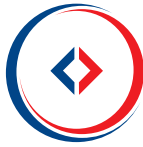


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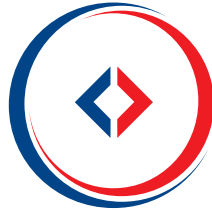
# USCBC 2013 China Business Environment Survey Results:

Tempered Optimism Continues Amid Moderating Growth, Rising Costs, and Persistent Market Barriers





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THE US-CHINA BUSINESS COUNCIL

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## USCBC 2013 China Business Environment Survey Results:

# Tempered Optimism Continues Amid Moderating Growth, Rising Costs, and Persistent Market Barriers

### Executive Summary

- » Slowing economic growth, rising costs, and persistent, unaddressed operating challenges in China continue to moderate corporate optimism toward the China market, though companies are decidedly not pessimistic. Fewer companies in this year's survey report that their profit margins in China are better than that of their global rates, and fewer companies report double-digit revenue increases compared to previous years.
- » Nonetheless, more than 90 percent of survey respondents report that their China operations are profitable, the highest percentage reported since the US-China Business Council (USCBC) began surveying its membership.
- » While a growing number of companies place China as one of the top five global market priorities, the number of companies that cited China as the top priority declined. Just over half of survey respondents plan to commit more resources to China in the next year, down from 67 percent in the 2012 survey.
- » Competition is intensifying. Most multinational companies in China contend with other foreign competitors as well as both state-owned and private Chinese companies. Survey respondents expressed concern over the benefits that Chinese companies (both state-owned and private) receive that are not available to foreign companies.
- » Problems with licensing occur at the central, provincial, and local levels and affect almost every aspect of doing business in China. Licensing issues often overlap with other issues in the top 10, including uneven regulatory implementation, lack of national treatment, and insufficient transparency in government rule drafting and decision making.
- » Investment and market access restrictions continue to be a priority concern for American companies operating in China, and one in which US and Chinese regulatory regimes diverge. Once a company invests and incorporates in the United States, it is treated as a US company under most laws and regulations. This is an approach that China should adopt as well.

### 2013 Top 10 Challenges

1. Cost increases
  2. Competition with Chinese companies in China
  3. [Tie] Administrative licensing
  3. [Tie] Human resources: Talent recruitment and retention
  5. Intellectual property rights enforcement
  6. Uneven enforcement or implementation of Chinese laws
  7. Nondiscrimination/national treatment
  8. Transparency
  9. Standards and conformity assessment
  10. Foreign investment restrictions
- » Lack of progress is a significant concern for a range of issues. Nine of the top 10 member company issues are characterized as "unchanged," suggesting that companies feel that little is being done to address their concerns.
  - » This year's survey also noted emerging challenges such as cybersecurity that affect a wide variety of companies. Progress on this issue will require government-to-government discussions and action.
  - » In order to be effective, government-to-government dialogue on any issue must focus on effective and practical solutions. The business community plays an important role in identifying the policies that are problematic and recommending ways to address them. USCBC has developed an array of recommendations to address concerns in the top 10 and beyond.

USCBC 2013 China Business Environment Survey Results:

**Tempered Optimism Continues Amid Moderating Growth, Rising Costs, and Persistent Market Barriers**

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**Table of Contents**

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Executive Summary ..... 1

USCBC 2013 China Business Environment Survey Results ..... 3

**Challenge 1.** Cost Increases ..... 8

**Challenge 2.** Competition with Chinese Companies in China ..... 9

**Challenge 3. [tie]** Administrative Licensing ..... 11

**Challenge 3. [tie]** Human Resources ..... 13

**Challenge 5.** Intellectual Property Rights Enforcement  
(trademark, patent, copyright, trade secrets) ..... 15

**Challenge 6.** Uneven Enforcement or Implementation  
of Chinese Laws and Regulations..... 17

**Challenge 7.** Nondiscrimination/National Treatment..... 17

**Challenge 8.** Transparency ..... 19

**Challenge 9.** Standards and Conformity Assessment ..... 20

**Challenge 10.** Foreign Investment Restrictions ..... 20

Other Issues of Interest ..... 21

Respondent Profile ..... 25

# USCBC 2013 China Business Environment Survey

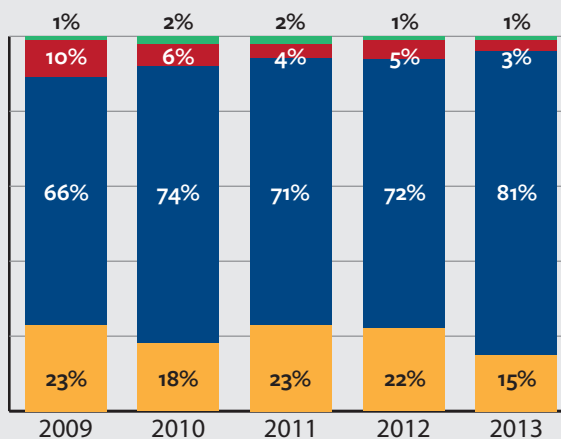
“**T**empered optimism” sums up corporate America’s view of the China business environment for the second year in a row. While most respondents to the US-China Business Council’s (USCBC) annual survey report that China remains among their company’s top five priorities, fewer respondents this year ranked China as their top priority. Moreover, for the second consecutive year respondents suggested that companies’ optimism about the prospects for the market in the next five years has moderated. Rising costs—particularly for labor—competition with Chinese companies, and challenges with the licensing and business approval process continue to rank as the top issues of concern to foreign companies doing business in China.

USCBC surveys its member companies each year to gauge the business climate in China and assess the top challenges of doing business there. As China’s economy has slowed over the past year—though still growing at strong rates compared to most other markets—USCBC’s survey results indicate that many companies face business and market access issues in a market that for the past five years has been a rare bright spot in a difficult global downturn.

## Still a priority market, but profitability and optimism leveling off

While 96 percent of survey respondents reported that China is among their top five priority markets for their company’s strategic investment planning—the highest response to this question over the past five years—fewer respondents labeled China as their top priority (Fig. 1).

**Fig. 1** How prominently does China currently figure in your company’s global strategic investment planning?

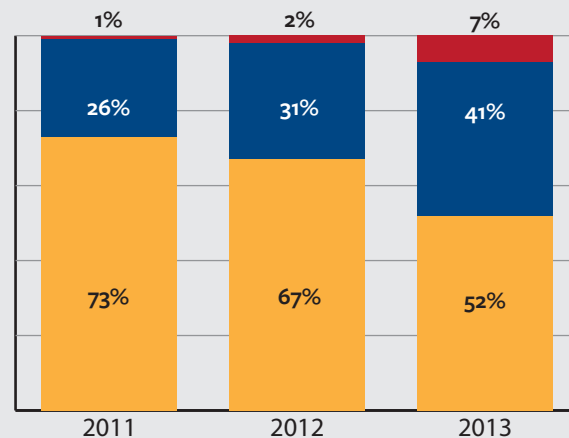


■ Top priority  
■ Among top five priorities  
■ One of many non-key priorities  
■ Not a priority

Other data indicate a similar tempering of expectations for the market compared to previous years:

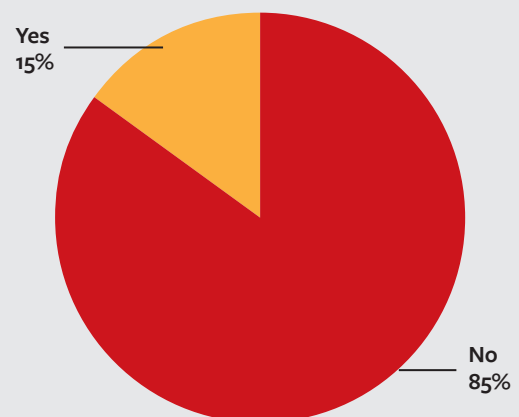
- » Just over half of respondents indicated that they will accelerate their resource commitment to China in the next year, reflecting a continued year-on-year decline since 2011 (Fig. 2).
- » Fifteen percent of companies reported that they had reduced or stopped planned investments in the past year (Fig. 3). Of those that reduced or stopped their investments, nearly 40 percent cited overall global economic uncertainty as the primary driving factor rather than China concerns. But nearly a quarter cited market access restrictions.

**Fig. 2** Resource commitment to China for the next 12 months

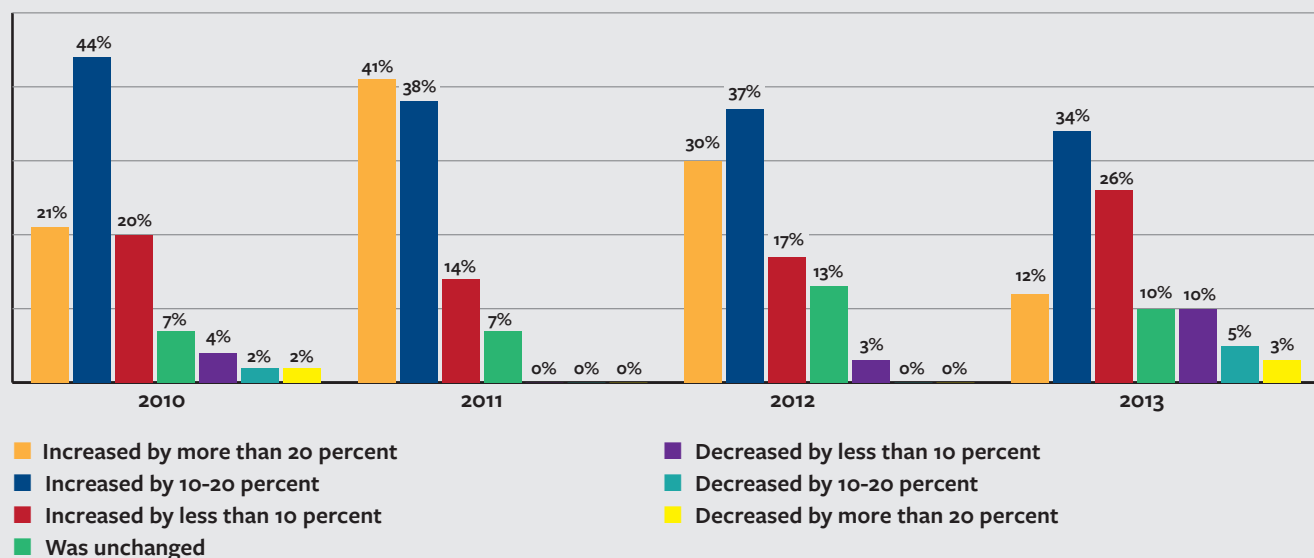


■ Will accelerate  
■ Will remain unchanged  
■ Will be curtailed

**Fig. 3** Did your company reduce or stop planned investment in China in the past year?



**Fig. 4 Revenue from China business compared to the previous year**

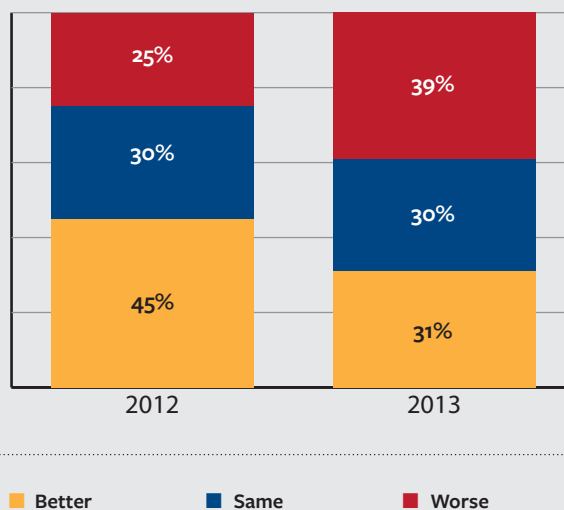


» Almost three-quarters reported that their revenue from China businesses increased in 2012, but explosive revenue growth has tapered off. Those reporting sales increases of 20 percent or more dropped from 30 percent in last year's survey to just 12 percent this year. Moreover, while nearly half of respondents reported double-digit revenue growth, the number of companies seeing sales rise by 10 percent or more declined for the third year in a row (Fig. 4).

