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

Docket Number USTR--2020-0033

September 15, 2020

The global economy has changed significantly in the 19 years since China joined the World Trade Organization (WTO). As part of its accession agreement, China lowered its overall tariff rate, dropping its applied import tariffs from a weighted average of 14.7 percent in 2000 to 4.8 percent in 2017. However, due to bilateral trade tensions, China has selectively raised the weighted average tariff rate on US goods to 20.3 percent, up from 8 percent in 2018. China agreed to open some, though not all, of its economy to foreign participation—these commitments have largely been implemented. The accession agreement also changed the way most American companies were able to do business in China, such as by allowing companies to distribute and service their own products in the market.

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

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

In 2000, the year before China's accession, China's gross domestic product (GDP) was approximately $1.2 trillion, ranking as the fifth-largest economy in the world. China's GDP was roughly $14.14 trillion in 2019, making it second only to the United States' economy which grew to $21.43 trillion. The United States remained the largest economy in the world throughout this time, even when taking into account the global recession in 2009.

China also lifted more than 800 million people out of poverty as a result of its market reforms. Its middle class is now larger than the entire population of the United States and still growing, making it a major driver of global demand for goods and services. According to the Bureau of

Economic Analysis, in 2000, US exports of goods and services to China were only $21.9 billion and US company sales in China were roughly $18.5 billion. The United States now exports approximately $164.5 billion of goods and services to China, placing it just behind Canada and Mexico as the United States' third-largest market. Likewise, as of 2018, the last year of available data, US company sales in China have grown to $392.7 billion, over 20 times the value in 2000.

The bilateral goods trade deficit has also grown from $83 billion prior to WTO accession to a peak of $418 billion in 2018. However, focusing solely on the bilateral trade balance misses an important change in the pattern of trade. After China entered the WTO, suppliers from Japan, Korea, Taiwan, Hong Kong, and other economies moved their export manufacturing to China, shifting the United States' long-standing bilateral trade deficits with those economies to China. China's proportion of the US global trade deficit has increased, while the rest of East Asia's proportion has decreased. Now China simply accounts for a larger piece of the region's overall share. Last year, the goods trade deficit with China fell to $344 billion, though it was accompanied by the loss of an estimated 300,000 American jobs, an 18 percent reduction in US goods exports to China, and a dampening of US investment as US-China tariff escalation intensified.

China's accession also made it subject to the WTO's dispute settlement process, intended to act as a de-politicized mechanism for resolving trade disputes. The United States has a positive track record in cases involving China—as of September 2020, of the 20 completed cases the United States has filed against China, 11 cases were won by the United States and nine were settled before a ruling was made. None were lost. The US blockage of appellate judge appointees currently threatens the effectiveness of this dispute resolution mechanism that has historically served the United States well with respect to China.

On balance, China's WTO entry has been positive for the United States and the world. Notably, China has taken some steps to further open its markets in the last couple of years, particularly in financial services and agriculture, and has strengthened protections for intellectual property rights, improved the approval process for foreign investments, and worked in other areas to address concerns raised by the US government and industry. The US-China Phase One trade agreement played a helpful role in pushing many of these changes forward.

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

Implementation of the "Letter" of Existing WTO Commitments

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

"WTO-relevant issues involving entrenched PRC bureaucratic and domestic commercial interests will likely require particular vigilance by the US government and the American private sector, in the interest of effective encouragement of China to reach the fullest possible realization of [its] WTO commitments."

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

National Treatment

The WTO's requirement that member countries treat domestic and foreign companies on an equal basis, also known as national treatment, is an essential principle for all companies doing business globally. However, USCBC's annual member survey showed again in 2020 that American companies continue to experience problems with discriminatory treatment, primarily in the form of regulatory challenges and preferential treatment for domestic companies. Regulatory and competition challenges are not new for US companies, but they still have a real effect on companies' ability to do business and are among the issues that companies perennially cite as primary restraints on their profitability in China.

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

Many Chinese companies thrive because they produce competitive, high-quality goods and services. However, several Chinese policies and practices continue to provide advantages to both state-owned and private domestic companies over foreign ones, an issue that 46 percent of the respondents to USCBC's 2020 member survey say affects their companies. This includes direct benefits and support from various levels of the government, as well as favorable licensing decisions, restrictions on foreign investment, and preferential treatment in enforcement actions—all issues identified among companies' top 10 concerns in 2020 as well as in previous years. Policies to level the playing field for foreign companies should ensure equal treatment of foreign companies regardless of their ownership form.

National Security and Innovation Policies

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

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

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

Licensing and Approvals

Over the past decade, licensing has consistently ranked among USCBC member companies' top 10 concerns. Certain regulations require expert panels to be convened for inspection, testing, and quarantine of equipment, facilities, products, and articles that directly concern public security, health, and safety of life and property. There are three major concerns about expert panel reviews among US companies.

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

In a positive step, China committed in the Phase One trade deal to prohibit third-party reviewers with financial or competitive interests from participating in the administrative review process. They also committed to establishing a mechanism for objecting to the participation of specific third-party reviewers. Recent draft documents would help to meet these commitments, but have yet to be implemented.

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

Intellectual Property Rights

China is slowly making progress in IP protection, but it remains an issue that US companies have consistently raised over the years—85 percent of USCBC survey respondents are concerned about IPR protection.

For the last decade, the majority of our members reported no change in China's IP protection environment. This trend reversed in 2019, and members continued to express greater optimism in our most recent survey: 61 percent saw improvement, 37 percent saw no change, and only 2 percent reported a deterioration in IP protection. Companies attribute these improvements to the Chinese government's increased emphasis on IP protection, a variety of new laws and regulations that aim to enhance protections, and US government efforts to elevate the protection of IP in the Phase One trade agreement.

One positive development in recent years that merits attention is the improvement in companies' ability to use China's various IP enforcement channels. Those channels include administrative agencies, civil courts, criminal courts, special IP courts, and China's recently-created Supreme People's Court IP appeals mechanism. Other positive developments in 2020 include the release of a two-year IP Action Plan, as specified in the Phase One agreement, and draft revisions to the *Copyright Law*, the *Patent Law*, and the *Criminal Law*, all of which include provisions that strengthen IP enforcement. Since March 2020, China's Supreme People's Court has also released a series of draft judicial interpretations and guiding opinions that address Phase One commitments on trade secrets, ecommerce, geographical indications, notarization services, the expeditious enforcement of court judgments, and evidence rules in civil IP litigation. These improvements build on those in 2019, including amendments to the *Trademark Law*, the *Anti-Unfair Competition Law*, and the *Administrative Law*.

These actions reflect progress that China has made on the full spectrum of IP issue areas. While China is on track to carry out its IP Action Plan, legal reform is a slow process, and there is still room for improvement in enforcement. According to USCBC's most recent member survey, 29 percent of companies curtail or choose not to embark on investments in China because of China's level of IP enforcement. Significant trade secret cases can languish in court for years, even when there are clear cut cases of Chinese violations of the IP rights of foreign companies. Chinese courts often stall recognition and enforcement proceedings for international arbitration awards obtained by foreign companies against Chinese companies. The delay or denial of prompt and credible enforcement of IPR violations erodes US, international, and, ultimately, Chinese interests in protecting IP and establishing the precedent to prevent further trade secret misappropriation. Continued reform, with follow-through in enforcement, would also help to reduce tensions between China and its major trading partners—something that industry would welcome.

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

One step that China is taking to improve IP protection is adopting a tougher deterrent against piracy. Under China's current system, violators are subject to a traditionally low fine rather than criminal sanctions, which would serve as a stronger deterrent. The Phase One deal attempts to address this problem by increasing punitive and statutory damages for IP cases. In what appears to be a larger trend, recent legal amendments have quintupled the previous maximum damages for IP cases, in line with Phase One obligations.

In addition, the *Foreign Investment Law*, which went into effect in January, stipulates that government officials must not reveal sensitive information or trade secrets that they have gained access to in the course of their work. It also requires that public officials of administrative organizations can be criminally prosecuted for illegally providing others with trade secrets they learned while performing their duties. While this is a step in the right direction, the effectiveness of these changes on IP enforcement will be tested as the law is implemented.

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

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 respondents to USCBC's member survey report that they have been explicitly asked to transfer technology to China as a requirement for gaining an investment, project, product, or market entry approval, down from 20 percent in our 2017 survey. While over the last three years, fewer of our member companies have reported technology transfer as an issue affecting their business in China, it is still an acute issue for affected companies.

China has taken some steps to address these concerns, such as committing not to require or pressure foreign companies to transfer technology in the Phase One agreement and through language prohibiting forced technology transfer in the *Foreign Investment Law*. These regulatory changes address some of the top concerns raised in USTR's Section 301 report on restrictions that reduce the ability of foreign companies to negotiate fair, market-based terms for the transfer of their technology into China. However, without specifics, it is unclear how this will reasonably be enforced. Additional reforms to joint venture requirements and administrative licensing requirements would be beneficial in protecting companies' trade secrets.

Structural Issues Encourage Tech Transfer
While the above regulatory changes are a step in the right direction, they do not address the structural issues—like JV requirements and foreign equity restrictions in certain industries—at the root of technology transfer issues in China.

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

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

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

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

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

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

Lastly, China should join the WTO's Government Procurement Agreement (GPA) and ensure that goods and services provided by all legal entities in China are treated equally during procurement processes, regardless of ownership. China's latest offer to join the GPA in October 2019 makes progress towards this goal. In advance of joining the GPA, China should immediately designate a formula of "substantial transformation" similar to those used by the United States to determine a product's national origin.

Transparency

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

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

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

Electronic Payment Services

When China joined the WTO in 2001, it committed to allowing non-Chinese electronic payment services (EPS) companies to compete and do business in its domestic market on equal terms with Chinese companies, including by processing renminbi-denominated transactions in China. While US EPS suppliers have continued to process "cross-border" transactions in China for decades, which primarily involve purchases by international travelers in a currency other than renminbi (RMB), through the end of 2019 no US EPS supplier was processing, or even authorized to process, RMB-denominated transactions in China.

Under the Phase One agreement, China committed to accept and make a determination on any application for a Bank Card Clearing Institution (BCCI) license from a US EPS supplier within prescribed time limits and without regard for the applicant's ownership structure. Following the signing of the agreement in January 2020, one US EPS supplier has completed its licensing process while others have applications still under consideration. US companies look forward to the processing of RMB-denominated transactions by all US EPS suppliers that have applied for a BCCI license, as contemplated under the Phase One and WTO agreements.

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

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

Leading By Example

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. Since 2018, the United States has been the subject of 22 requests for consultation and dispute settlement—some of them initiated by China—but complaints have also been filed by Canada, Mexico, South Korea, the European Union, Vietnam, India, Norway, Russia, Switzerland, Venezuela, and Turkey. In at least two separate instances in 2019, 40 WTO members jointly voiced objections to US tariff plans at the WTO Council on Trade in Goods. These complaints, in addition to others, represent a substantial increase in our global trading partners' perceptions that we, ourselves, are not acting in accordance with our commitments or following WTO rules.

Neither China nor the United States should implement policies that violate the spirit of WTO commitments despite conforming to the letter of the rules. We must push ourselves and encourage our trading partners to implement policies that uphold WTO principles. If existing rules fall short, we should not abandon them, but instead should take the lead to improve them.

