SECTION 301 INVESTIGATION: CHINA'S ACTS, POLICIES, AND PRACTICES RELATED TO TECHNOLOGY TRANSFER, INTELLECTUAL PROPERTY AND INNOVATION
Docket No. USTR-2017-0016
US-China Business Council
September 28, 2017

The US-China Business Council (USCBC) represents 200 American companies engaged in business across all industries and sectors in China, employing millions of Americans across the United States.

Protecting intellectual property and market-based decisions on technology transfer are top priorities of USCBC's membership. We appreciate the Office of the US Trade Representative's focus on these important issues to reach the ultimate goal of eliminating policies that harm US companies. The requirement to transfer technology as a condition to gain market access in China is an acute concern of American companies in key sectors, who often must make difficult choices about managing the tradeoff of technology sharing and access to the world's second largest economy. The protection of intellectual property rights, a broad term that encompasses patents, trade secrets, trademarks, and copyrights, is also critically important. Addressing these issues with effective measures will positively contribute to building a stronger and more durable commercial relationship between the United States and China.

As we look to address the issues, we should keep the overall bilateral commercial relationship in perspective: while there are numerous challenges that companies face, US trade and investment with China supports roughly 2.6 million American jobs, across many industries. China is expected to continue to be one of world's fastest, if not the fastest, growing major economies, fueling more market opportunities for US businesses. According to research by Oxford Economics, US exports to China are expected to rise to more than $520 billion by 2030. Given those important benefits, the United States should seek to preserve the gains we have made for American companies in China while addressing the problems that remain.

USTR's August 24, 2017 Federal Register notice cited four specific areas in which Chinese policies may result in US and other foreign technology and IP being transferred unwillingly to China. USCBC's submission includes recommendations of how problems identified in each area could be effectively addressed.

While Section 301 provides a variety of options that the United States may use when it finds that trading partners' policies are unreasonable or discriminatory, the ultimate goal of the US statute – and the goal of US companies who face discrimination – is the elimination of those policies. Eliminating those policies would allow greater access to what is currently at least a $400 billion market for the US economy, but should be much more. Rather than simply seeking to impose penalties or restrict trade, which could have the effect of inhibiting commercial cooperation that benefits US companies and US citizens, the preferred approach should be to develop and achieve enduring solutions -- changes to Chinese policies and practices that resolve the issues. Any related trade actions taken by the United States should be compliant with US international trading obligations, able to withstand a challenge at the World Trade Organization, and address the concerns of American companies about the protection of their intellectual property and technology. Such an approach should prioritize bilateral or multilateral agreements with enforcement options tailored to deal with specific concerns, to ensure that progress made in these areas can be effectively locked in. If existing agreements do not cover all of the United States' concerns, new agreements should be negotiated to do so.

Intellectual property protection
Intellectual property protection remains a top concern of American companies operating in China. In USCBC's recently-concluded survey of its membership on the business environment in China, IP enforcement was ranked the fifth highest issue of concern; eighty-three percent of respondents said they have some level of concern about protecting IP.

It should be noted that USCBC's membership as a whole sees China's IP protection regime as slowly improving, rather than deteriorating. In our surveys over the past decade, each year a plurality of our members see no change in the IP enforcement environment in China. However, of the remainder, more companies report improvement in the IP environment rather than deterioration. Our 2017 survey results were consistent with this trend line: while 51 percent saw no change, 45 percent reported some level of improvement in the IP enforcement environment in China and 3 percent saw deterioration.

A development in recent years is the improvement in companies' ability to use China's various IPR enforcement channels. Those channels include administrative agencies, civil courts, criminal courts and China's recently-created special IP courts. A majority of companies now say that China's enforcement channels are viable in at least some cases; successful case outcomes outnumber unsuccessful cases by about two to one, although the number of cases pursued remains small.