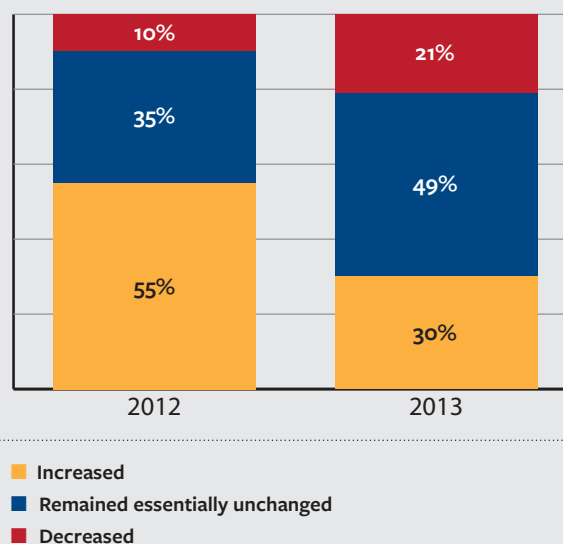
» Sixty-one percent of respondents report that their China operations have profit margins greater than or equal to their company's global profit margins, down from 75 percent in the 2012 survey (Fig. 5).

» Profitability was another area of decline: less than one-third of respondents said their profitability increased from the previous year, while the number that reported decreased profitability doubled from 10 percent to 21 percent (Fig. 6).

**Fig. 5 Profit margin rate of China-based operations in 2013, compared to the company overall**



**Fig. 6 Profitability in 2013 compared to previous year**



These factors, along with the challenges discussed later in the top 10, are moderating companies' assessments of the China market. Since 2007, around 90 percent of respondents consistently reported that they were optimistic or somewhat optimistic about China's prospects for the next five years. While this year's survey shows a similar but slightly lower response rate in those two categories (88 percent), this year's results affirmed an important change that emerged in last year's survey — a shift of nearly 20 percentage points from "optimistic" to "somewhat optimistic" over the past two years (Fig. 7).

Many companies have growing concerns about the business environment in China. As one respondent explained, "It is getting more and more difficult for foreign companies in China, with the cost hikes (both material and HR), with the economic downturn, overcapacity in China, and a gloomy global economy."

Not all of the top issues reflect policy choices — but many of them do, as this report will describe. The active economic reform debate underway in China provides an opportunity for PRC policymakers to take positive steps to further remove discriminatory barriers and allow American companies to more fully support and participate in China's economic transformation.

## Restraints on profitability; overlapping challenges to doing business in China

The moderation of optimism is due to a combination of factors. Most prominently, greater competition, cost increases, and enduring problems with obtaining the variety of licenses necessary to do business in China are hindering investors' abilities to access and compete fairly in the market. These three issues ranked highest as the primary restraints on increased profitability (Fig. 8).

In addition, signs of protectionism in China negatively impact companies' views of the market. Respondents most frequently claimed to have experienced protectionism in licensing and regulatory approvals, while also noting discriminatory enforcement and preferential policies favoring domestic Chinese companies in many forms (Fig. 9).

Fundamentally, there continues to be a significant difference in how foreign companies are treated, both formally and informally, versus their domestic Chinese counterparts. As one respondent noted, "As long as the term 'foreign-invested company' exists [in Chinese policies and regulations], the competition will not be very fair and the discrimination will exist in some way." In other words, there is an inherent element of bias in the system.

Fig. 7 Five-year outlook

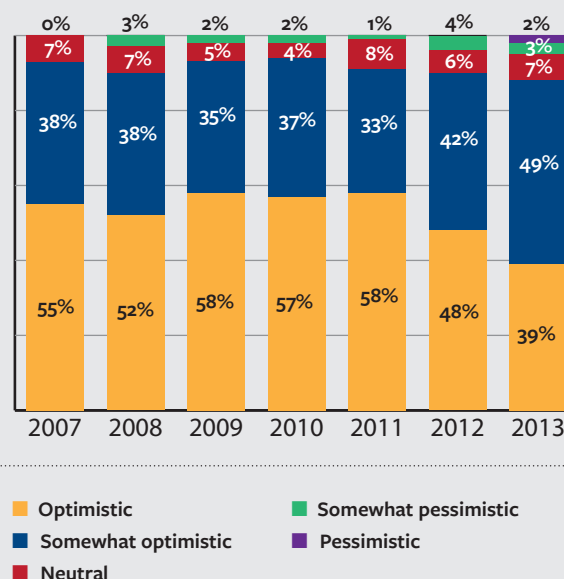


Fig. 8 Primary restraints on increased profitability in China

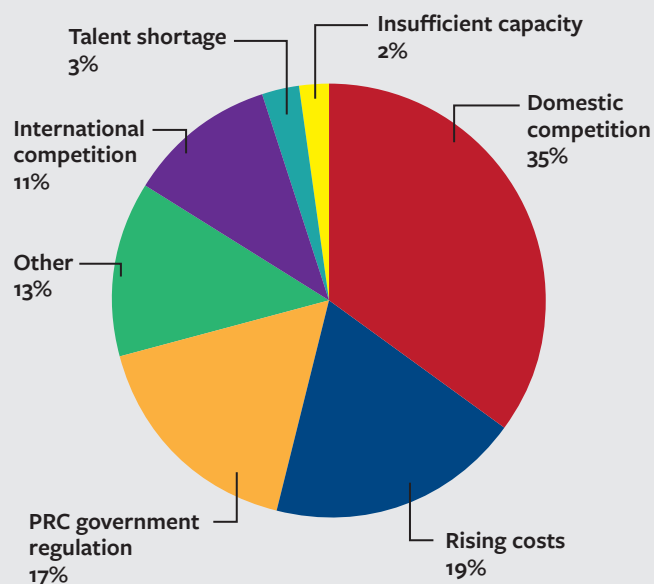
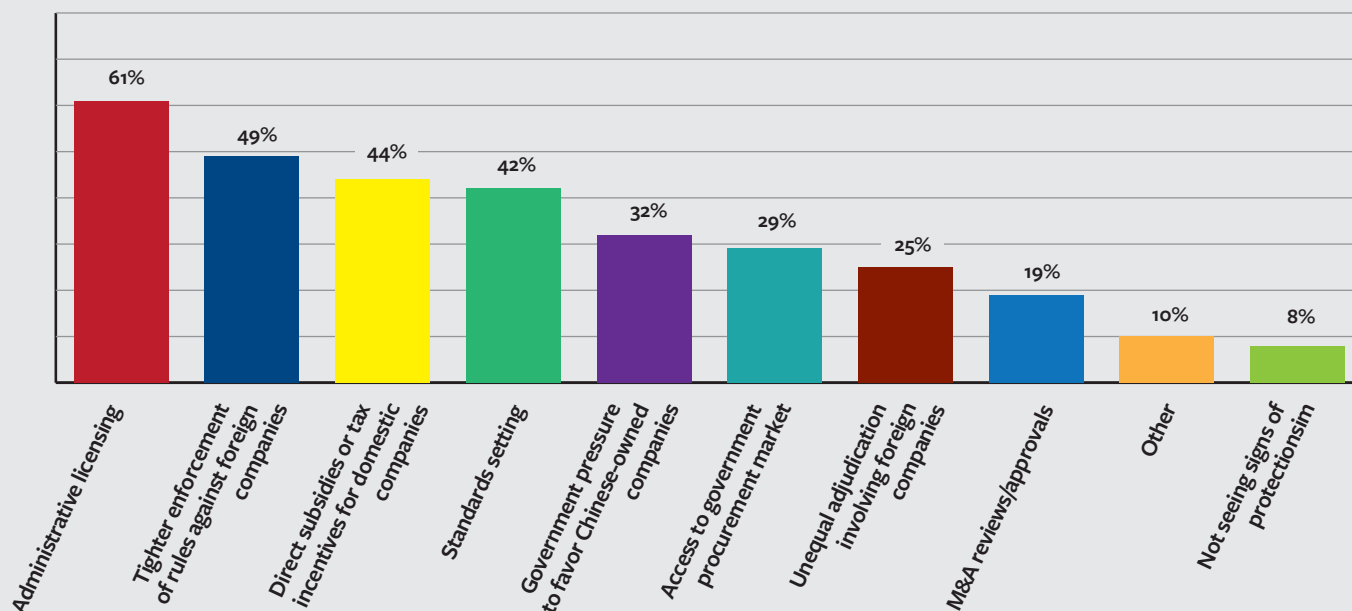


Fig. 9

## Signs of protectionism in China



Multiple responses allowed.

That bias shows up in numerous ways, many of them overlapping. While each of the top 10 challenges could stand on its own, these issues magnify each other and often make resolution of the problems more complicated:

- » Competition with Chinese companies (#2), licensing and approvals (#3), uneven enforcement (#6), inadequate transparency (#8), standards and conformity assessment regimes (#9) and foreign investment restrictions (#10) are all channels through which companies may experience discrimination or unequal treatment (#7).
- » While human resources challenges (#3) are a significant contributor to cost increases (#1), cost increases are also driven by other factors that can reflect discriminatory practices, including cumbersome or lengthy licensing processes (#3), uneven enforcement of laws and regulations (#6), and lack of transparency (#8).
- » The absence of intellectual property rights (IPR) protection (#5) is often exacerbated by uneven regulatory implementation across jurisdictions (#6) and lack of transparency (#8).

### Lack of movement on top issues a significant concern

It is also worth noting that most respondents indicated that there had been no improvement on each of their top concerns. Nine of the top 10 member company issues are categorized as “unchanged.” This suggests an additional reason for companies’ tempered optimism: there is a general sense that while the rhetoric of Chinese policymakers regarding improving the investment environment for foreign firms has been positive, in recent years little has been done to address their major concerns.

Ultimately, the solution to these problems will have to include a change of approach by China’s government to foreign investment in its country. Companies incorporated in China should be treated equally, regardless of ownership. Once a foreign company invests and incorporates in the United States, for example, the resulting US entity is treated the same as any other US company under US laws and regulations. This approach is one that China should adopt as well.



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## What's not in the top 10

It is useful to keep in mind the issues that did not make the list of top 10 challenges for companies doing business in China. Many of them are topics that frequently receive widespread media attention in the United States.

Cybersecurity moved up significantly in the overall rankings this year to 14th, up from 23rd in 2012. Challenges cited in this area include the impact of Chinese cybersecurity inspections, restrictions on the use of foreign computer security products in China, the risks of potential trade secrets theft, and the impact of political discussions about cybersecurity on the overall US-China bilateral relationship.

The inability of service sector companies to fully access the China market ranked 13th overall, but jumped to the #2 issue when answers were filtered to show responses only from services companies. Other top concerns of services companies mirror those of non-services respondents—licensing barriers, competition with Chinese companies, discriminatory treatment, and human resources.

At the bottom of the list again this year: China's exchange rate. The impact of the renminbi (RMB) exchange rate on competitiveness and the political aspects of China's currency value ranked 29th and 30th in this year's survey—the lowest rankings possible. This strongly indicates that meaningful bilateral engagement to address concerns American companies face when doing business in China should focus on topics other than currency.