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

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

In recent years, the trilateral with the EU and Japan aimed at addressing "non-market-oriented policies and practices" provides another example of constructively working with like-minded partners to address inappropriate Chinese practices. The three countries have held a series of meetings to develop stricter rules governing subsidies and state-owned enterprises, with a longer-term goal of similarly upgrading the WTO's existing rules. This offers a clear indication that like-minded global trading partners are eager to work with the United States in ways consistent with international agreements to address common concerns regarding China's trade and investment policies. USCBC encourages the United States to undertake more actions that include this kind of cooperation.

Written Testimony Attachments
USCBC 2020 Member Survey Report

Member Survey

US-China Business Council | 2020

THE US-CHINA BUSINESS COUNCIL
美 中 贸 易 全 国 委 员 会

The past year has been one of victories, pitfalls, and surprises in US-China relations. Several of the most defining moments took place in the trade sphere, having a profound impact on US companies that do business in China. Since the US-China Business Council (USCBC) released our last member survey, the United States and China finalized a Phase One trade agreement, putting tariff escalations of the past two years to a halt. While China began making structural reforms to implement its Phase One commitments and both countries entered what would have been a conciliatory period, a novel pathogen began wreaking havoc on public health and the global economy, reigniting discord in the US-China trade relationship just as the United States heads into an election year.

These tumultuous circumstances, and particularly the COVID-19 pandemic, have bred uncertainty into the business environment, clouding companies' perspectives on the short-term business outlook for China. Companies also remain concerned about long-held operational issues like fair competition, data and cybersecurity policy, and intellectual property protection. Despite high tensions, all indicators suggest that companies remain largely committed to the China market over the long term.

Unlike last year, uneven enforcement and human resources did not make it into this year's ranking of the top 10 challenges faced by member companies. Instead, COVID-19 and tariffs made their way onto the list, and prominently. This report delves into some of these challenges and other common themes appearing in our survey data this year.

Top 10 Challenges

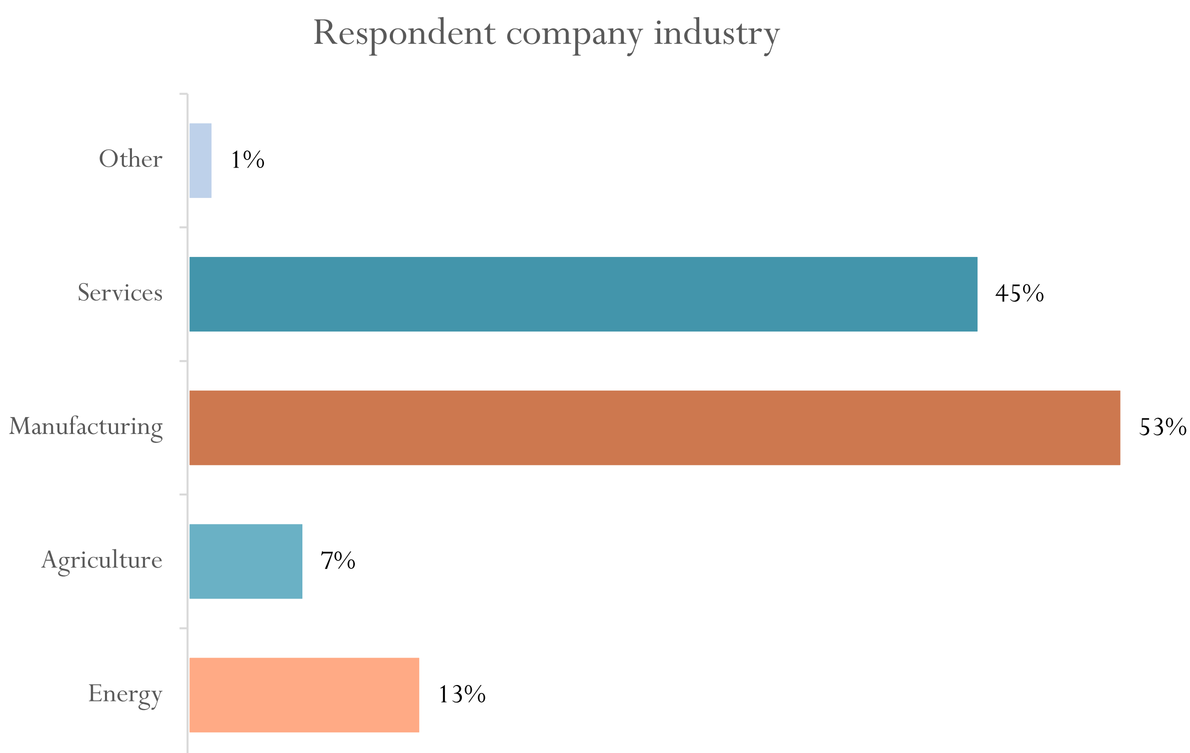
1. US-China relations
2. COVID-19 impacts
3. Competition with Chinese companies
4. Tariffs
5. Cost increases
6. Licenses and approvals
7. IPR enforcement
8. Data flows
9. Innovation policies
10. Investment restrictions on foreign companies

Methodology

For over a decade, USCBC's member survey has captured sentiments from a multitude of US companies operating in China. This year's report draws from a pool of more than 100 member companies. Slightly more than two-thirds of respondent company executives in this year's survey were based in China, with a third located in the United States. Responses were collected in late May and June 2020.

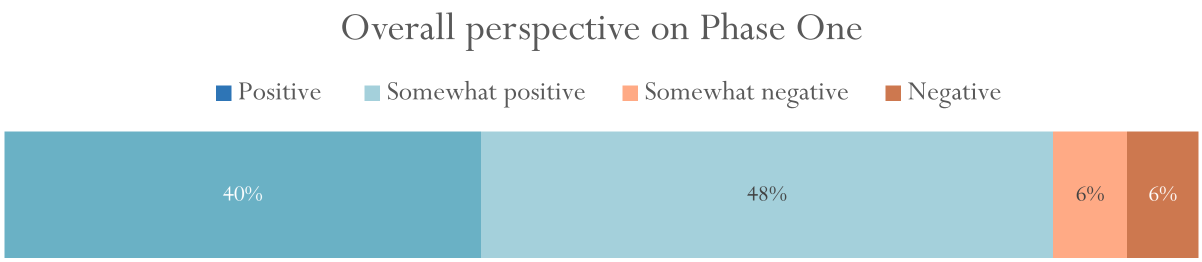
Companies' top 10 challenges were calculated using a weighted system to reflect the most significant issues they encounter while doing business in China. The same methodology has been used in previous years to ensure consistent analysis of the issues over time.

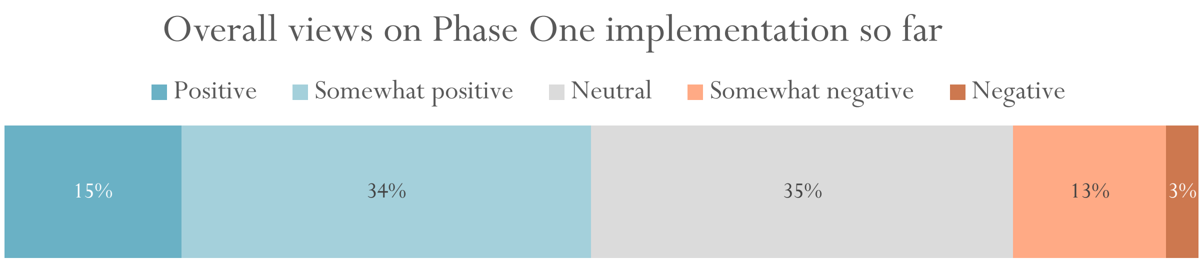
Due to rounding, some chart totals may add up to more or less than 100 percent.



The Phase One Trade Deal

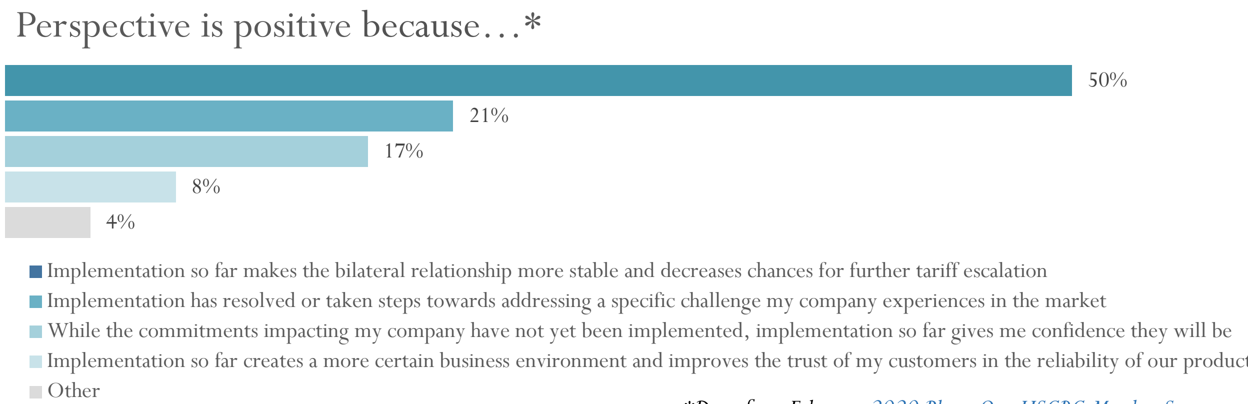
The signing of the Phase One Trade Agreement between the United States and China in mid-January of this year was met with a range of reactions from lawmakers, analysts, and the business community. Seven months after the United States and China signed the Phase One deal, American companies remain overwhelmingly supportive, with 88 percent of respondents reporting a positive or somewhat positive view of the agreement. Since the deal's signing, China has taken steps to liberalize its financial services sector to foreign companies, significantly reduce barriers to trade in the agriculture sector, and strengthen its domestic legal and enforcement regime for protecting intellectual property rights.





While roughly half of respondents recognize the progress China has made and report a positive or somewhat positive view of Phase One implementation, a significant portion—35 percent—take a neutral view. This may suggest that many are still waiting to see if all commitments will be met, or that the deal does not directly impact the respondent's business operations. While the agreement contains commitments that will span over the next two years, only five months have passed since the deal formally went into effect in February.

USCBC has been surveying its members on the Phase One agreement since then. Responses from member companies over the last several months indicate that US companies' support for the Phase One agreement stems less from the commitments themselves, but instead, from the perception that the agreement is a stabilizing force in an otherwise rapidly deteriorating bilateral relationship.



