satisfactorily before a ruling was made.

On balance, China's WTO entry has been positive. China's economy is more open now than it was in 2000, even if too many market access barriers remain. The United States benefits from having a rules-based system through which China can be held accountable when it falls short of its commitments. At the same time, there are numerous policies implemented by China after WTO accession that appear to be done purely for the purpose of protecting or promoting domestic industry at the expense of foreign companies, which calls into question China's commitment to the WTO's national treatment principles.

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, some of the broader WTO principles have fallen short of implementation. In particular, national treatment and transparency remain challenging, as does consistent protection of intellectual property rights, even though USCBC's surveys show slow but steady improvement in this area.

National Treatment

The WTO's rules require member countries to treat domestic and foreign companies on an equal basis, known as national treatment. This is an essential principle for all companies doing business globally. However, in China, American companies continue to experience problems with discriminatory treatment.

China's leadership has stated repeatedly that it will treat domestic and foreign companies on an equal basis, but work still must be done to implement those commitments. There is a simple approach that would make a significant difference on national treatment: China's policymakers should move toward eliminating terminology in its 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. The better approach would be to treat equally all companies legally established under China's Company Law, regardless of ownership nationality.

Many outside observers assume China's economy is dominated by Chinese state-owned enterprises (SOEs). While many Chinese SOEs operate in the market and do dominate certain sectors, privately-owned Chinese companies are numerous and also present competitive challenges for American companies. Some Chinese companies thrive because they produce competitive, high-quality goods and services. At the same time, many Chinese policies and practices 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 2016 member survey.

Since these benefits are given to both domestic SOEs and private Chinese companies, policies to level the playing field for foreign companies should ensure equal treatment of foreign companies with 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 draft Cybersecurity Law, measures issued by the China Insurance Regulatory Commission and China Banking Regulatory Commission 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 to protect genuine security goals.

Discrimination also appears 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 the users of technology, 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— and despite China's commitments in bilateral meetings to that effect – only 6 percent of USCBC members report that these policies have positively affected their sales and operations in China. In contrast, 54 percent of companies view these policies as a strategic concern or have seen a significant negative affect from them.

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, it is important that regulations in these areas are 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 governments seek to limit how and where it occurs, or dictate technology choices.

Licensing
USCBC members regularly cite licensing as a top challenge for conducting business in China. Over the past decade, the issue has consistently ranked among the top 10 priority concerns in USCBC's annual membership survey. In the 2016 survey, licensing ranked third.

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. Depending on the industry sector, companies may need dozens of licenses to do business, and many of these licenses require frequent renewal. Fifty-five percent of American companies report that they have experienced licensing challenges during renewal processes in China. The inconsistency of licensing procedures across provinces and government agencies frustrates company operations. American companies often face challenges obtaining licenses that their domestic competitors do not.

Despite central government efforts to simplify or reduce the licensing burden on businesses, China's licensing reforms have yet to address most American companies' concerns. Seventy-two percent of companies in USCBC's survey have seen no changes and about 10 percent have seen negative results from licensing reforms.

Transparency
Regulatory and rule-making transparency remains a challenge in China, ranking fifth among top company concerns in USCBC's 2016 member survey. Transparency problems are not limited to the release of draft rules and regulations for public comment. As noted above, companies also face transparency challenges in their ability to get accurate information on the status of licensing applications, as well as their ability to participate in the standard-setting process, and to provide input on government regulatory developments.

Greater transparency is essential if China is to meet its own goal of developing a market-based, competitive economy. USCBC recommends that the Chinese government ensure all administrative regulations, departmental rules, and regulatory documents are posted on the designated State Council Legislative Affairs Office (SCLAO) information website comment page for at least a 30-day period, as per China's bilateral commitments and domestic laws and regulations. China should take a further step by permitting a longer comment period of 60 or 90 days to ensure high-quality comment contributions, and expand the scope of regulatory documents subject to the public comment process.

Anti-Monopoly Law
Many USCBC companies continue to report concerns about China's implementation of its Anti-Monopoly Law (AML), though some have seen improvements in the past year in the enforcement process. China should continue to build upon this progress and fully implement commitments on fair treatment and nondiscrimination, improve due process and regulatory transparency, and reduce time periods for merger and acquisition (M&A) reviews and the determination of remedies and fines. Ongoing and future antitrust investigations and M&A reviews should be transparent and nondiscriminatory, follow internationally-accepted due process procedures, and allow legal counsel participation.

Intellectual Property Rights
Over the 11 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 IPR protection, the issue remains a "top 10" concern 15 years after China's accession to the WTO.

This lingering problem carries an economic consequence for China: three-quarters of companies report that they hold back on investments in research and development and in manufacturing in China due to concerns about protection of their intellectual property. Those lost investments are lost economic growth opportunities.

While there is no single fix for the range of IPR challenges companies face, there are an array of specific steps China should take to improve the regulatory and enforcement environment. China should take steps to prevent IPR infringement before it occurs by adopting and implementing tougher deterrents. These steps should include increasing the level of fines and damages for IPR infringement, and replacing the current value-based thresholds for criminal prosecution with a system that applies criminal penalties for commercial-scale infringement, in line with WTO practices.