## Pursuing solutions

USCBC estimates that China was roughly a \$300 billion market for American companies in 2012—and could have been much larger without the market access barriers. China is the third-largest market in the world for US exports. Companies with operations in China sell more than \$130 billion in goods and services there. Those operations continue to support jobs for companies here in the United States. And despite China's lower growth rate, its economy is still growing at more than 7 percent per year, with a middle class set to double to 600 million persons over the next decade. As a consequence, China is—and should continue to be—an increasingly important component of economic growth and jobs in the United States.

Those numbers underscore why reducing market access and other barriers in China is so important. Progress on the issues is often frustratingly slow. Nonetheless, the business community and policymakers must continue to seek practical solutions through expanded engagement.

Both the US and Chinese governments need to be involved in order to fully develop commercial ties, tackle unresolved problems, and bring greater benefit to each country's economy, companies, employees, farmers, and consumers. This requires high-level engagement from both countries through the current dialogue structure, including the US-China Strategic and Economic Dialogue (S&ED), the US-China Joint Commission on Commerce and Trade (JCCT), and the US-China Investment Forum. Consistent engagement at the presidential level has also been beneficial to the relationship, and perhaps should be formalized into an annual summit.

The business community must play an important role in identifying the policies that are problematic and recommending specific ways to address them. USCBC has recommended steps that China can take to address the kinds of concerns in the top 10, including market access in legal services,<sup>1</sup> improving enforcement of intellectual property rights (IPR),<sup>2</sup> and increasing imports of foreign goods and services into China.<sup>3</sup> In addition, USCBC's board of directors' statement of priorities provides additional recommendations on issues of importance to US companies.<sup>4</sup> USCBC will continue to use this solutions-focused approach in its advocacy with both governments.

Beyond the specific problems on which foreign companies seek progress, China's leaders should be concerned about the downturn in optimism and take steps to address the persistent concerns that recur in the top 10. These issues not only negatively impact companies' business decisions about China, but they also dampen enthusiasm for supporting Chinese investment in the United States. As Chinese companies seek a greater role in the United States and globally, there should be an increasing appreciation of the need to reduce barriers. This year's survey results and weakening foreign investment into China over the past two years should provide sufficient data to serve as a catalyst for new policy breakthroughs in China.

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1. Legal Market Access Issues in China, February 2013. <http://uschina.org/sites/default/files/legal-market-briefer.pdf>

2. USCBC Intellectual Property Rights Review and Recommendations, May 2013. <http://uschina.org/sites/default/files/ipr-recommendations.pdf>

3. Rebalancing the Economy: Practical Ways That China Can Increase Imports and Boost Consumption. <https://www.uschina.org/policy/rebalancing-economy-practical-ways-china-can-increase-imports-and-boost-consumption>

4. USCBC Board of Directors' Statement of Priorities in the US-China Commercial Relationship, January 29, 2013. <https://www.uschina.org/reports/priorities-thu-05302013-1325>



# Challenge #1

## Cost Increases

### Progress on Issue in Past Year: Deteriorated

Rank in 2012:	4
Rank in 2011:	3
Rank in 2010:	5
Rank in 2009:	13
Rank in 2008:	3
Rank in 2007:	Unranked
Rank in 2006:	Not asked

Rising costs have been a concern in China for many years, but this year's survey suggests that the increases may have outpaced company expectations of tolerable expense increases. This is the first time rising costs have ranked number one in USCBC's survey and it is the only issue characterized as having "deteriorated" over the last year.

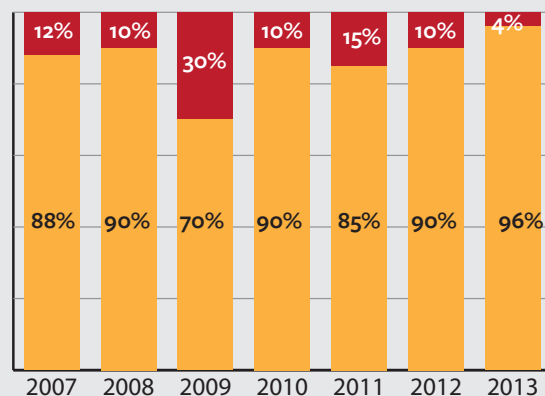
As one company put it, "Costs, particularly in major metropolitan areas, are moving to a point that China is no longer world-competitive."

The vast majority of respondents have expressed concern about rising costs since the question was first asked in 2007. Only in 2009 as the global recession was at its height and wage pressures eased did that number dip below 80 percent (Fig. 10).

Human resources costs have consistently been the specific cost of most concern, reaching 92 percent in this year's survey; a further discussion of those issues can be found under human resources (#3). Concerns about materials and land costs also increased this year; concerns in all other areas decreased (Fig. 11).

Fig. 10

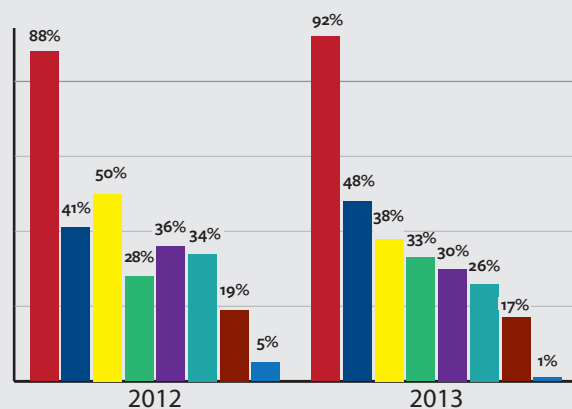
### Are rising costs for your company's operations in China a concern?



Yes No

Fig. 11

### Top cost concerns



Human resources  
Materials  
General inflation  
Land purchase or rental  
Rising tax burden  
Energy & utilities  
Payroll taxes/insurance fees  
Other

Multiple responses allowed.

## Challenge #2

### Competition with Chinese Companies in China

#### Progress on Issue in Past Year: Unchanged

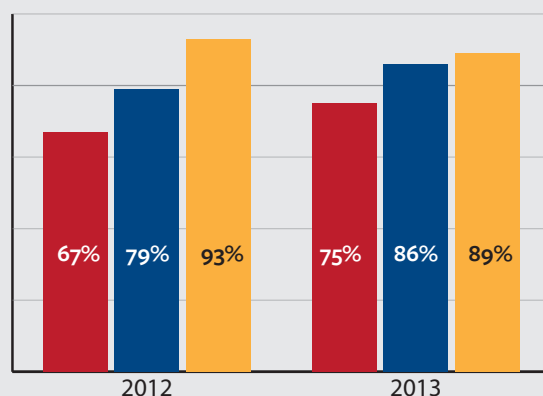
Rank in 2012:	3
Rank in 2011:	4
Rank in 2010:	1 (tie)
Rank in 2009:	4
Rank in 2008:	7
Rank in 2007:	4
Rank in 2006:	4

As has been the case in past USCBC surveys, most companies report that they have a variety of competitors in China, including Chinese state-owned enterprises (75 percent), Chinese non-state-owned and private companies (86 percent), and US and other foreign companies (89 percent) (Fig. 12).

The soft global economy and slowing growth in China's domestic economy has only served to make the competitive environment in China more intense. As one respondent said, "Local competition is gaining strength in the slower economy." Chinese companies are certainly improving their product and service offerings as they gain more experience. However, a slower-growth economy with a more competitive landscape also shines a spotlight on practices that may place foreign companies at a disadvantage when compared with their domestic counterparts, such as opaque licensing procedures, discriminatory treatment, and restrictions on foreign investment.

As noted in last year's survey supplement, most respondents feel that China's SOEs receive benefits or other favorable treatment not available to foreign-invested companies. Only about one-third have concrete knowledge that such benefits are provided to SOE competitors, while nearly two-thirds suspect such benefits are provided – underscoring the transparency problem (Fig. 13).

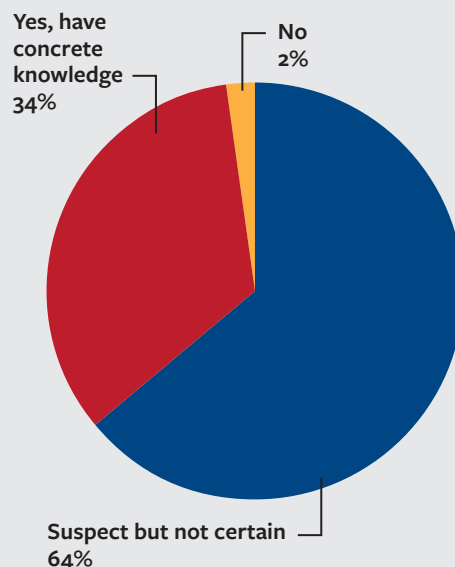
Fig. 12 Who are your competitors in China?



■ Chinese state-owned enterprises (SOEs)  
■ Chinese non-state-owned & private companies  
■ US and other foreign companies

Multiple responses allowed.

Fig. 13 Are SOE competitors receiving tangible benefits?



Also like last year, it is important to note that respondents believe their non-SOE competitors receive such benefits. Almost three-quarters of respondents reported that they know or suspect that their private Chinese competitors also receive benefits or subsidies that foreign firms are not able to receive (Fig. 14).

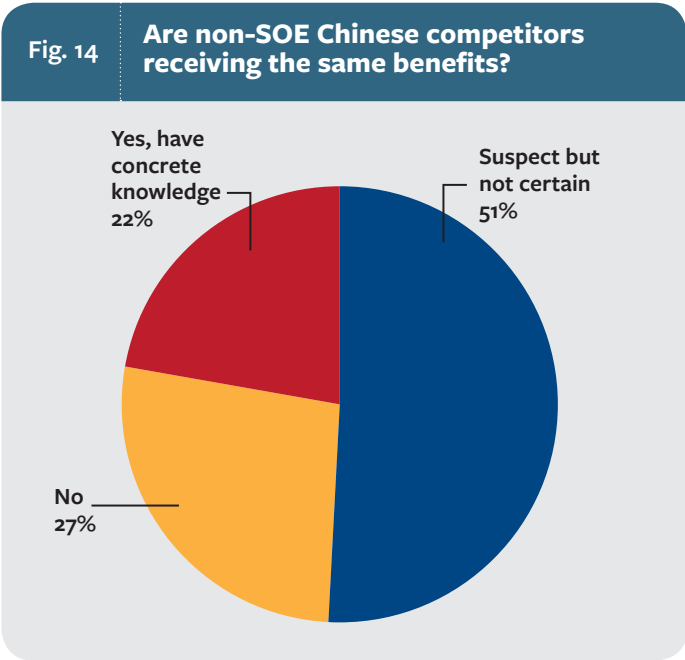
In short, the discriminatory treatment problem is not just an SOE problem. It is a problem of Chinese companies versus foreign and foreign-invested companies.

Over the past three years, survey respondents have consistently named preferential government financing and preferential licensing and approvals as the areas in which they are seeing Chinese companies – state-owned and private – receive benefits their companies cannot. In addition to preferential access to government contracts, also consistently cited by survey respondents, this year companies indicated that their Chinese competitors received tax benefits that they cannot (Fig. 15).