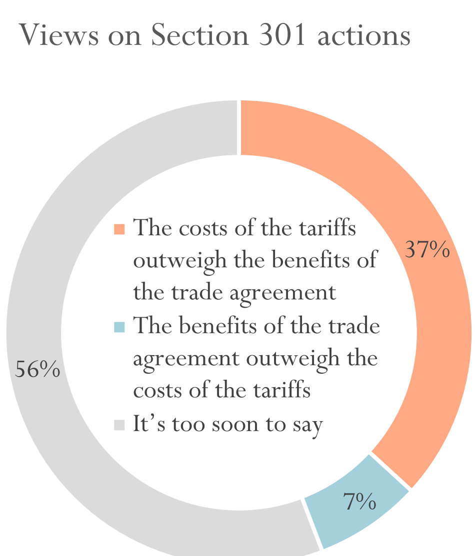
**Data from February [2020 Phase One USCBC Member Survey]*

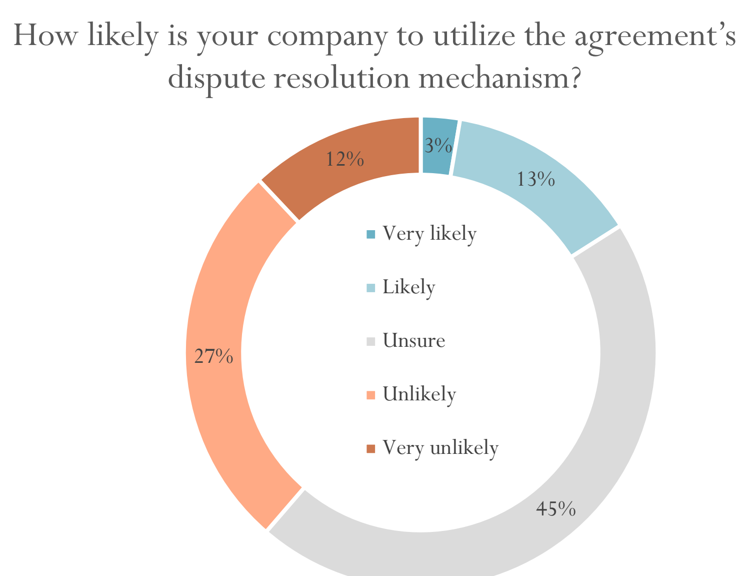
Despite agreeing to halt any further tariff increases, as of the release of this report, tariffs remain on $370 billion of Chinese goods and more than $110 billion of US goods.

Only 7 percent of respondents feel that the benefits of the Phase One agreement outweigh the costs of tariffs incurred along the way, while 36 percent say that costs outweigh the benefits of the agreement. Importantly, a 56-percent majority believe it is too soon to say, suggesting that for most, the jury is still out on the Trump administration's policy approach to China.

The deal's dispute resolution mechanism, heralded as one of the key achievements of both the US and Chinese negotiators, appears to be having trouble gaining traction with the US business community. The dispute resolution chapter establishes a process for addressing perceived shortcomings or disagreements related to the agreement and invites companies to relay their concerns directly to either government, though the mechanism will still function if companies decide not to participate.

While this mechanism provides more opportunities for the US government and, by proxy, companies, to resolve their problems in the China market, many companies are circumspect about actually utilizing the mechanism, with only 16 percent expecting to do so if issues with Phase One arise. Members indicate this hesitation stems from a general uncertainty about how their concerns would be rectified under this arrangement. Some companies noted that there is a fear of potential retaliation in the China market, while others expressed concerns about company privacy.

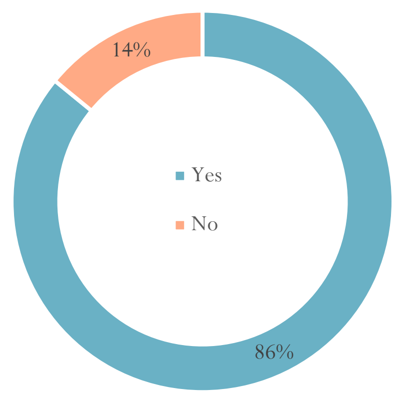




US-China Relations

Despite China's first economic recession in a generation, it is the US-China relationship that poses the top challenge for US companies in China for the third consecutive year. From investment decisions to cybersecurity and standards setting, the emerging competition between the United States and China pervades nearly all aspects of company operations in China. Returning to a stable and constructive US-China relationship is of the utmost importance to USCBC and our member companies.

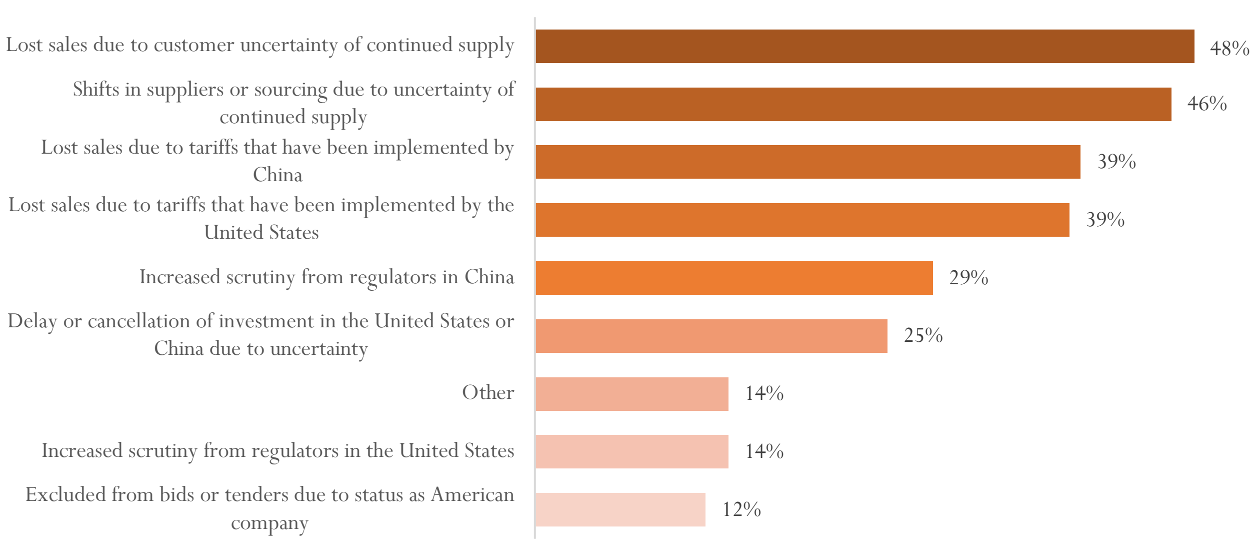
Have you seen any impact on your company's business with China from current US-China trade tensions?



Eighty-six percent of USCBC members report that bilateral trade tensions have impacted their business with China. In 2019, the most significant result of those tensions was lost sales due to retaliatory tariffs enacted by China. While Chinese tariffs continued to impact US company sales to China in 2020, 10 percent fewer companies cited this as a top concern this year compared to last. This is likely a result of their success with China's tariff exclusion process established this year as well as the uptick in Chinese purchases of US goods in accordance with the Expanding Trade chapter of the Phase One agreement.

In 2020, the most perverse impact of bilateral trade tensions—reported by half of respondents—was lost sales due to customer uncertainty about continued supply. Members were similarly concerned about sourcing products as a result of tariffs. Recent US policies restricting the sales of certain products and services to some Chinese companies have begun to impact more commercial interactions between US companies and their Chinese customers. Conversations with USCBC member companies indicate Chinese customers are increasingly concerned about sustained access to American companies' products and about the potential for US export control and other policies to inhibit access to those products in the future. As one business affirmed, "we have been cut out of some bids because we are a US company."

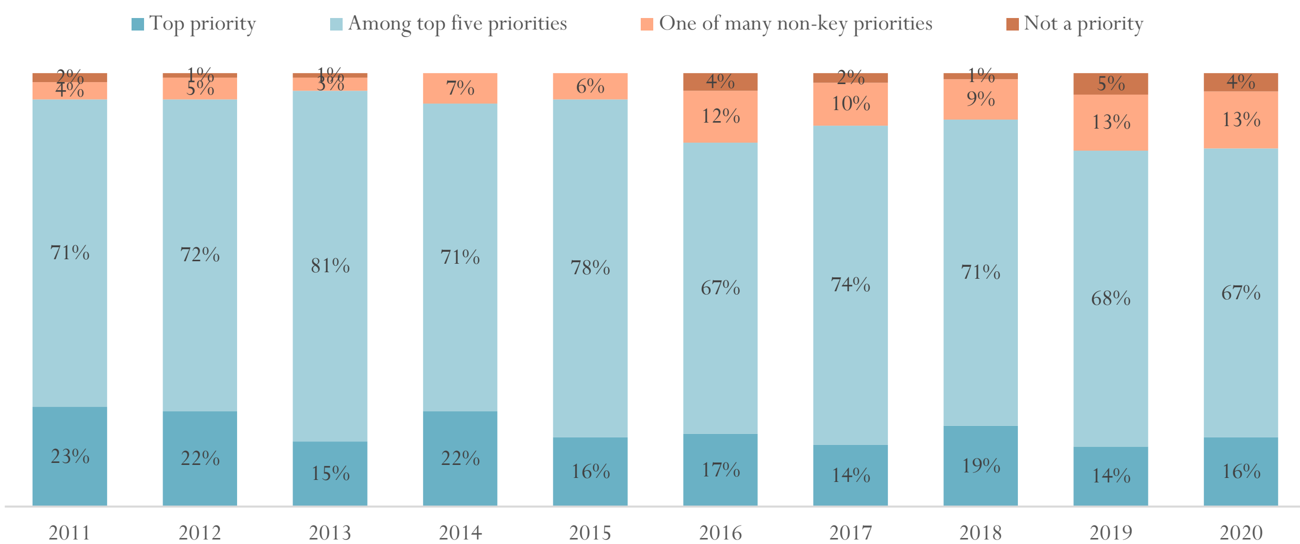
Impact of US-China trade tensions on business



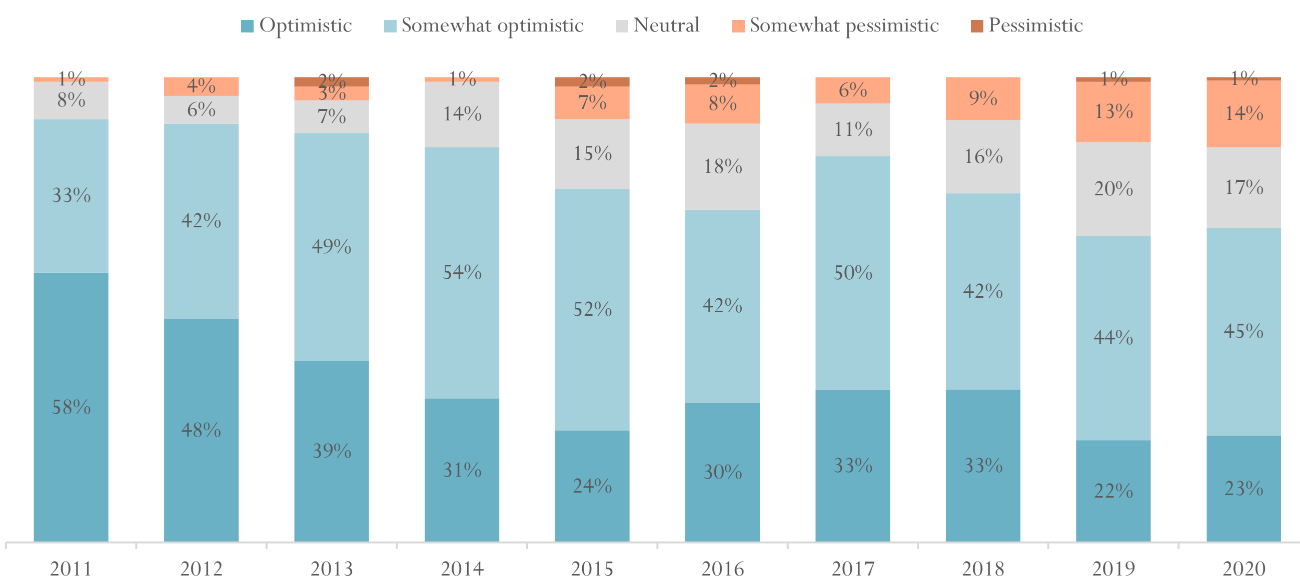
The Investment Environment

Despite years of trade friction and swelling calls for economic disengagement by hawks in the United States and China, both our data as well as conversations with member companies indicate that American companies remain committed to the China market over the long term. Eighty-three percent of companies counted China as either the top or among the top five priorities for their company's global strategy. Projections about the five-year business outlook in China are similarly sanguine, with nearly 70 percent expressing that they are optimistic about the commercial prospects of the market. While business uncertainty remains high across the board, the Phase One agreement provided a modicum of confidence in the China investment environment by freezing additional tariff increases and stabilizing the overall commercial relationship.