Even with this progress, there are specific problems that our members note are important to address. There is a perception that some Chinese judges favor local defendants in IP cases. Unequal adjudication is among the signs of protectionism that companies reported in the 2017 survey, and this perception likely influences companies' decisions to pursue civil cases. China's evidence collection requirements make it cumbersome to collect and preserve evidence, impacting companies' ability to cost-effectively challenge infringers. In addition, tools that many companies use in the United States and other markets to protect their IP, such as through 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 may place foreign-owned companies at a competitive disadvantage, such as subsidies offered to Chinese companies for patent prosecution.

Despite the slow improvements noted above, China's enforcement of IPR remains insufficient, as evidenced by the issue's ranking as the fifth most important problem facing American companies doing business with China. One solution is for China to adopt a tougher deterrent against piracy. Currently, China maintains a system of thresholds that determine whether an IP violator will be subject to a fine versus the stronger deterrent of criminal sanctions. IP violators exploit these thresholds to avoid criminal sanctions; for those who get caught, paying a fine merely represents a cost of doing business and does little to deter piracy. China should adopt the stronger, WTO-consistent deterrent of criminal penalties in cases of commercial-scale infringement. Broadening the use of higher penalties and stronger deterrents in both civil and criminal cases against all types of IPR infringement—including patent, copyright, trademark, and trade secrets violations—will benefit all companies and IPR holders in China.

The United States should also continue to vigorously prosecute IP violations that occur on US soil, using the power of the US courts and rule of law to send a clear message that IP piracy will not be tolerated.

Technology transfer

Tech transfer requirements are among the issues that all WTO members have acknowledged is an unfair trading practice. China explicitly agreed to not use such requirements as part of its WTO accession in 2001. Despite these commitments, as part of China's drive to become more innovative, foreign companies have been encouraged and, in some cases, pressured or required to transfer technology to their China subsidiaries or Chinese companies.

The Federal Register notice requests information on the "variety of tools" that China uses "to require or pressure the transfer of technology and intellectual property to Chinese companies." Measures cited are:

- Opaque and discretionary administrative approval processes
- Joint venture requirements
- Foreign equity limitations
- Procurements
- Other mechanisms to regulate or intervene in U.S. companies' operations in China

The notice also cites "vague and unwritten rules" and "local rules that diverge from national ones, which are applied in a selective and non-transparent manner by Chinese government officials to pressure technology transfer."

In USCBC's recent survey, most companies report that they are concerned about transferring their technology to China, regardless of the circumstances, because of concerns about the protection of intellectual property rights and proprietary information, as well as concerns about enforcing technology licensing agreements.

The survey found that nearly 20 percent of companies have been asked to transfer technology in the past three years, which is consistent with responses in prior years of the survey. While not all companies face this concern, the issue is acute for affected companies in key sectors, who often must make difficult choices about managing the tradeoff of technology sharing and market access. Sometimes the request for technology is part of a commercial negotiation (although in some cases the hand of the government is behind the negotiating process); other times it is a direct request of the Chinese government. Sometimes companies can fend off or mitigate the request, sometimes not. There are multiple ways that such requests effectively become a requirement in order to do business in China.

Government approval processes

Every company doing business in China encounters the government licensing and approvals system at multiple points throughout the business process. Approvals in China cover everything from requiring multiple approvals from different agencies to set up a joint venture, to lengthy product license approvals that may require disclosure of sensitive details about a product's contents or production.

While Chinese companies may face the same types of requirements, the structure of China's legal system creates opportunities for inappropriate – and potentially illegal – requests for technology transfers by foreign companies during the approval process, since separate approval processes are frequently used for domestic and foreign companies. As USCBC's board of directors has regularly noted in its annual board priorities statements, companies legally established under China's Company Law should all be treated equally by regulators, regardless of ownership nationality. China's leadership has stated that it will treat domestic and foreign companies on an equal basis, but further work must be done to implement those commitments. Licensing and other government approval decisions should be made without prejudice against type of ownership, without influence from competing entities, and with consistent interpretation.