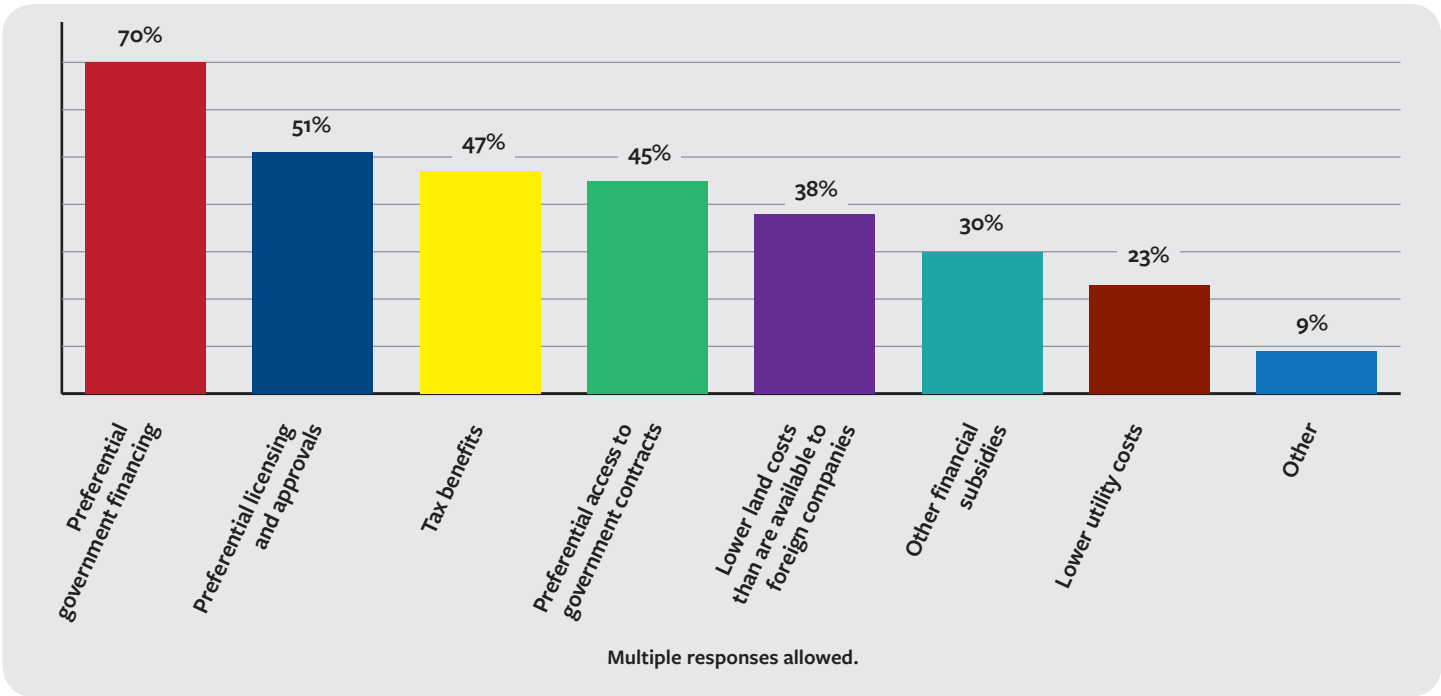
Possible solutions

Addressing concerns about an unlevel competitive playing field provides a good example of the vital importance of solutions that focus on the right problems. Focusing simply on state ownership misses the similar benefits that many non-SOE companies also receive.

Instead, comprehensively engaging the Chinese government on competition policy – regardless of SOE or non-SOE ownership – independent regulators, and improved corporate governance may be a more productive approach to level the playing field for American companies.



**Fig. 15** Areas of preferential treatment for state-owned enterprises



## Challenge #3 [tie]

### Administrative Licensing

#### Progress on Issue in Past Year: Unchanged

Rank in 2012:	2
Rank in 2011:	2
Rank in 2010:	2
Rank in 2009:	1
Rank in 2008:	1 (tie)
Rank in 2007:	2
Rank in 2006:	2

Administrative licensing – which refers to the array of licenses and government approvals required to do business in China – has been at or near the top of USCBC’s survey results for eight years, and it remains one of the most complex challenges to address.

Almost 70 percent of respondents in this year’s survey indicated they had experienced challenges with licensing in China. The most frequent problems came in getting approval for products to be sold in the market, expanding operations, and securing approvals of foreign investments more generally (Fig. 16, 17).

These problems are occurring not only at the central government level, but also at the provincial and municipal levels (Fig. 18).

Fig. 16

#### Has your company experienced challenges with administrative licensing in China?

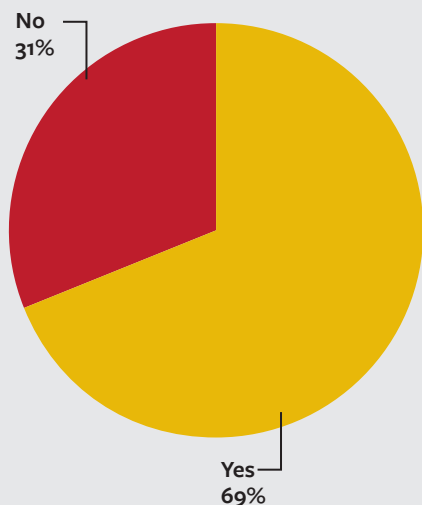
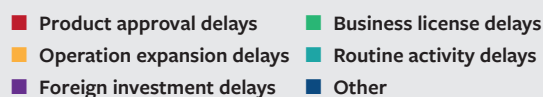
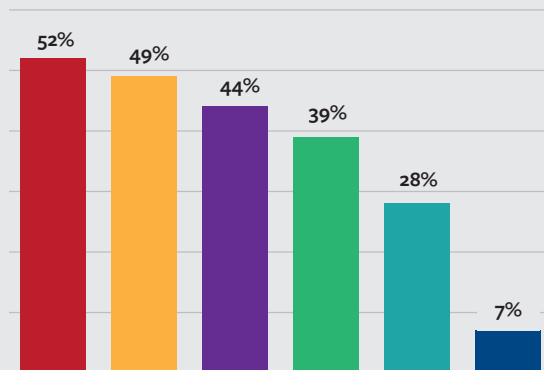


Fig. 17

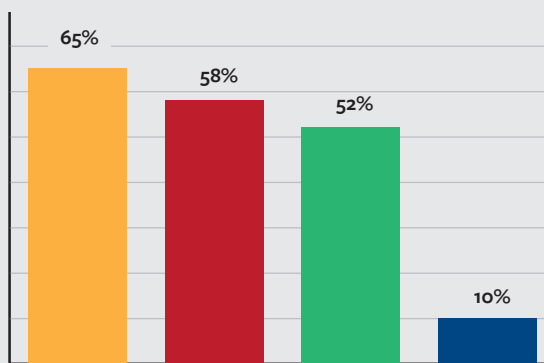
#### What types of problems has your company experienced?



Multiple responses allowed.

Fig. 18

#### At what level(s) of government did you experience these problems?



Multiple responses allowed.



Further complicating the possible solutions to these challenges, over half of respondents report that their domestic competitors are not facing the same licensing problems (Fig. 19). Of those respondents whose Chinese counterparts have an easier experience obtaining licenses, the vast majority report that the differential treatment is not based on laws or regulations that discriminate against foreign companies (Fig. 20). Instead, the differential treatment may be a combination of local companies having better access to information about the licensing and approval process and, as is often the case at the local level, regulator preference for domestic (and often local) companies. Indeed, administrative licensing was the most cited area in which respondents saw signs of protectionism.

China's central government has begun an initiative to reduce the number of approvals necessary to do business in China. USCBC analysis of the changes through fall 2013 indicated that China's central government did not make significant improvements in administrative licensing issues for foreign companies, but the initiative may signal a shift from central to local oversight and administration in areas related to manufacturing and transportation. It is an issue that should be monitored closely, particularly to determine if subsequent changes address the concerns of foreign companies.

### Possible solutions

Recommendations discussed in detail in USCBC's 2013 Board Priorities Statement<sup>5</sup> to help address these issues include:

- » Ensuring equal treatment in licensing for all companies regardless of ownership;
- » Strengthening implementation of the Administrative Licensing Law; and
- » Further improving rule-making transparency.

Fig. 19

**Are your domestic competitors experiencing the same problems?**

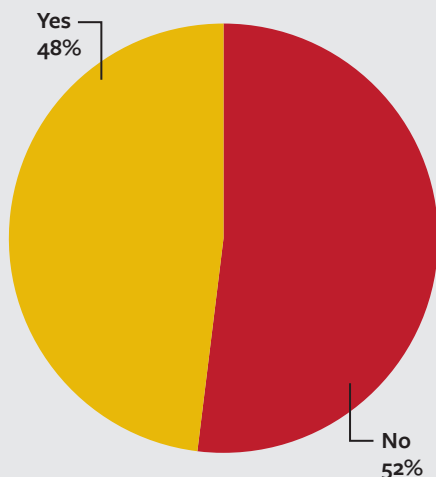
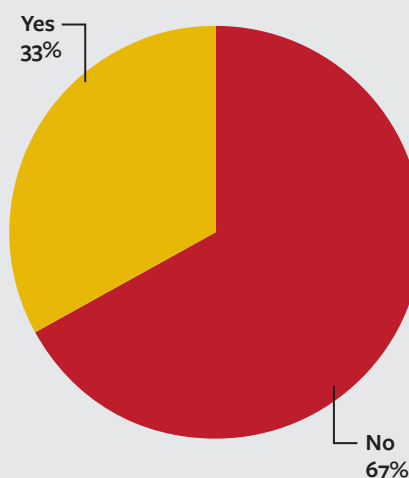


Fig. 20

**Are there laws or regulations in place that specify differential treatment for domestic competitors?**



5. USCBC Board of Directors' Statement of Priorities in the US-China Commercial Relationship, January 29, 2013. <https://www.uschina.org/reports/priorities-thu-05302013-1325>

## Challenge #3 [tie]

### Human Resources

#### Progress on Issue in Past Year: Unchanged

Rank in 2012:	1
Rank in 2011:	1
Rank in 2010:	3
Rank in 2009:	3
Rank in 2008:	2
Rank in 2007:	1
Rank in 2006:	1

**D**emand for qualified workers continues to outstrip availability, resulting in significant competition among companies – Chinese and foreign – for employees.

One way in which companies have usually sought to retain employees is by increasing wages and salaries. Survey data shows that companies appear to be adjusting their human resource strategies, however. In 2012, almost 30 percent of companies reported that they had increased wages between 10 to 15 percent in the past year. This year, only 18 percent of companies reported wage increases of 10 to 15 percent (Fig. 21). Respondents indicated the fastest increases in wages are for middle management and highly skilled technical workers, consistent with reporting in the 2012 survey (Fig. 22).

Fig. 21 Wage increases in current year

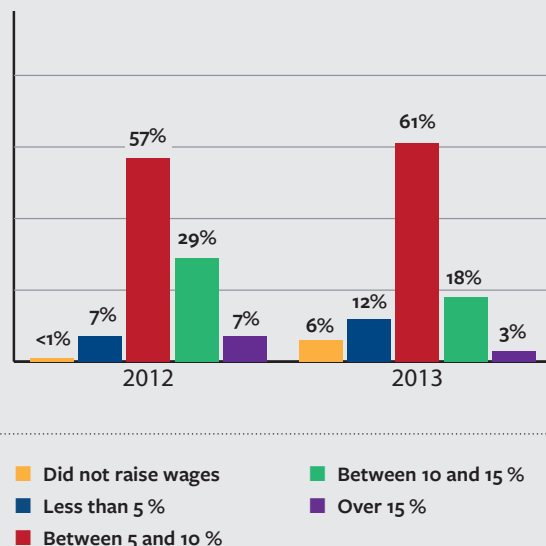
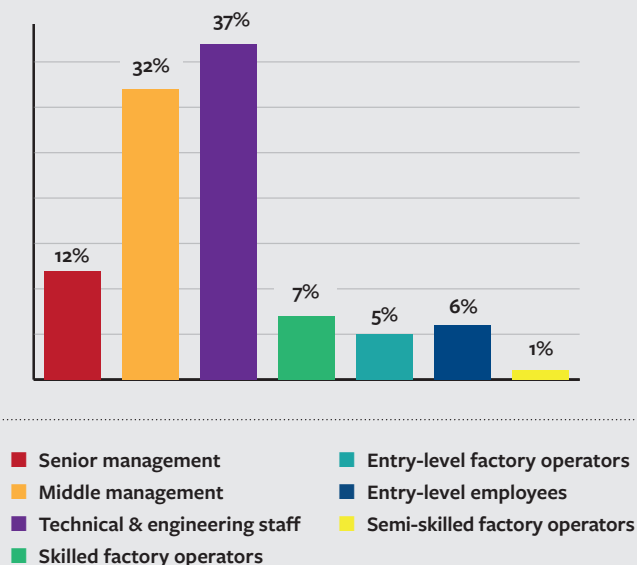


Fig. 22 For which position are wages rising fastest?