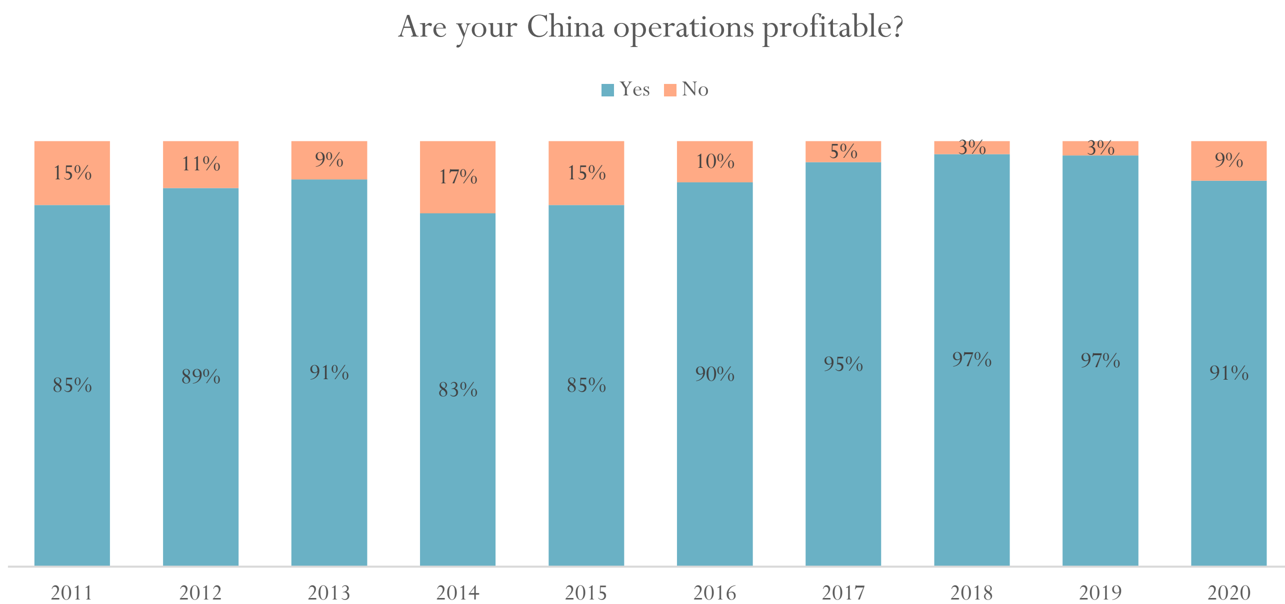
China's prominence in overall company strategy

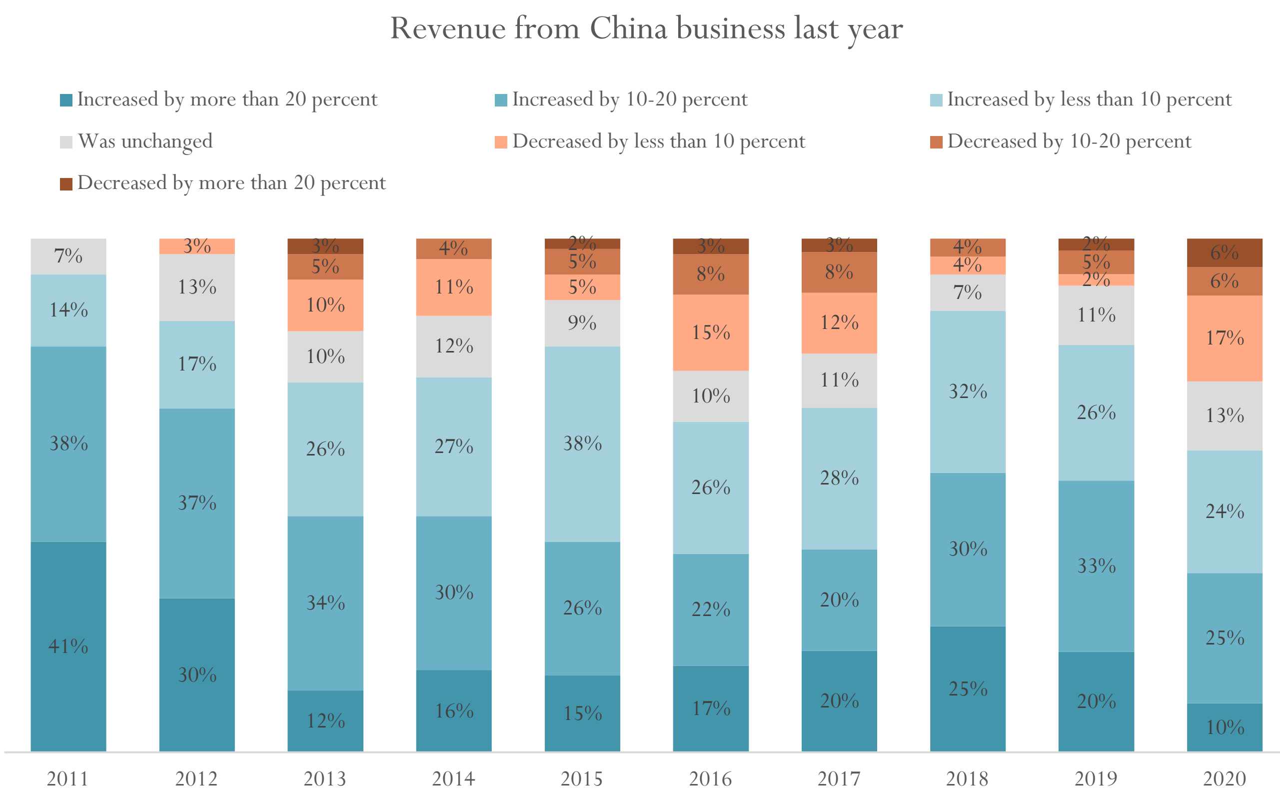


Five-year outlook for business in China

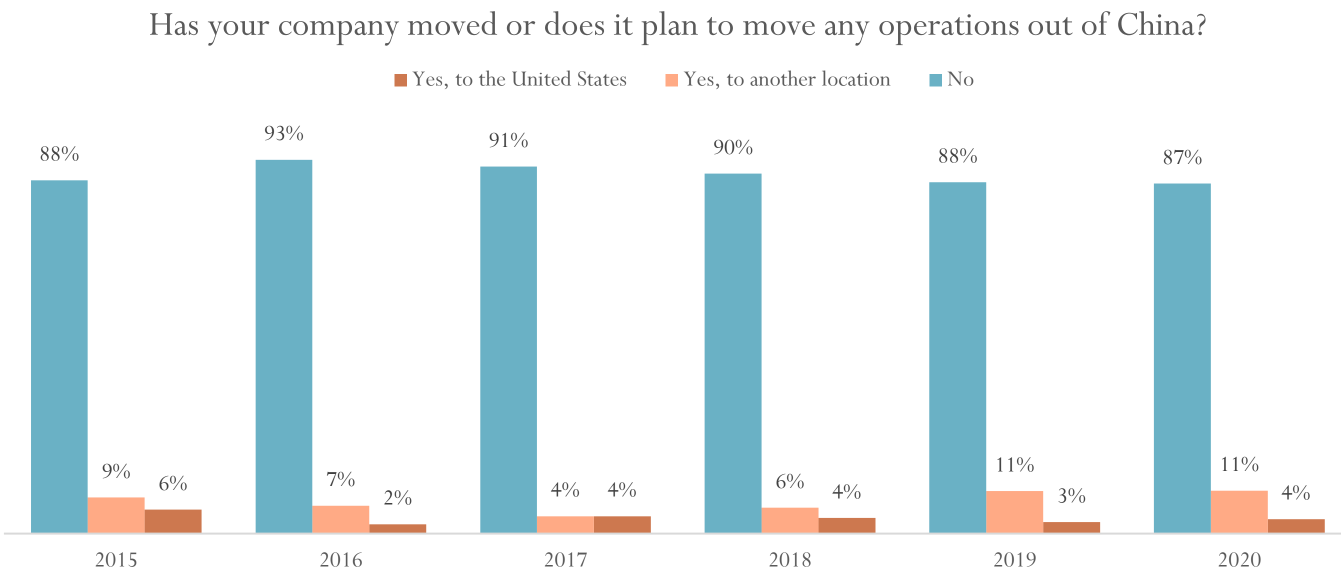


Profitability is also a key component of long-term confidence in the China market. Ninety-one percent of companies indicate their China operations are profitable, albeit at a lower margin than in years past. According to our data, the primary restraint on profitability is COVID-19 and its impact on the economy. The majority of respondent companies also saw an increase in revenue last year.

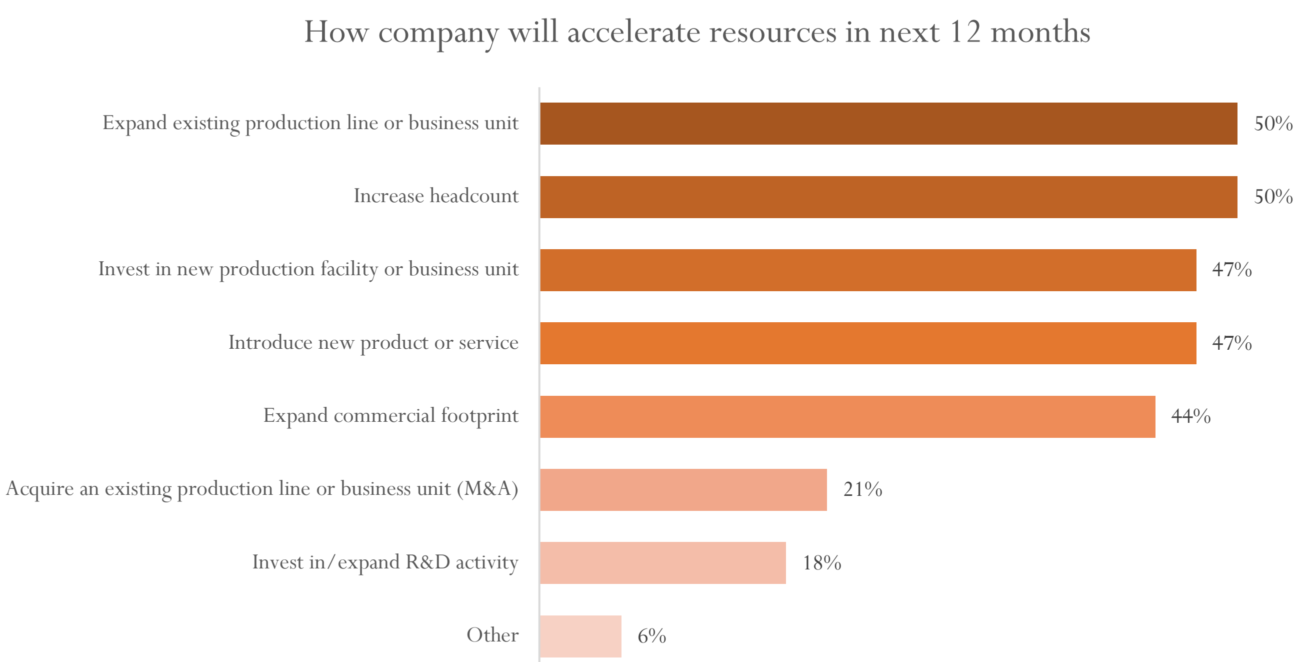




As a result of this long-term confidence in the China market, 87 percent of companies reported no plans to shift production out of China. Only four percent have shifted or plan to shift operations to the United States, and this is largely due to lagging consumer demand in China. The other 11 percent reported recent or planned production shifts to other parts of the world, with Thailand and Mexico as the leading alternative destinations.