Additional steps China should take to improve IPR protection include:
- Increasing resources at the central and local levels to combat IPR infringement;
- Improving trade secret protection through legislative and enforcement reforms;
- Establishing and implementing clear and enforceable regulations and policies in IPR-related areas such as competition, standards, taxation, and R&D;
- Working with industry representatives to discuss outstanding issues with draft policies, such as the draft Service Invention Regulations, Patent Law, Copyright Law, and IP abuse regulations;
- Creating innovation and government procurement policies that do not discriminate against a company's IPR based on ownership;
- Restricting the use of compulsory licenses;

- Promoting better protection of trademarks and copyrights through traditional means and over Internet platforms; and
- Removing market access barriers to legitimate products, such as imported films.

Government Procurement

Despite a commitment to join the WTO's Government Procurement Agreement (GPA) at the earliest possible time, China has yet to do so 15 years after accession. The inability to implement this intention undermines China's credibility when it makes assurances that other issues will be addressed. Taking the necessary steps to accede to the GPA therefore would not only create mutually beneficial market access, but also serve as a confidence-building measure.

In the meantime, China should finalize the draft Administrative Measures for Government Procurement of Domestic Products with modifications recommended by USCBC to ensure that goods and services provided by all legal entities in China are treated equally during procurement processes, regardless of ownership. If appropriately revised, the rules would roughly parallel similar rules applied to Chinese companies in the United States.

The unfinished business of China's WTO entry—a high-standard US-China BIT

Much of the dissatisfaction 15 years after China's WTO entry has to do with what the accession agreement didn't cover. The overwhelming majority of American companies are doing business in China to access the Chinese market. However, China's continued restrictions on foreign investment in roughly 100 sectors effectively limit market access for American manufacturers, service providers, and resource and agricultural companies.

USCBC strongly supports the Obama administration's goal of completing a high-standard US-China Bilateral Investment Treaty (BIT). A high-standard BIT would pick up on the unfinished business of China's WTO entry and open sectors that continue to be fully or partially closed in the accession protocol. A high-standard BIT would also introduce additional enforceable measures on national treatment to address discrimination against American companies in China.

While the BIT negotiations proceed, USCBC continues to urge China to reduce foreign ownership restrictions prior to the enactment of a BIT. Doing so would help China meet its own economic transformation goals, such as developing the services sector of its economy. It would also help build crucial support in the United States for the BIT negotiations, which will be necessary for ultimate approval and implementation of the agreement by the US Senate.

US Commitments

While the task of the annual TPSC hearing is to evaluate China's implementation of its WTO commitments, it is important to note that the United States has a commitment that comes due in 2016 as well: ending the use of non-market economy (NME) calculations for antidumping cases, in line with the provisions of China's accession agreement. It is important that the United States honor the commitment made 15 years ago. If we fail to do so, we will be sending a message to China that it is acceptable to break WTO commitments— a message that it is not in our interests to send.

Some have argued that the accession agreement's provisions do not clearly require the United States to stop using the NME calculation. This legalistic attempt to avoid the commitment does not stand up to close scrutiny of the negotiating record. It is also contrary to the repeated statements that US officials have made on the record since the United States and China reached bilateral agreement on China's accession in 1999.

To be clear, USCBC does not believe that China should be declared a market economy at the end of this year, because it does not fully meet the criteria under US law. However, the accession protocol does not require the United States to declare China to be a market economy; it simply requires the United States to stop using its NME methodology in antidumping cases after December 11, 2016.

Fortunately, there is a solution that should allow the United States to continue to use special measures in cases where market distortions in China are leading it to dump products in the US market, yet still honor the commitment made 15 years ago. Last year's trade preferences bill grants the Commerce Department the authority to use an "alternative methodology" in cases where market distortions exist— be that in China or in any other country. Use of an alternative methodology would provide a means to address unfair pricing of exports from non-market based sectors and producers in China, such as those with overcapacity propped up by government support. Producer prices paid by American companies operating in China are in-country data that could possibly be used in the new methodology.

Conclusion

In closing, USCBC would like to reiterate a previous recommendation that could streamline the annual assessment of China's WTO compliance. Much of the information gathered for this compliance report is duplicative of what is compiled for the Office of the US Trade Representative's annual National Trade Estimate. We urge relevant policymakers to consider consolidating these statutory reporting requirements, particularly given USTR's limited budget and staffing. The purpose of conducting a regular review of China's compliance record would still be achieved by combining the reports, with the benefit of reducing costs and more efficiently using limited US government resources.

Please let us know if you have questions on the issues raised in this submission.

Attachments:

<u>USCBC Reports</u>

- US-China Business Council Board of Directors Statement of Priorities, January 2016
- Economic Reform Scorecard, February 2016
- Licensing Challenges and Best Practices in China, April 2016
- USCBC Annual Member Survey: Key Findings, August 2016
- Trade Facts: The US Trade Deficit with China, May 2016

- Trade Facts: China's Non Market Economy Status, July 2016

USCBC Comments on PRC laws and regulations

- Industry comments on CIRC Administration Regulations on the Informatization of Insurance Institutions, October 30, 2015
- USCBC comments on draft Antimonopoly Law Guidelines on Abuse of IPR, November 2015
- Industry comments on draft Patent Law, December 30, 2015
- USCBC comments on CFDA draft Measures for the Administration of Infant Formula Milk Powder Production Formulation, March 3, 2016
- USCBC comments on draft Anti-Unfair Competition Law revisions, March 25, 2016
- Industry letter on WTO TBT notification of China Insurance Regulatory Commission technology regulations, June 1, 2016
- Technology Security and IT in China: Benchmarking and Best Practices, July 2016
- USCBC comments on implementation of the Law on the Management of Foreign Non-Governmental Organizations Activities within Mainland China, July 4, 2016
- Industry comments on draft Cybersecurity Law, August 4, 2016