About 70 percent of companies anticipated increasing wages by 5 to 10 percent in 2014, and 19 percent predicted increases of less than 5 percent. Those numbers are up from last year, when nearly 60 percent planned increases of 5 to 10 percent and 14 percent expected to increase wages by less than 5 percent (Fig. 23).

Despite these still significant year-on-year wage increases, most companies report that they plan to expand head count for their China operations in 2014 and that hiring more staff is the top vehicle through which the company plans to expand their resource commitment in China. Only 8 percent of companies predict that they will reduce their number of employees in China next year (Fig. 24).

Fig. 23

### Estimated percentage of wage increases in next year

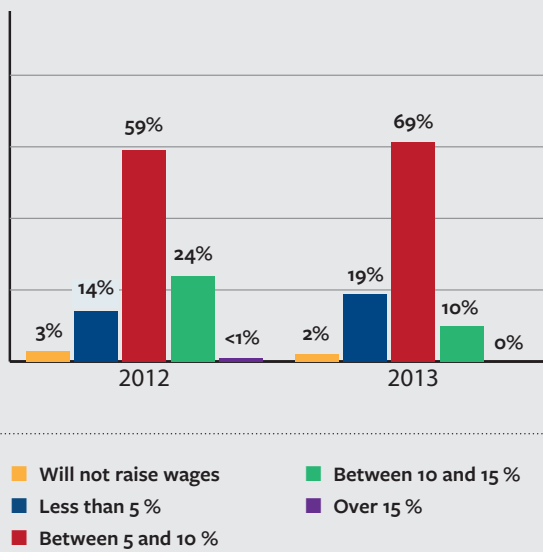
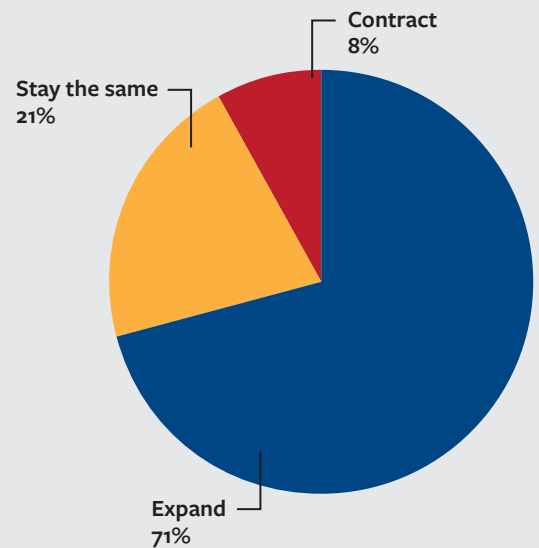


Fig. 24

### Company head count in 2014 expected to...



## Challenge #5

### IPR Enforcement

#### Progress on Issue in Past Year: Unchanged

Rank in 2012: .....	5
Rank in 2011: .....	5
Rank in 2010: .....	4
Rank in 2009: .....	8
Rank in 2008: .....	6
Rank in 2007: .....	3
Rank in 2006: .....	3

While the protection of intellectual property rights (IPR) has shown modest improvements in recent years, the vast majority of companies – 98 percent – still say IPR enforcement is a concern for them. A shifting IPR landscape and continued issues with enforcement have led a majority of respondents to state that IPR protection has gone “unchanged” from a year ago (Fig. 25). Similar to last year’s survey, 41 percent said the IPR environment had “somewhat improved,” while only 4 percent cited deterioration.

The inadequate protection of IPR continues to have a tangible impact on companies’ willingness to expose technology in China through manufacturing, licensing, and research and development (R&D) activity. Only 22 percent of companies report that China’s IPR environment has no impact on their business operations there (Fig. 26).

Fig. 25

#### Over the past year, China’s protection of IP has...

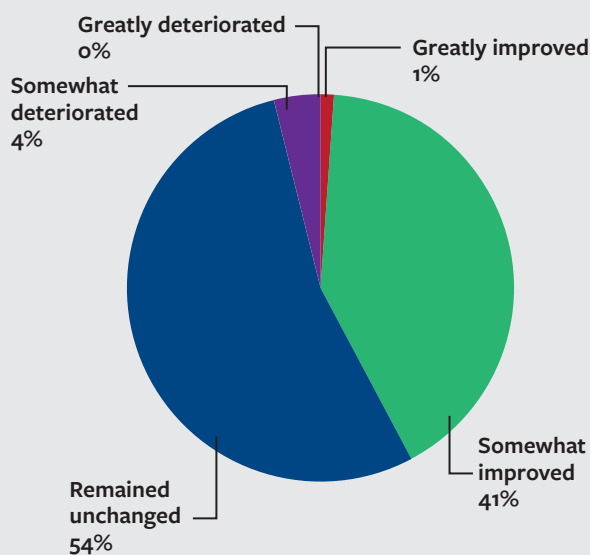
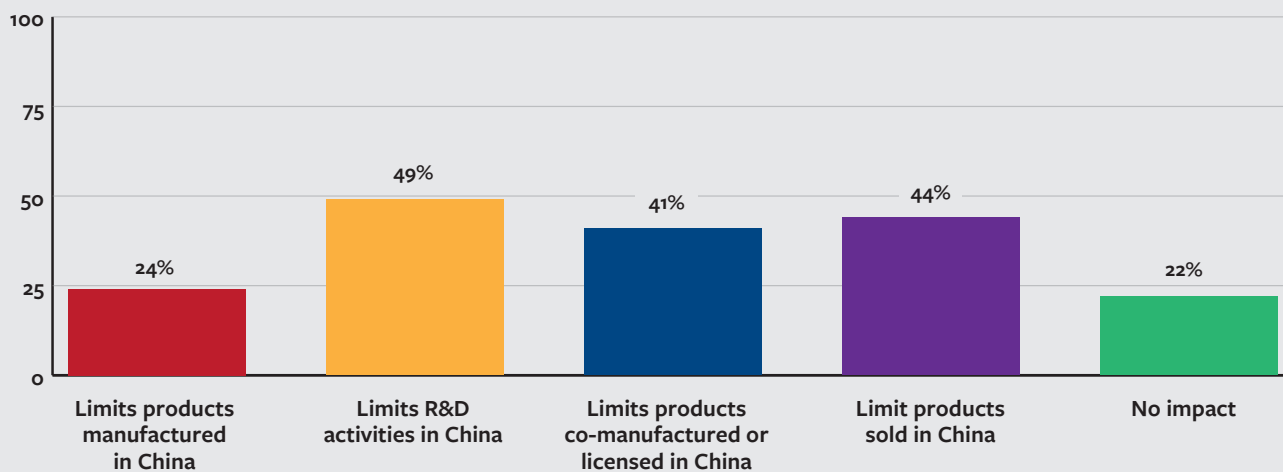


Fig. 26

#### Impact of level of IPR enforcement on activities undertaken in China



Multiple responses allowed.



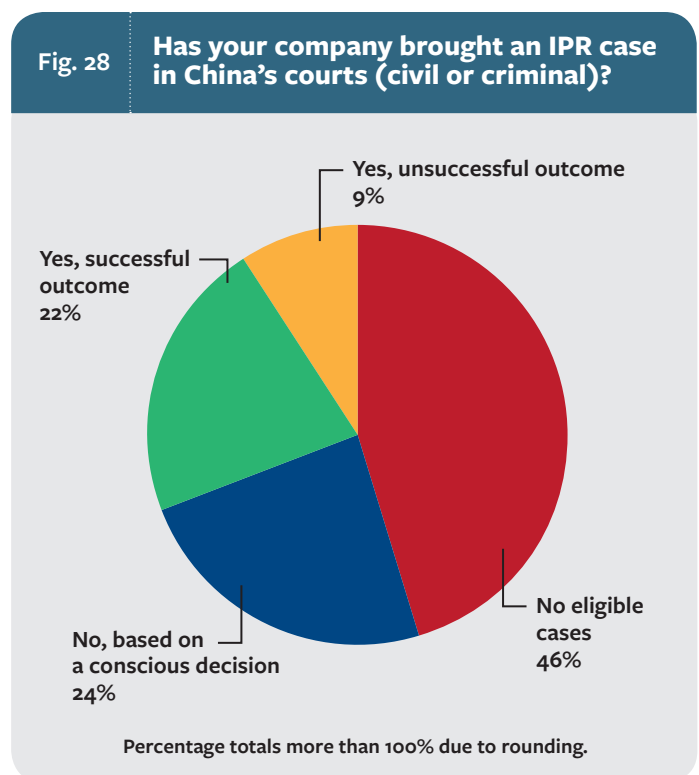
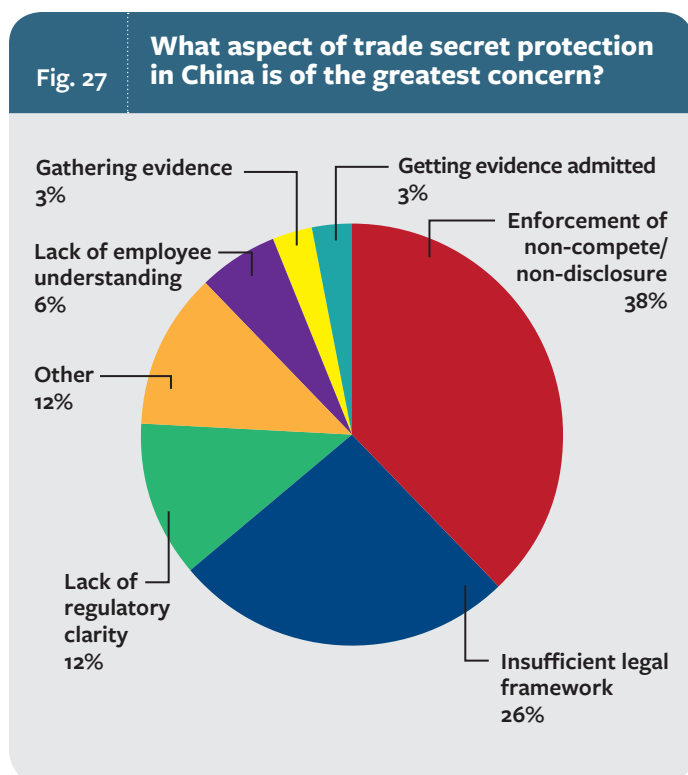
For the second year, protecting trade secrets remained the top priority for companies, with a record high number of respondents – 40 percent – citing trade secrets as the IP of greatest concern. Ensuring appropriate enforcement of trade secret rights is highly complex, however, and requires numerous protections and enforcement mechanisms that China’s legal system may still be in the process of fully developing. For example, over a third of respondents noted the difficulties in enforcing non-compete agreements, which are a primary tool companies use to protect their trade secrets. Over a quarter of respondents said that the legal framework remained insufficient to fully prosecute a trade secrets case (Fig. 27).