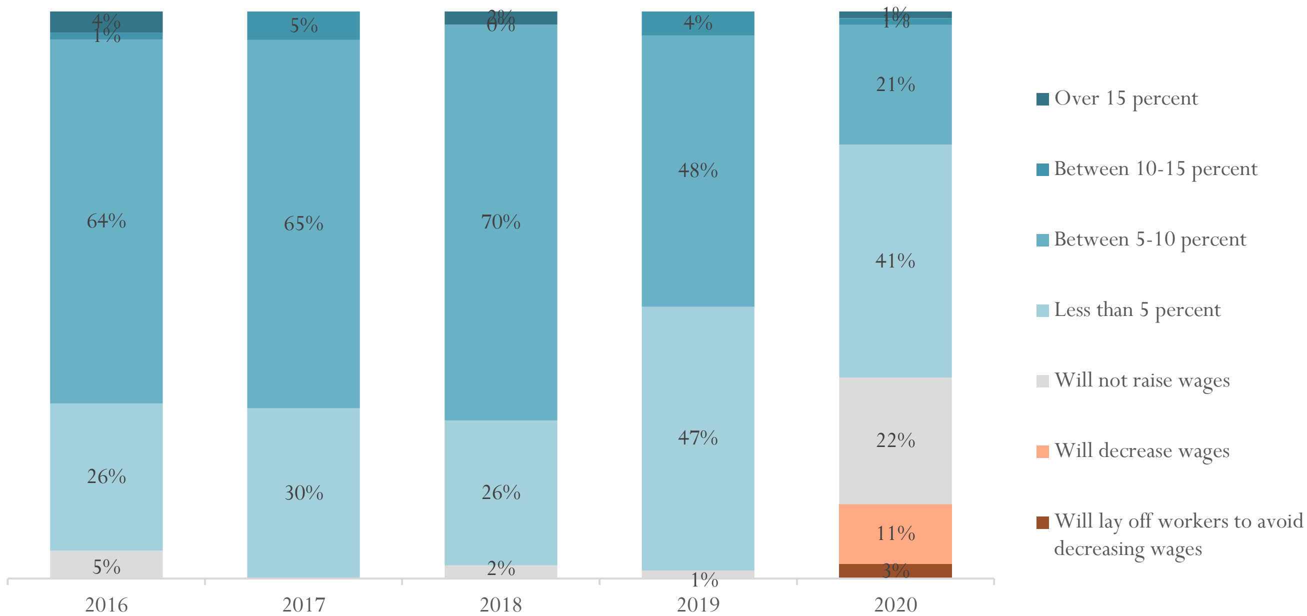


Of the 75 percent of companies reporting that their resource commitments to China operations will remain static or accelerate in the coming year, the most common reasons were to expand their existing commercial footprint and production, increase their headcount, and launch new products.



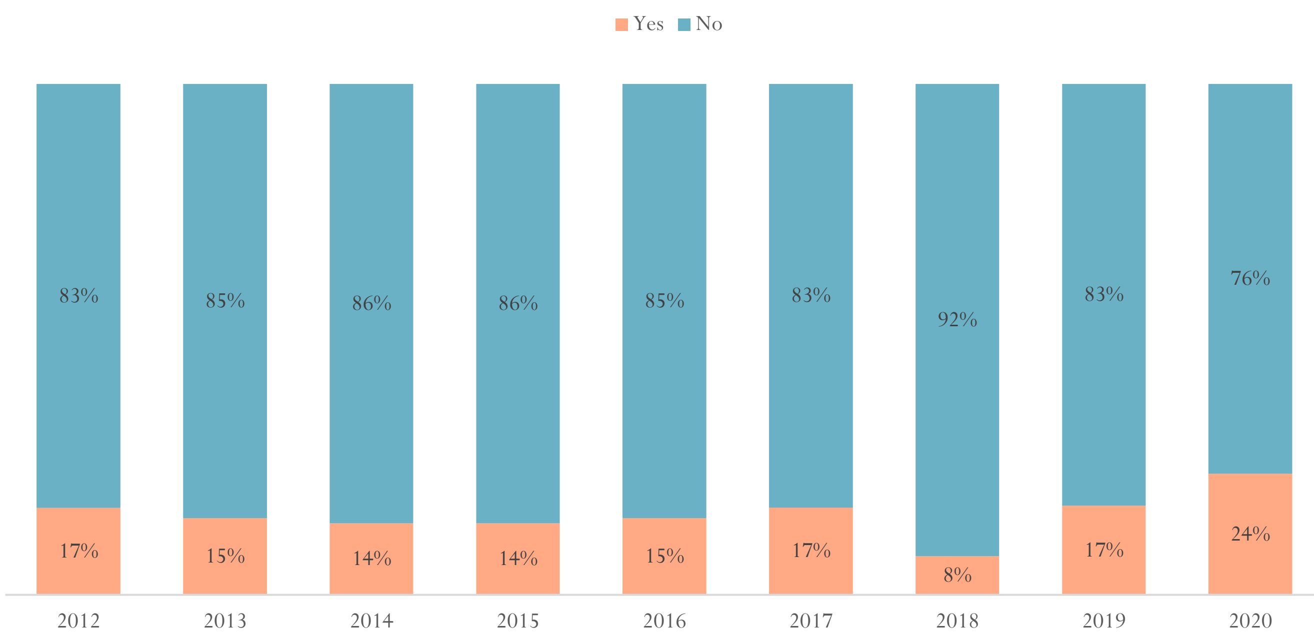
But despite long-term optimism, bilateral trade friction and especially the outbreak of COVID-19 are weighing on the investment decisions and near-term economic prospects of American companies in China.

Estimated wage increases for next year

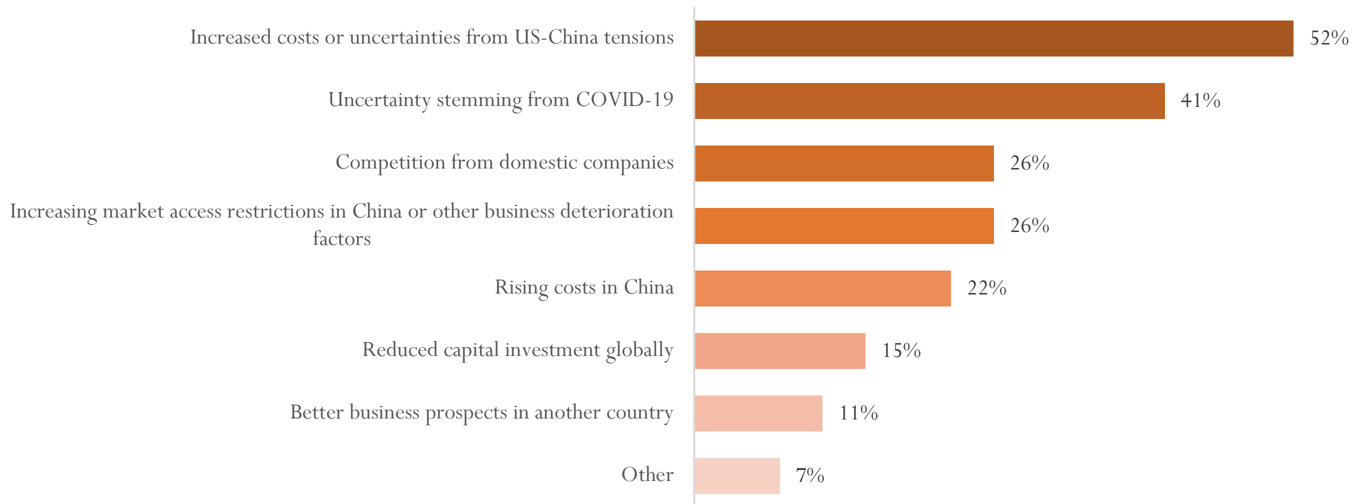


A quarter of USCBC member companies have reduced or stopped planned investment in China in the last year, a historic high for this survey. The top reasons for reducing or stopping investment in China are increased costs or uncertainties from US-China tensions and uncertainty stemming from COVID-19.

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



Why did your company reduce or stop planned investment in China in the last year?

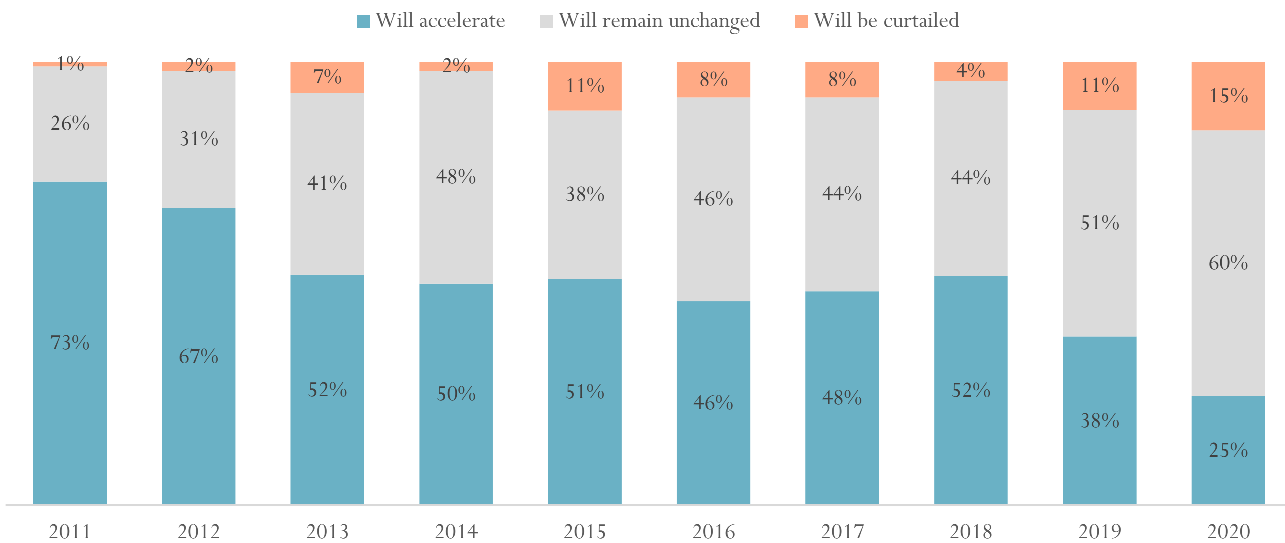


The trend of reduced investment is particularly apparent in research and development (R&D). In 2020, for those increasing investment in China, only 18 percent indicated that investment would go to R&D spending. This compares to 33 percent in 2019, and 47 percent in 2018. Part of this decrease might be a result of increasingly onerous data flow restrictions, the development of Chinese export control policies, and changes in US tax policy incentivizing investment in the R&D area.

The political uncertainty and lingering COVID-19 pandemic are also impacting revenue and wage projections. Only 30 percent of companies expect their revenue to increase this year, a historic low for this survey. Companies' estimated wage increases are also telling. For the past decade, companies reporting that they would not increase wages in the next year have consistently been in the low single digits. In 2020, 36 percent of respondents indicate that they will keep wages static, reduce wages, or lay off workers to avoid cutting wages in the year ahead, a 35 percent increase from the previous year.

The abrupt downturn in projections this year and the absence of an observed trend suggest that wages and resource commitment to China may see a revival when the domestic economy improves.

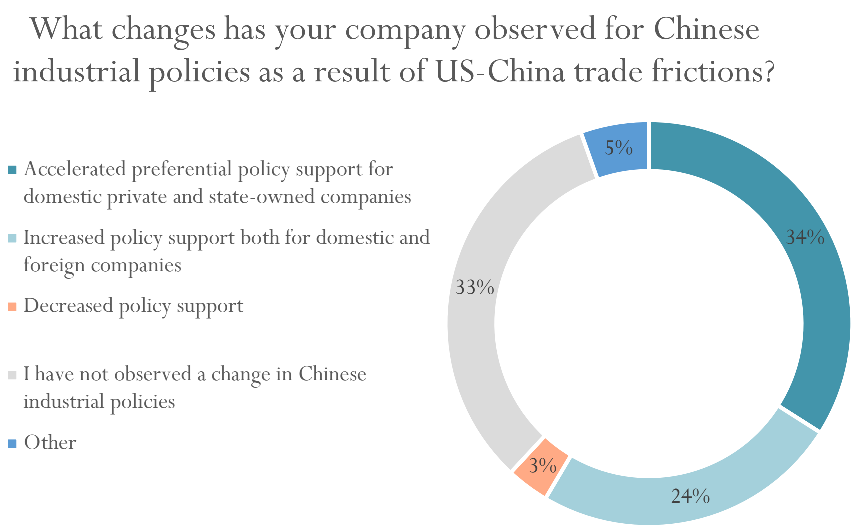
Resource commitment for next 12 months

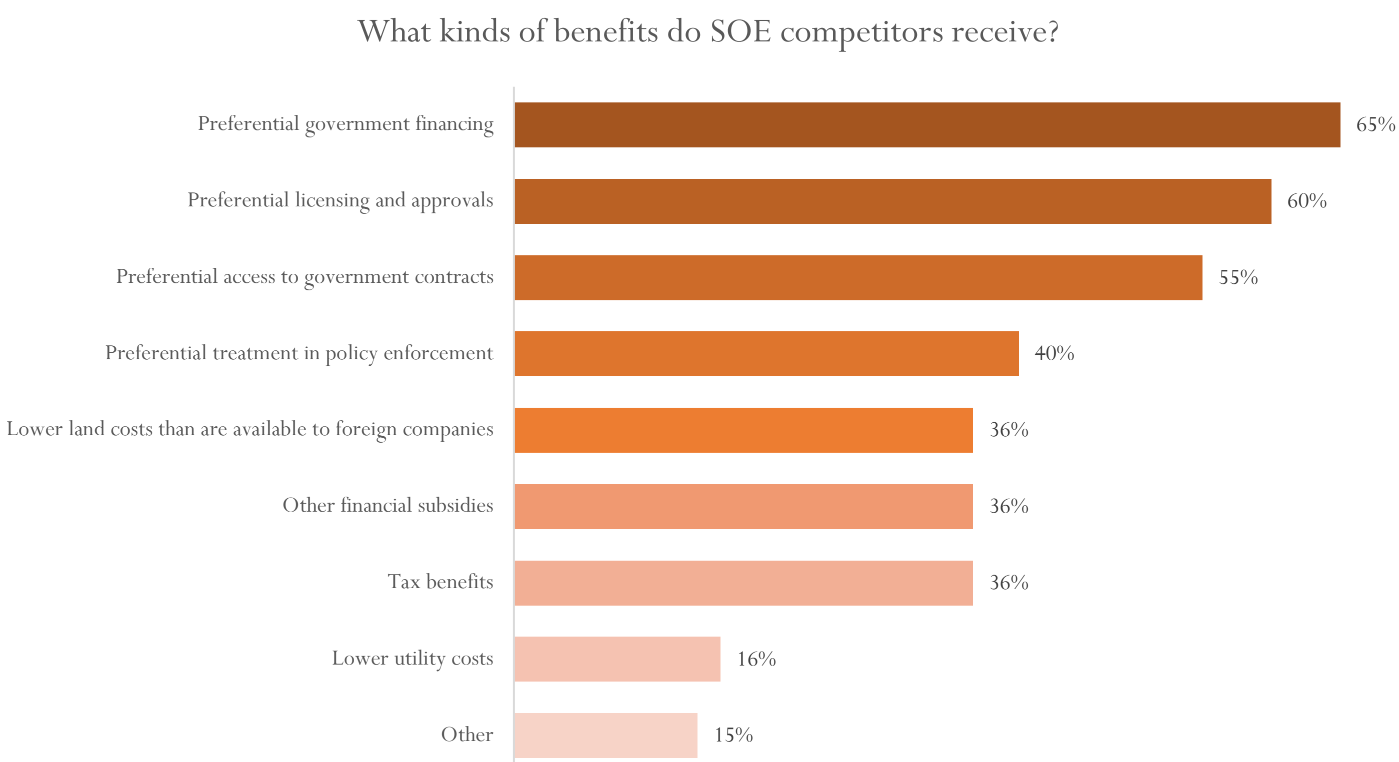


Competition

US companies have had different experiences when it comes to the competitive environment in China. This year, one-third of respondents observed accelerated preferential policy support for Chinese companies directly as a result of US-China trade frictions. Protectionism, particularly China's industrial policies such as Made in China 2025 and a push toward domestic procurement, has created a more difficult competitive environment for some US companies. Twenty-five percent of respondents said that increased competition with Chinese companies had hurt their profit margins last year.

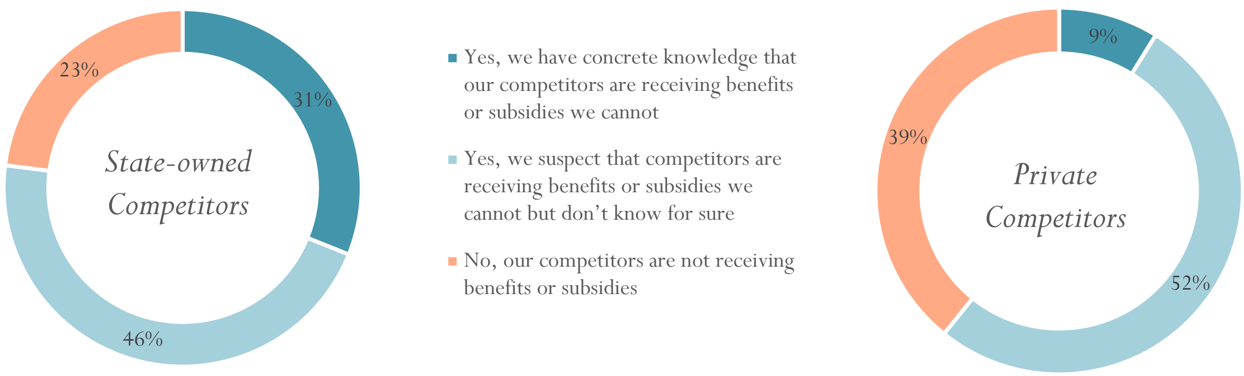
But in other areas, particularly when it comes to the state sector, the picture is less straightforward. While the majority—77 percent—either have concrete knowledge of or suspect state-owned competitors are receiving subsidies or benefits from the Chinese government, twenty-three percent report that they do not believe SOE competitors are receiving tangible benefits.

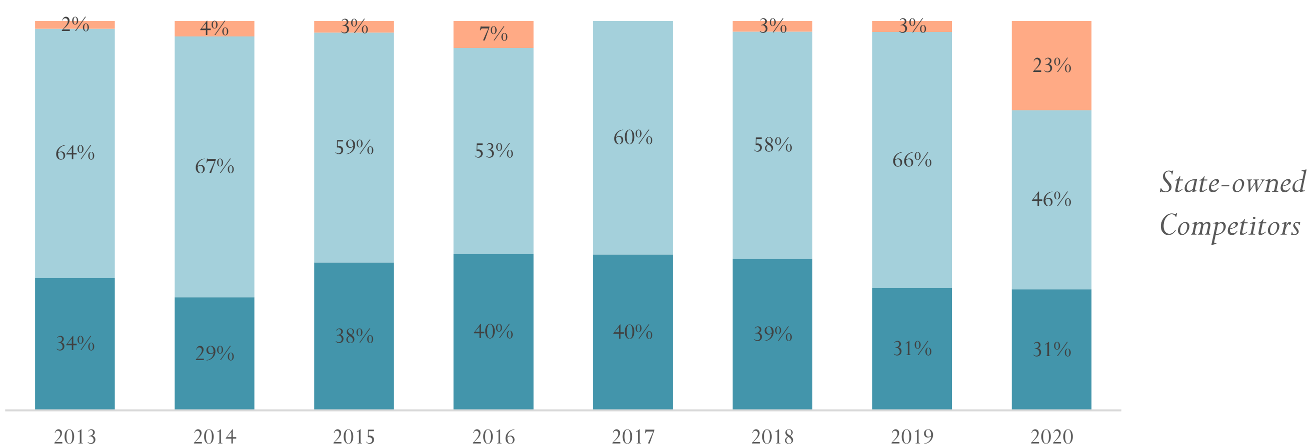


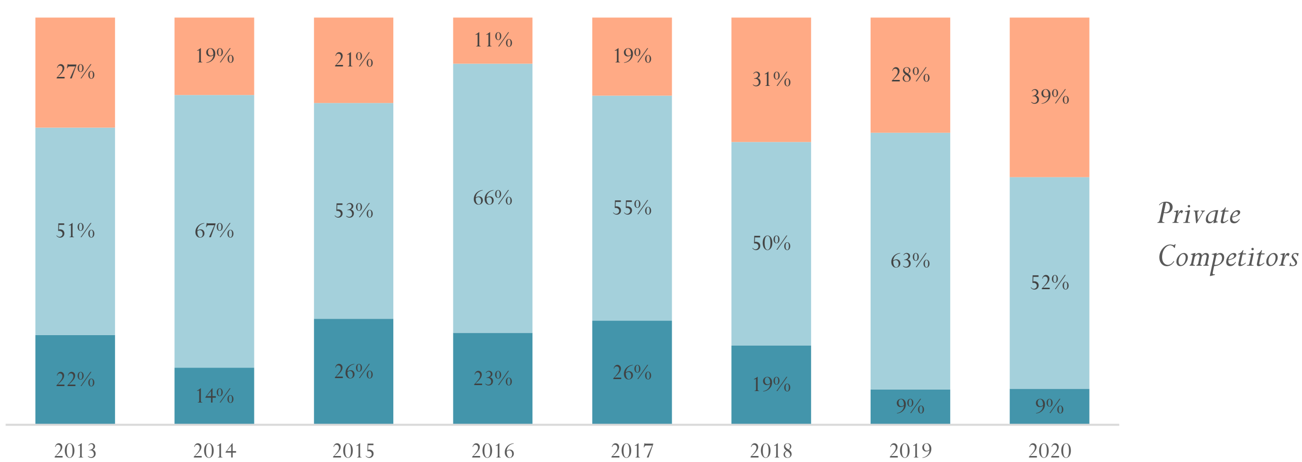


Likewise, 61 percent of respondents either have concrete evidence or suspect that their privately-owned competitors in China are receiving similar benefits. While this is an improvement from years past, competition with Chinese companies still ranks as the third most common challenge for respondents to this year's survey.