One company put these results in context, however, stating, “It is impossible to pick one [top concern with trade secrets]. They are all very significant concerns. There is an overall lack of acknowledgement of the value of trade secrets. The penalties associated with violations are minor slaps of the hand. If the entity that misappropriated the trade secret is a government entity or well-connected private entity, you have no chance at even minimal redress. With respect to cases specifically, the lack of discovery and the strict requirement that all evidence be notarized makes it very difficult to even bring a case.”

For IP enforcement more broadly, China’s courts continue to gain momentum as a viable channel for addressing problems, though not in all cases. More companies reported they have brought court cases in China, with increasingly successful outcomes: just over 20 percent of companies reported that they had brought a case with a successful outcome (Fig. 28). This figure is higher for the third year in a row, suggesting that in some jurisdictions, China’s court system is improving in its protection of IPR, albeit slowly.

## Possible solutions

While there is no single fix to these problems, at a minimum China should adopt a tougher deterrent to IP theft, that is, the international standard of allowing criminal penalties (not just civil) in cases of IP theft on a commercial scale. Not only is this the global best practice, but it will also help Chinese companies protect IP as they expand into higher-value services and products. In addition, China should continue its work in this area by improving the protection of trade secrets, restricting the use of compulsory licenses, and removing market access barriers to products such as imported films so that the absence of legitimate products does not incentivize the production and sale of counterfeits.<sup>6</sup>



6. USCBC Intellectual Property Rights Review and Recommendations May 2013. <http://uschina.org/sites/default/files/ipr-recommendations.pdf>

## Challenge #6

### Uneven Enforcement or Implementation of Chinese Laws and Regulations

#### Progress on Issue in Past Year: Unchanged

Rank in 2012:	6
Rank in 2011:	13
Rank in 2010:	13
Rank in 2009:	11
Rank in 2008:	5
Rank in 2007:	Not asked
Rank in 2006:	Not asked

Challenges #6 and #7 are closely related and deal with how foreign and foreign-invested companies are treated in China versus their domestic competitors. In essence, respondents have indicated that rules and regulations are not applied consistently or equitably in China, and that their companies often are not treated the same as Chinese companies with regard to regulation and implementation. In some cases, such uneven enforcement may be due to protectionism, but in others, it may spring from a lack of communication and coordination between government agencies in different regions or at different levels.

For example, foreign law firms operating in China pay higher taxes than their Chinese law firm competition and they are not able to join their clients in meetings with Chinese government officials although lawyers from Chinese firms can. Moreover, Chinese lawyers who come to work for a foreign firm must give up their domestic law licenses to do so. More details on these issues can be found in USCBC's report on legal services.<sup>7</sup>

In the retail sector, foreign companies seeking to expand in China encounter zoning and site-selection processes that are more cumbersome and time consuming than the processes their domestic competitors face, thus raising costs for the foreign retailer, delaying time to market, and putting the foreign retailer at a competitive disadvantage.

## Challenge #7

### Nondiscrimination/ National Treatment

#### Progress on Issue in Past Year: Unchanged

Rank in 2012:	15
Rank in 2011:	8
Rank in 2010:	12
Rank in 2009:	12
Rank in 2008:	17
Rank in 2007:	15
Rank in 2006:	9

As noted in the introduction to this report, companies report seeing signs of protectionism in a variety of areas, including licensing and regulatory approvals; tighter enforcement of rules against foreign companies; government pressure to buy goods and services from Chinese companies; and direct benefits such as direct subsidies, preferential financing and better ability to sell products to the government (Fig. 29).

#### Possible solutions

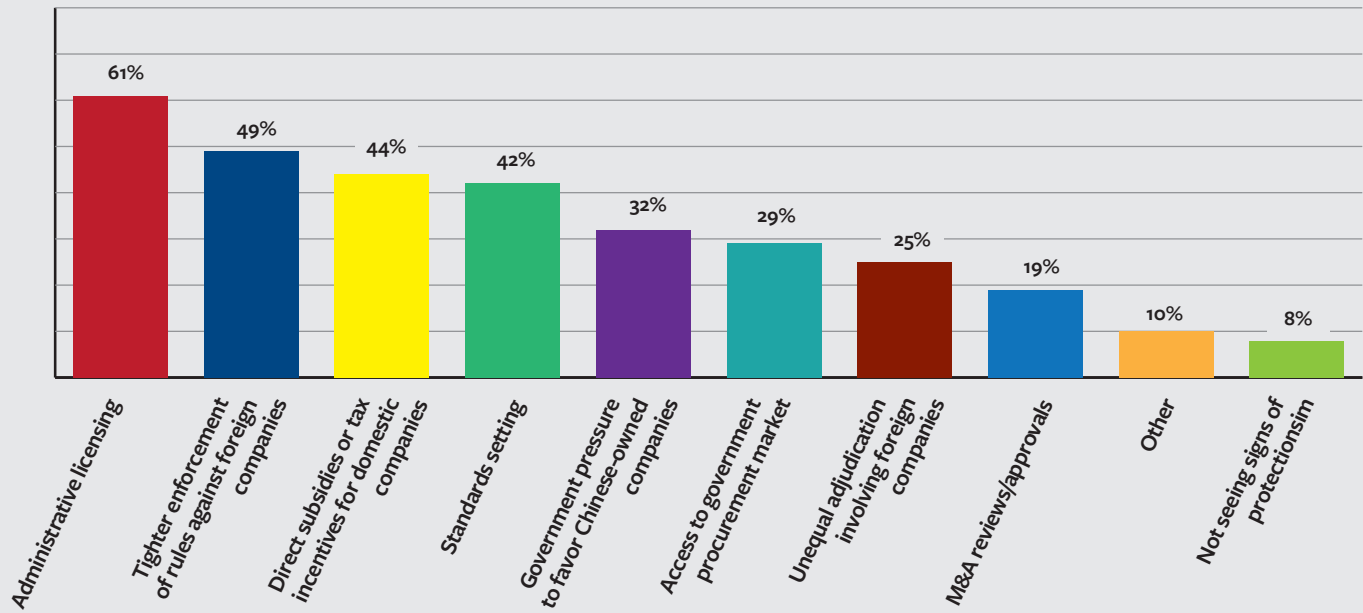
There are many changes Chinese regulators can make to solve the problems created by uneven enforcement and unequal treatment. In its 2013 Statement of Priorities,<sup>8</sup> USCBC's Board of Directors recommends two important actions: ensuring equal treatment in licensing for all companies operating in China regardless of ownership, just as the United States does, and ensuring equal treatment in government procurement for all legal entities in China, regardless of ownership. An added benefit to China: addressing disparities in licensing and government procurement practices will go a long way toward restoring optimism in China's market for the future, and creating goodwill for Chinese companies looking to expand abroad.

7. Legal Market Access Issues in China, February 2013. <http://uschina.org/sites/default/files/legal-market-briefer.pdf>

8. USCBC Board of Directors' Statement of Priorities in the US-China Commercial Relationship, January 29, 2013. <https://www.uschina.org/reports/priorities-thu-05302013-1325>

Fig. 29

## Signs of protectionism in China



Multiple responses allowed.

## Challenge #8

### Transparency

#### Progress on Issue in Past Year: Unchanged

Rank in 2012:	11
Rank in 2011:	9
Rank in 2010:	7
Rank in 2009:	8
Rank in 2008:	4
Rank in 2007:	5
Rank in 2006:	5

**T**ransparency is a broad subject that ranges from the public release of draft laws and regulations for comment to fair and open government decision making. As such, it is a core element of a well-functioning licensing regime in that greater transparency increases understanding about the licensing process, reduces the potential for bureaucratic mismanagement and corruption, and speeds time to market for products and services. As one company noted, “With respect to licensing, i.e., permitting for site approvals, we have experienced constantly changing requirements, rules, and regulations that are subject to local and/or many times ‘personal’ interpretation. This dynamic results in loss of crucial time, increases costs, and [losses] of proprietary trade secret information.”

China’s central government has made inconsistent improvements in rule-making transparency over the past several years. USCBC’s report on China’s transparency efforts goes into further details about the transparency records of the key ministries and agencies in China affecting business operations.<sup>9</sup> Among those findings:

- » The National People’s Congress, the State Council, and other selected government agencies have varying levels of compliance with these transparency commitments, and all agencies need considerable improvement.
- » The NPC continues to have a mixed record of posting draft laws and keeping them open for comment for a full 30-day period. Only 40 percent of laws passed over a recent eight-month period had been published to the NPC website for comment at some point during their drafting process.
- » The State Council posted less than 15 percent of its own administrative regulations and departmental rules for public comment through the State Council Legislative Affairs Office (SCLAO).

» Other government agencies did no better. The National Development and Reform Commission (NDRC), Ministry of Commerce (MOFCOM), Ministry of Finance (MOF), Ministry of Industry and Information Technology (MIIT), General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), State Administration of Industry and Commerce (SAIC), and Ministry of Human Resources and Social Security (MOHRSS) all posted only a small fraction of relevant documents for comment on either the SCLAO or their respective agency websites. These agencies posted less than 10 percent of regulations to the SCLAO site and less than 17 percent of additional regulations to their agency sites.

» Among the small percentage of regulations that are being posted for public comment in line with the State Council’s commitments, however, the majority are being posted for at least the full 30-day period. The average comment period for administrative regulations and departmental rules posted for public comment on either the SCLAO or agency websites exceeded 25 days.

#### Possible solutions

China should fully implement its commitment to publish all draft trade and economic-related laws, administrative regulations, and departmental rules for a full 30-day period, but it should also consider going further by posting draft regulations on a designated website for a 60- or 90-day public comment period. In addition, China’s central government should ensure that laws and regulations, once finalized, are consistently interpreted and implemented nationwide.

9. China 2013 Regulatory Transparency Scorecard, May 2013. <http://uschina.org/policy/china-2013-regulatory-transparency-scorecard>



# Challenge #9

## Standards and Conformity Assessment

Progress on Issue in Past Year: Unchanged	
Rank in 2012:	10
Rank in 2011:	6
Rank in 2010:	10
Rank in 2009:	6
Rank in 2008:	14
Rank in 2007:	6
Rank in 2006:	6

China’s standards and conformity assessment regime raises concerns for companies in a variety of sectors—as they set the ground-rules that dictate if and how companies and products can enter new markets. This year’s survey shows that companies remain concerned with a number of long-standing issues, such as China’s use of unique standards for goods and services sold in its market and the inability of conformity assessment service providers to test goods for China’s market. Both challenges significantly raise costs for American companies trying to sell to China while also limiting the access that Chinese consumers have to the fullest possible range of the latest products and services.

This year’s survey also sheds light on an aspect of standards and conformity regimes that sometimes gets lost in consideration of such a technical issue: the negative impact on companies’ abilities to get products certified and approved for sale in China. As noted in challenge #3, administrative licensing, over half of respondents that reported problems in licensing said they were related to the standards and conformity assessment system, be it China Compulsory Certification (CCC) approvals, import licenses, or others.

### Possible solutions

As noted in the 2013 USCBC Board Statement of Priorities, China should use global standards as the basis for Chinese standards wherever practical and adopt a fairer, more equal, and transparent market-led approach to standards setting and development. The system should be open to all companies regardless of nationality, including domestic, foreign-invested, and foreign-based manufacturers.

Other ways that China could address concerns in this area are discussed in USCBC’s 2011 report, “Recommended Changes to the Development and Implementation of China’s Standards and Conformity Assessment Policies and Processes.”<sup>10</sup>

# Challenge #10

## Foreign Investment Restrictions

Progress on Issue in Past Year: Unchanged	
Rank in 2012:	7
Rank in 2011:	7
Rank in 2010:	14
Rank in 2009:	Not asked
Rank in 2008:	Not asked
Rank in 2007:	Not asked
Rank in 2006:	Not asked

China’s Catalogue Guiding Foreign Investment maintains foreign ownership restrictions in nearly 100 manufacturing and services sector categories in China. Additional restrictions on foreign investment appear in other policies and regulations.

Key sectors for reduced foreign ownership restrictions include financial services, agriculture, cloud computing, data centers, health insurance, hospitals, refining, petrochemicals, audiovisual, and other media industries.

Discriminatory restrictions on foreign investment have spillover consequences that negatively affect core Chinese government goals, such as creating a more innovative society or developing the services sector. Limiting competition and excluding internationally innovative companies hurt China’s ability to compete in these sectors.

### Possible solutions

Another important component of investment liberalization would be for the United States and China to negotiate and finalize a meaningful bilateral investment treaty (BIT). A BIT provides one of the best opportunities to reduce investment barriers in both countries and improve protections for US and Chinese investors in each others’ markets. The most important elements of a strong BIT are national treatment provisions that apply to both new and existing investments (“pre-establishment”), and an approach that covers all investments except those specifically excluded in the agreement (“negative list”). The United States and China announced in 2013 they will use this approach. Both the Chinese and US governments should seek to conclude a BIT incorporating these elements as quickly as possible.

10. USCBC Standards Review and Recommended Changes to the Development and Implementation of China’s Standards and Conformity Assessment Policies and Processes, December 2011. [http://uschina.org/sites/default/files/standards\\_reviews\\_recs\\_0.pdf](http://uschina.org/sites/default/files/standards_reviews_recs_0.pdf)

## Other Issues of Interest

### Strategic Emerging Industries

In 2010, China's central government announced plans to promote the development of seven strategic emerging industries (SEIs): energy efficient and environmental technologies; next-generation information technology (IT); biotechnology; high-end equipment manufacturing; new energy; new materials; and new-energy vehicles.

As noted in USCBC's report on SEIs, the most immediate impact of the central government's announcement was to signal to Chinese government agencies at all levels that future government policies on issues such as taxation, human resources, and R&D must support SEI development. Implementation of those policies is occurring at the provincial and local levels, but foreign companies' ability to get information on the programs and to participate remains uneven, a problem resulting from China's transparency issues. USCBC's report on SEI policies goes into greater detail about those specific challenges.<sup>11</sup>

Most companies report that they have had some difficulty obtaining information about the specific industries being promoted and types of incentives offered, as well as having mixed experiences in turning information leads into business development opportunities. Only a third indicated that they have had good access to this type of information (Fig. 30).

As one company explained, "The information published is limited, the incentives offered are not known to the public, the process of application is unclear, and all provinces have their own regulations."

The lack of published materials can be particularly problematic in the case of government-supported pilot projects in encouraged industries. Foreign companies often do not have any knowledge of these projects before they have been launched and the suppliers decided. This not only eliminates foreign companies' abilities to compete in critical projects in innovative industries important to China, but it also appears to act as a marketing tool for domestic companies, a further advantage to building a customer base in nascent industries.

While foreign companies are closely watching SEI programs and policies, it is also unclear whether foreign companies' are interested because they want to participate in SEI programs or because they are concerned about the advantages that SEI programs may provide to domestic competition. While 45 percent of respondents indicated their companies are very interested, just over half said participation is not a top company priority, with interest determined by whether SEIs sectors align with overall company priorities (Fig. 31). Most companies report they have not yet applied for an SEI incentive or project (Fig. 32).

Fig. 30

**Ability to participate in the development of strategic emerging industries**

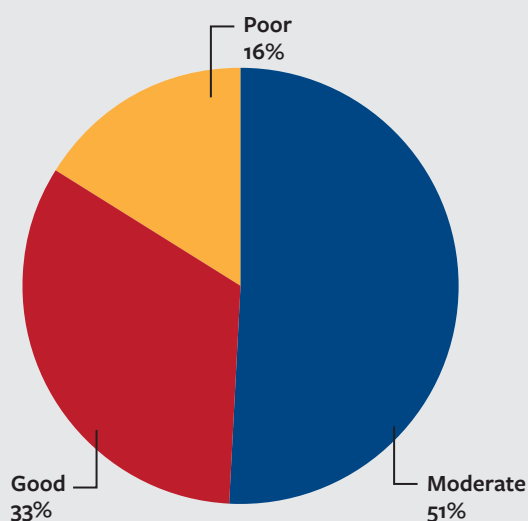
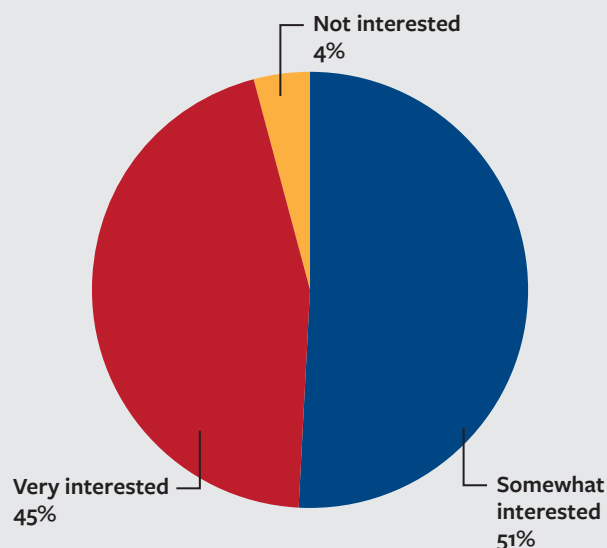


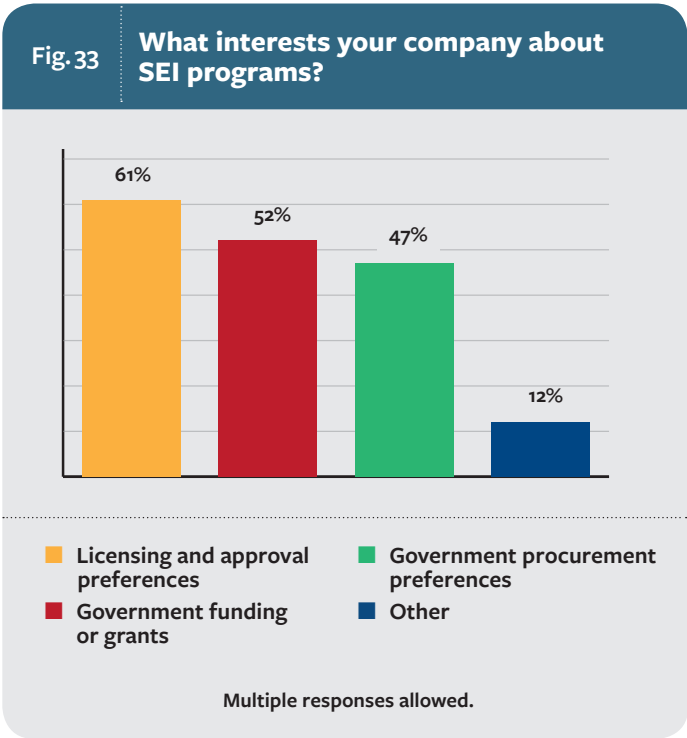
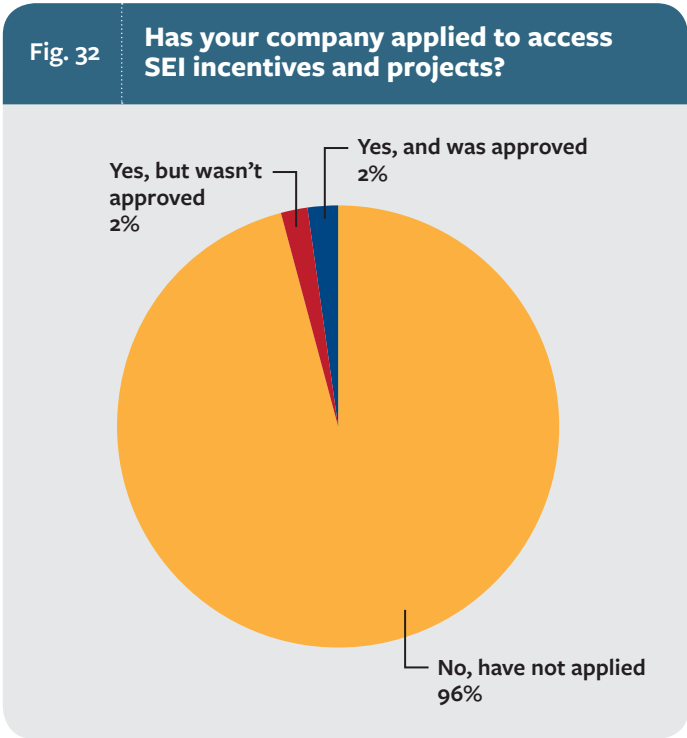
Fig. 31

**Interest level in accessing SEI incentives and projects**



11. China's Strategic Emerging Industries: Policy, Implementation, Challenges & Recommendations, March 2013. <http://uschina.org/sites/default/files/sei-report.pdf>

Interestingly, the types of SEI benefits that are of most interest to companies are among those that would address some of the challenges they report seeing in China's market overall: preferences in licensing and approvals, government subsidies, and procurement preferences (Fig. 33).



USCBC's SEI report includes detailed recommendations on changes that China should implement in these programs to ensure equal treatment of foreign and domestic companies, including steps to address transparency, IP protections, and procurement concerns.

**Technology transfer**

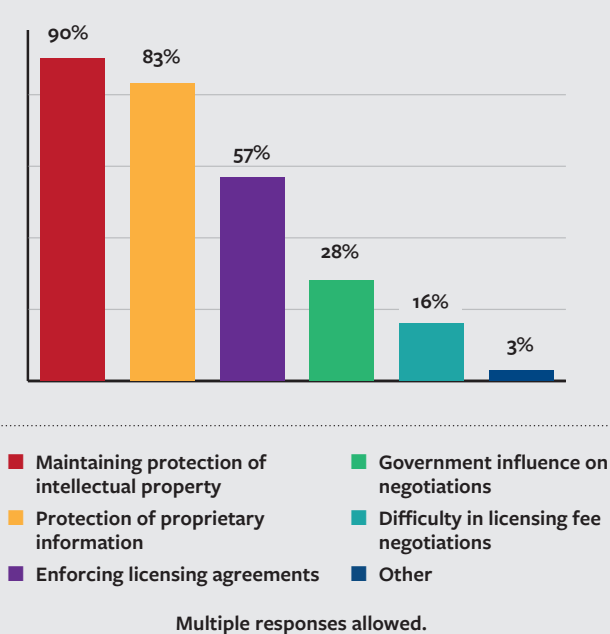
Seventy percent of respondents report that they are concerned about transferring technology to China, generally because of concerns about IP protection and enforcing licensing agreements (Fig. 34).



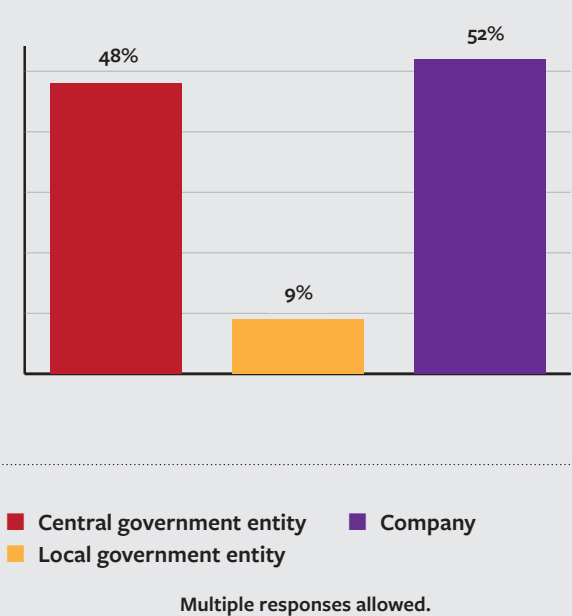
The issue that gets the most attention in the United States — the active role of government in “forcing” technology transfer — was cited by only 28 percent of respondents (Fig. 35).