Are your private/state-owned competitors receiving tangible benefits?





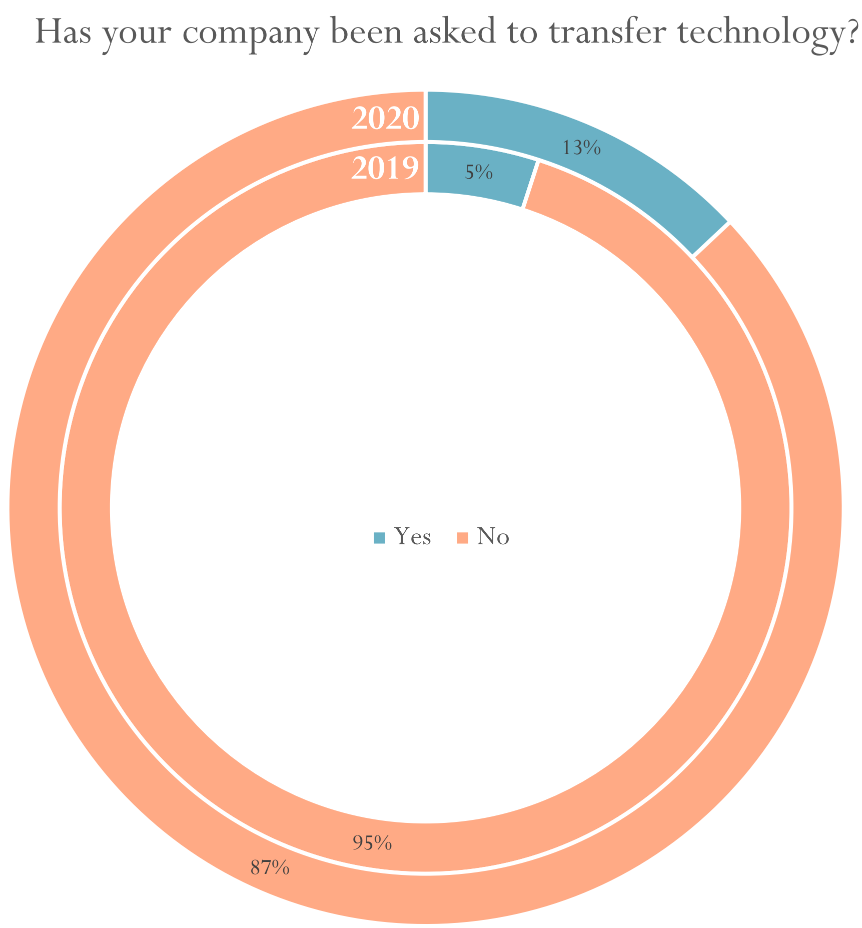


Technology Transfer

Market access restrictions, joint venture requirements, or administrative licensing requirements, such as those embedded in standardization and industrial policies, often preclude a company's ability to enter the China market. When asked to transfer technology as part of this process, companies are compelled to weigh the relative values of both their technology and access to the China market.

Technology transfer does not affect all companies, but for those that it does, it is an acute concern. Although the issue has remained a sticking point in bilateral tensions between the United States and China, two-thirds of companies report that technology transfer does not have an impact on their operational decisions in China. Even so, 13 percent of respondent companies have been asked to transfer technology this year, compared to only 5 percent last year. The reason for this uptick is unclear.

China has taken some steps to address these concerns, such as committing not to require or pressure foreign companies to transfer technology in the Phase One agreement and through language in its *Foreign Investment Law* that went into effect this year. However, without specifics, it is unclear how this will reasonably be enforced. Additional reforms to joint venture requirements and administrative licensing requirements would be beneficial in protecting companies' trade secrets.

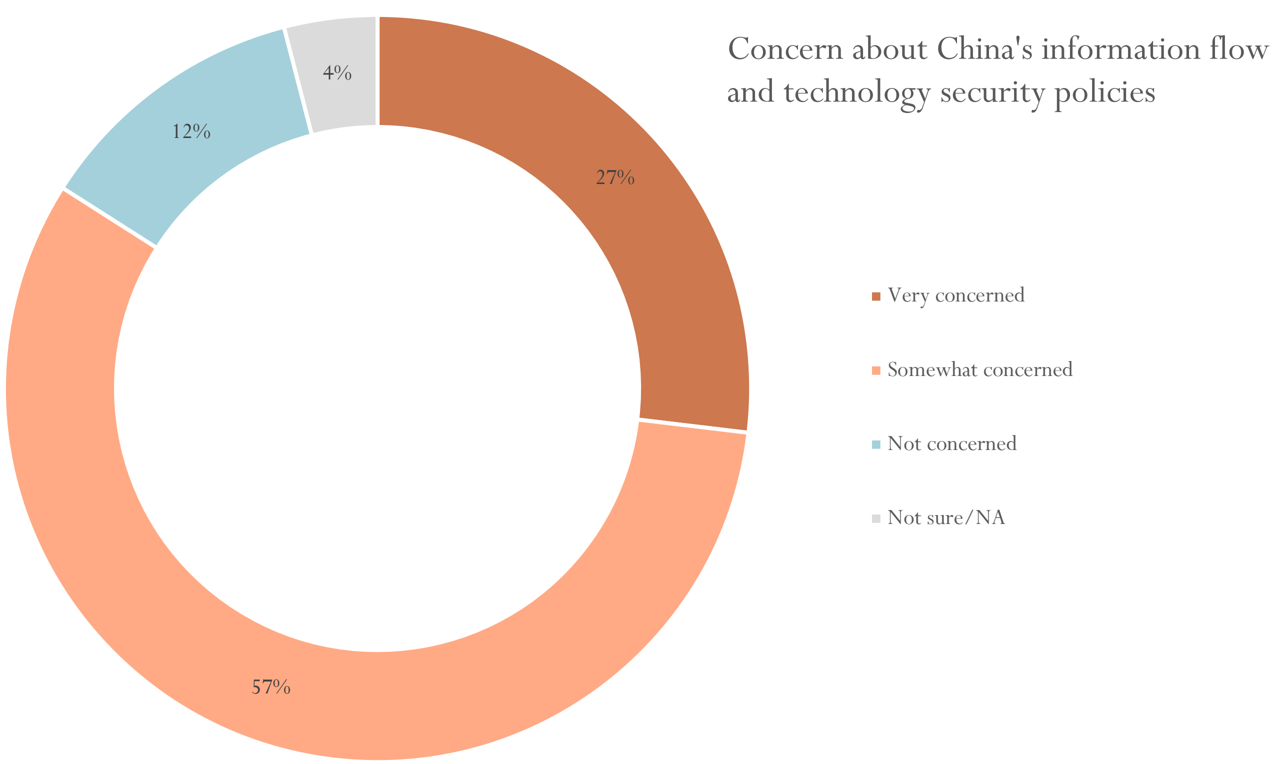


Data Flows and Cybersecurity

Over the past few years, China has expanded its cyber and data security regime, which includes new requirements for virtually all companies that do business in China. While China's overarching *Cybersecurity Law* went into effect in June of 2017, its implementing regulations—which are crucial in determining how the law will be applied in practice—have been released gradually, with many still yet to be finalized. The percentage of companies that are somewhat or very concerned about China's information flow and technology security policies increased this year to 84 percent from 76 percent in 2019.

According to companies, these concerns are driven by the negative trajectory of the US-China relationship. Bilateral tensions are likely to remain at the center of concerns around data and cybersecurity issues moving forward. Although foreign technologies provide more options for users in the China market, increasing rancor between the United States and China, and policy escalation, may curtail companies' ability to operate effectively in the market. Increasingly assertive US technology policies and Chinese domestic protectionism for homegrown tech firms may produce a more unstable operational environment and less product options for companies in the sector.

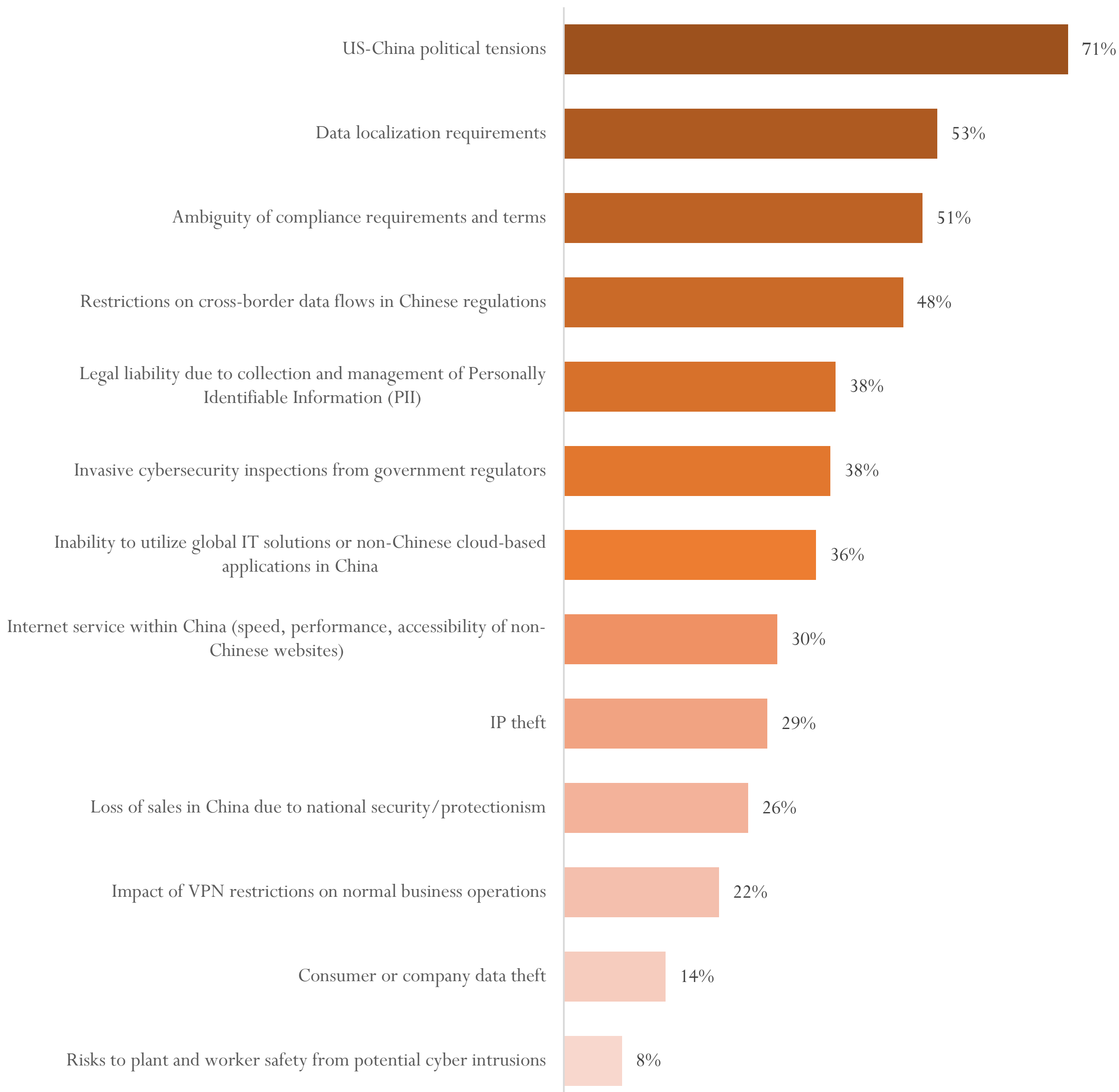
Top cyber-related concerns cited by companies this year are similar to those raised in the past few years. Seventy-one percent of companies said they were concerned about US-China political tensions in relation to China's policies in this arena, a 15 percent increase from 2019. Other common concerns were data localization requirements and restrictions on crossborder data flows, both of which have seen policy developments in the last year.