Of companies that have received requests for technology transfers, just over half said the request came from a company as part of a commercial negotiation and 48 percent reported that the request came from a central government entity (Fig. 36). Under those requests, most said that the technology would have been controlled by their company and a Chinese entity, though about a third said their own company would retain control. No respondents indicated they would fully give up control of the technology (Fig. 37).

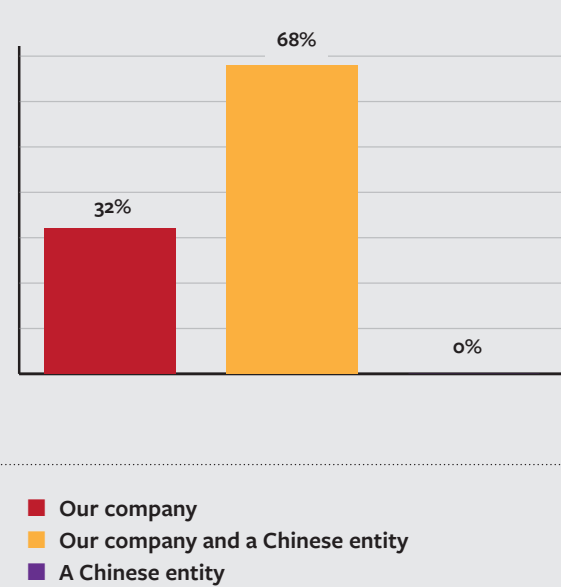
**Fig. 35** Top concerns related to transferring or licensing technology in China



**Fig. 36** Who made the request(s) to transfer the technology?



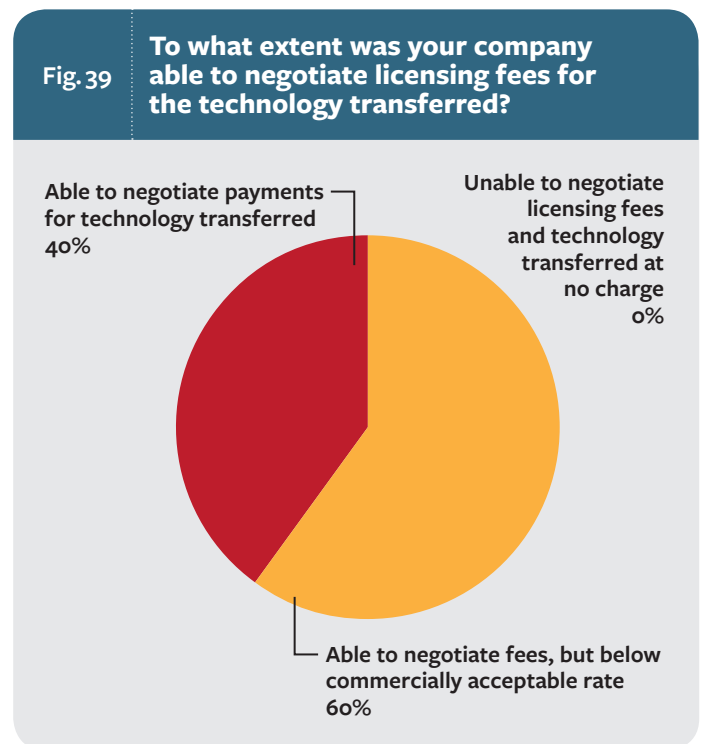
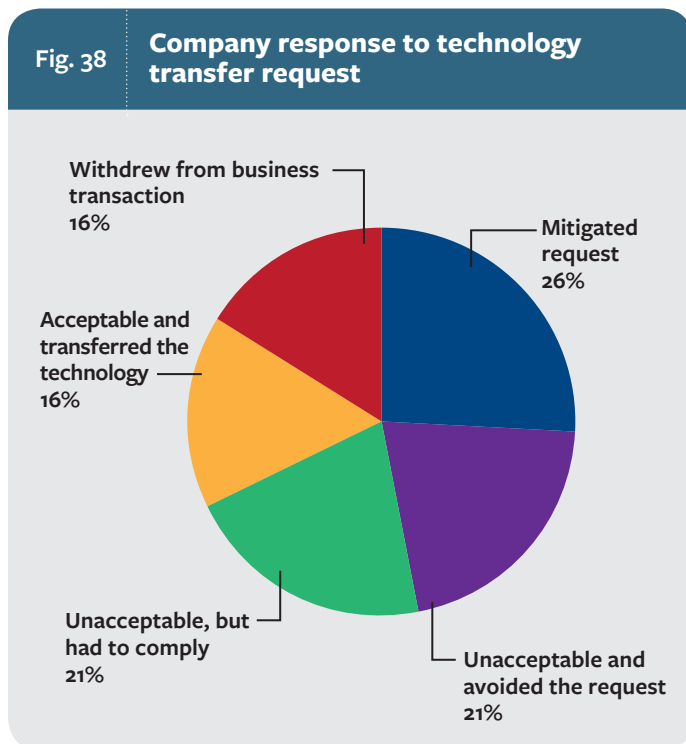
**Fig. 37** Who would control the technology in China?





Responses to these transfer requests varied. Equal numbers found the requests acceptable and proceeded as found the requests unacceptable and halted the proposed transactions. About 20 percent were able to simply avoid requests that they found unacceptable and a quarter of companies were able to mitigate the request and transfer only some technology, suggesting for both groups that commercial negotiation strategy was at the core of the original request. However, about 20 percent had to comply with the transfer requests in order to access the market despite their concerns (Fig. 38). Sectors in which this occurred included power generation, medical devices, and automotive, among others.

Of companies that transferred technology because of one of these requests, 40 percent reported that they were able to negotiate commercially acceptable payments for the technology. The remaining 60 percent received some payments, but below the amount that they considered acceptable. This was particularly true for companies that were required to transfer the technology in order to gain market access. No companies reported that they had to transfer technology at no cost (Fig. 39).



# Respondent Profile

## US- and China-based executives

USCBC’s survey incorporates a unique mix of US- and China-based executives. Just over half the respondents were based in China with an on-the-ground perspective, and 45 percent were based in the United States and view the China environment with a global perspective. The remainder were located elsewhere in Asia (Fig. 40).

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

## Cross-sector representation

USCBC members who completed this year’s survey represented a cross-section of US companies doing business in China. Sixty-four percent of respondents represented manufacturing companies, and 40 percent represented service providers – and many respondents’ companies are active in both sectors. Nineteen percent worked for companies in primary industries, such as agriculture and oil and gas (Fig. 41).

Fig. 40 Respondents’ locations

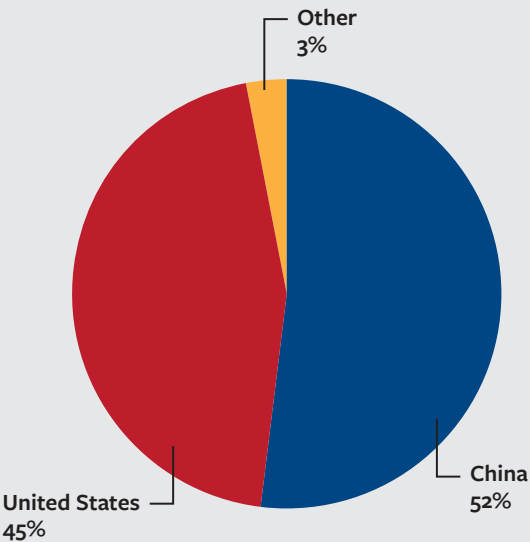
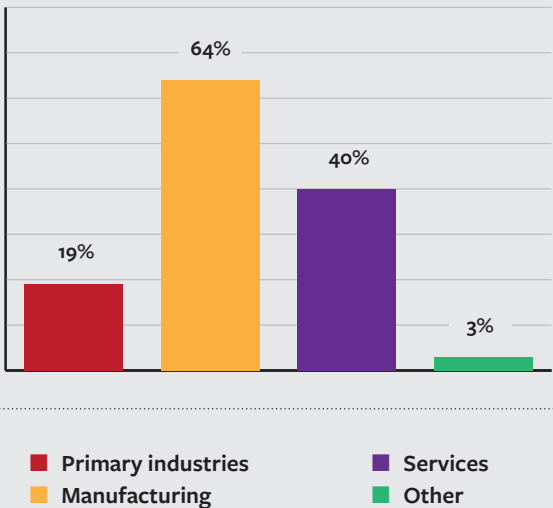


Fig. 41 Type of business operations in China



Multiple responses allowed.

### Long experience in the China market

USCBC member companies have a long history of doing business in China: 57 percent of respondents' companies have been in China for more than 20 years, and 29 percent have been in China for 11–20 years (Fig. 42).

### In China to access Chinese customers

The overwhelming majority of USCBC member companies report that they are doing business in China to access China's domestic market. Twenty-one percent use China as an export platform to reach other markets around the world, though only 8 percent use their China operations to produce products that are shipped back to the United States (Fig. 43).

Fig. 42 Years doing business in China

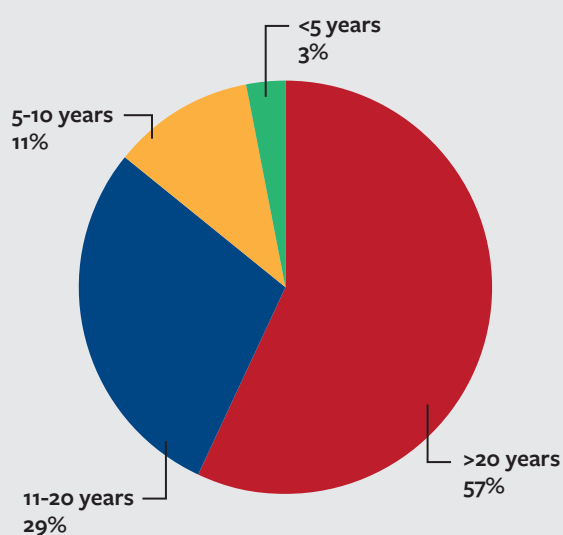
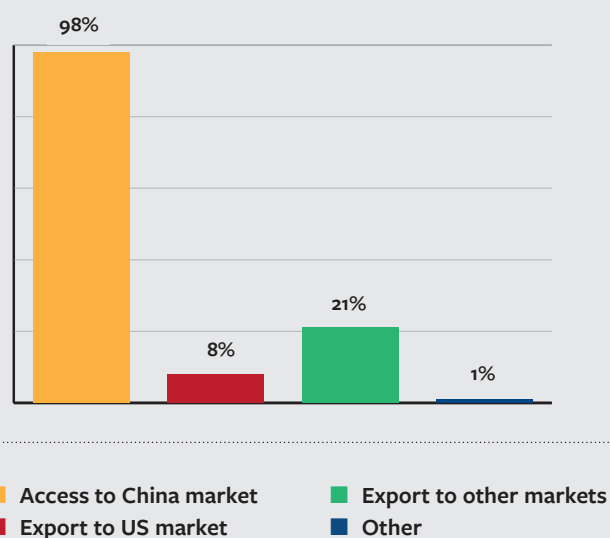


Fig. 43 Objectives for existing and future investments in China



Multiple responses allowed.