Not everything has remained static, however. Concerns over virtual private network (VPN) restrictions, for example, have fallen significantly. Only 22 percent of companies identified VPN restrictions as an issue, compared to 50 percent last year when Chinese regulators articulated plans to restrict VPN access. The use of VPNs is common among the foreign business community, as it can be necessary for the ease of communication and recordkeeping on company-wide platforms that may be restricted by China's internet firewall.

Likewise, concern around data theft has seen a marked decline in the last few years, with only 14 percent of companies identifying it as a problem compared to a peak of 53 percent in 2017.

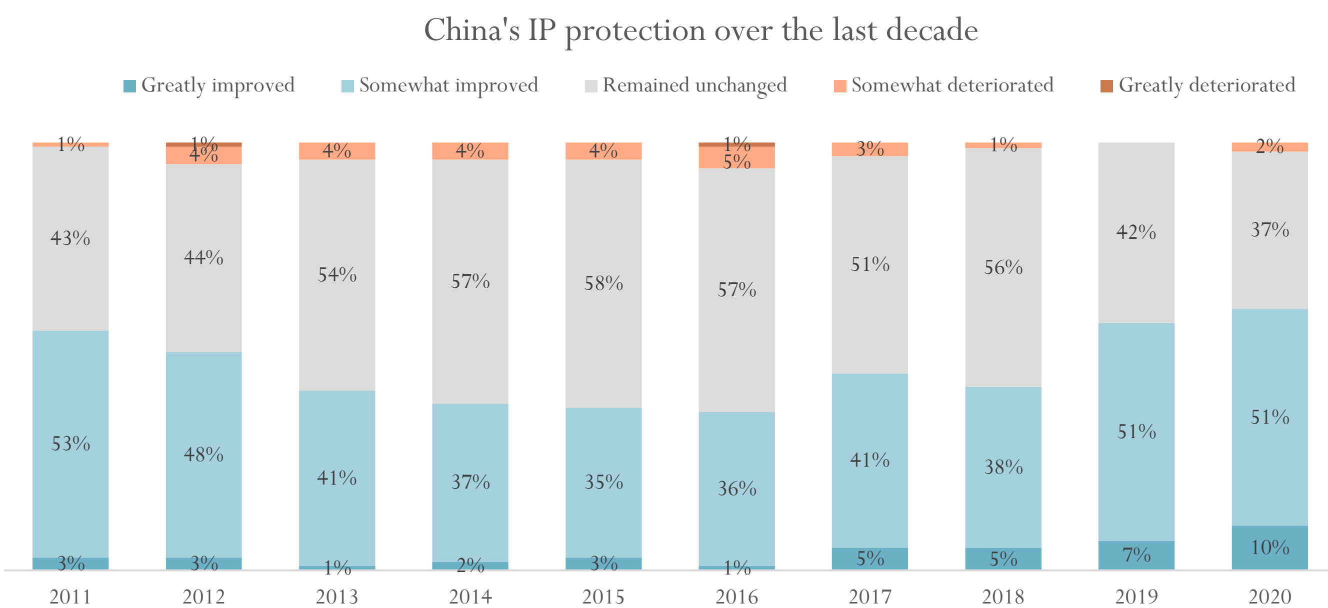
Concerns regarding cyber-related issues

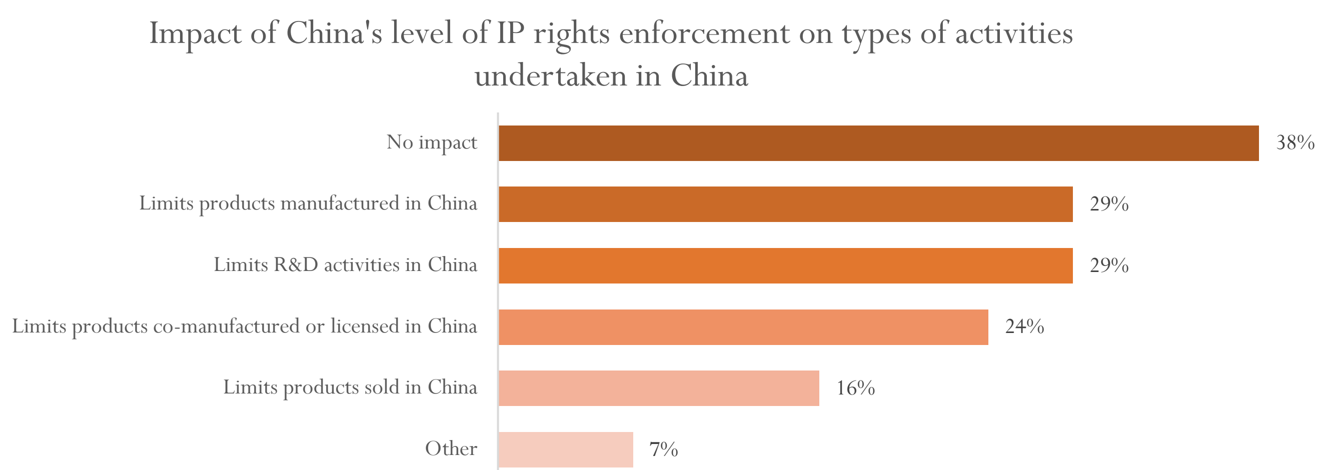


Intellectual Property Protection

The lingering challenges of protecting intellectual property (IP) rights in China remain at the center of the bilateral friction between the United States and China. As in years past, respondents indicate incremental improvements in both the protection and enforcement of IP rights. Companies report that their cases are increasingly handled by judges with a nuanced understanding of IP disputes and by more motivated police that are willing to raid infringing factories. It appears that there is a general awareness from partners and license holders about the importance of protection.

Despite improvements, the percentage of companies that curtail or choose not to embark on investments in China is not insignificant. Responses from several companies indicate that the impact of IP rights enforcement limits their products manufactured, licensed, and sold in China, in addition to their R&D activities. For China, improved IP enforcement is not simply a matter of ensuring that IP owners are compensated for their discoveries, it is also an economic issue. When American companies are limiting their operations in China because of the lack of full protection for IP rights, opportunities for job creation and innovation are lost.





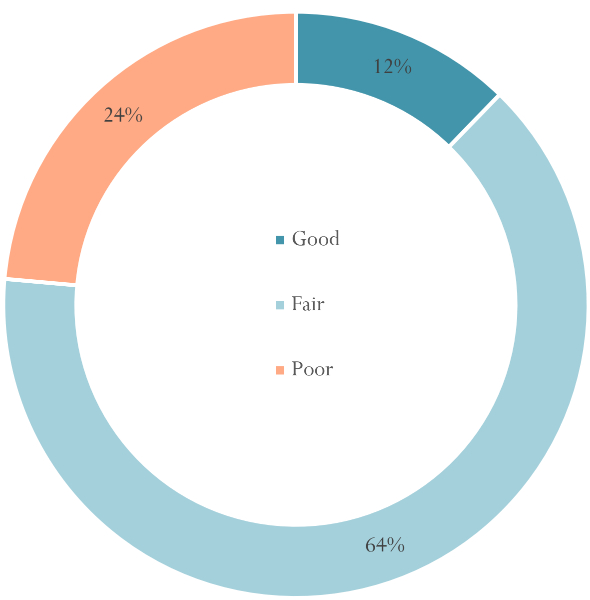
Participation in Standards Setting

China sometimes employs technical standards that differ from the standards that companies use in other markets internationally, which can act as a market access barrier and hinder interoperability. Despite new commitments in China's *Foreign Investment Law* to allow equal access to standards setting for foreign and Chinese companies, respondents report that in many cases, they are still unable to participate fully. Of the approximately two-thirds of respondents attempting to participate in standards setting, most rate their ability to do so as only fair (64 percent), and nearly a quarter as poor.

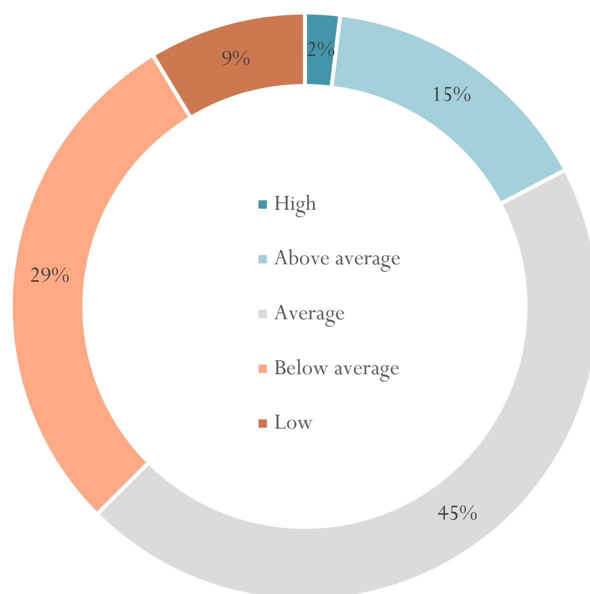
Seventeen percent of companies report high or above average influence in standards setting, and indeed industry leaders are often able to be influential in standards setting by contributing their technical expertise.

However, the ability to participate does not always translate to influence. Only 45 percent of companies feel they had average influence in standards setting, while nearly two-fifths feel that it was below average or low.

Your company's ability to participate in China's standards setting process is…



Degree of influence in standards setting



Visa and Travel Restrictions

Visa and travel restrictions due to COVID-19 have had an impact on company operations. In 2020, 32 percent of USCBC member companies indicate it was more challenging to acquire visas for US employees, compared to 3 percent last year. The travel restrictions have also had an impact on regular operations, with 60 percent of USCBC members cancelling international events and board meetings in China, 55 percent cancelling all US-China business travel, and 34% cancelling international executive exchange programs.