A simple solution would make a significant difference in this area: China's policymakers should eliminate terminology in its laws and regulations that distinguish between domestic and foreign-owned companies, such as "foreign-invested enterprises." Continued use of this term invites discriminatory treatment of various types of domestic legal entities, based solely on ownership.

In addition, China should require officials involved in licensing and approval processes to implement regulations based on the explicit details included in those measures, rather than allowing interpretation of rules and intent. Companies regularly report that implementation of laws and regulations remains uneven and inconsistent, impacting both Chinese and foreign companies. While most companies in USCBC's annual membership surveys report that the licensing problems they have experienced have been at the central government level, about one-third of companies have also experienced these problems with provincial and local authorities. Regardless of the level, when officials make such requests, companies should have a reliable channel to report abuses and to appeal adverse decisions when their applications are denied due to those factors, without fear of retaliation.

Related to the issue of varying interpretations of China's laws are vague rules governing the protection of trade secrets. China can take positive steps in this area by expanding its efforts to address trade secrets concerns, including the development of a trade secrets law with stakeholder input, including from American companies, broader use of judicial procedures on preliminary injunctions and evidence preservation orders, clearer measures requiring government agencies to protect confidential information collected from companies during government review processes, and reducing the high evidentiary burden that plaintiffs face during trade secrets cases.

Another risk in the licensing process comes in the form of expert panel reviews. Current Chinese licensing regulations require expert panels for inspection, testing, and quarantine of equipment, facilities, products, and articles that directly concern public security, health, and safety of life and property. Some companies are concerned these panels may expose their companies' technology during the review process. Chinese regulators have the authority and tendency to nominate panelists who work at domestic companies in competition with applicants. Reports submitted to review panels often include detailed information about project costs and revenue, capacity and equipment, raw material and energy requirements, and other confidential operational details that are considered to be trade secrets. In addition, experts are given unlimited authority to ask for information from applicants, even when it has little or no relation to the panel's decision. While companies are willing to share information that is necessary and directly-related to the licensing process, sharing this information with expert panels that include competitors creates a significant—and unnecessary— commercial handicap.

To address these problems, China should prohibit expert panelists that have potential conflicts of interest and enhance trade secret protection mechanisms in review processes for any third-party reviews. China should also institute a formal process for applicants to dispute expert panel nominations where conflicts of interest exist. This process should include a public timeline for consideration, review, and resolution of the dispute to minimize disruptions in the investment process. To aid in that process, companies undergoing reviews should be allowed to provide input on expert panel nominations. To that end, regulating agencies should provide updated and complete lists of approved experts to companies and allow them to nominate a certain number of experts to the panel. Finally, China should require experts to support information requests with substantiated facts, commercial experience, and sound science.

More generally, China should ensure that government reviews and decision making in areas such as investment security and antitrust reviews, government procurement decisions, licensing, and trade remedies such as anti-dumping and countervailing duties cases are fact-based, shielded from political pressures, and non-retaliatory. In particular, licensing and other government approval decisions should be made without prejudice against type of ownership, without influence from competing entities, and with consistent interpretation.

This is also an area where a high-standard BIT would be useful in providing additional tools for the United States and individual companies to address differential treatment between domestic and foreign companies in China. Given China's agreement to incorporate pre-establishment national treatment in the BIT under negotiation with the United States, American companies would be not only treated on an equal basis for existing investments in China where they face ongoing problems, they would also benefit from equal treatment before they enter the market -- that is, protected from unfair or discriminatory treatment as they negotiate the terms of their business operations in China.

In addition, the US model BIT's performance requirements bar treaty partners from requiring technology or IP transfers as the basis of receiving an investment approval. The performance requirements could also be negotiated to include restrictions on the use of incentives to encourage IP and tech transfers. This is an area in which United States could work with allies to create momentum for China to agree to such changes: if similar provisions were included in other agreements, such as NAFTA 2.0, it would demonstrate that China's trading partners are in agreement that these types of incentives should not be allowed. In addition, if the United States and China were to conclude a high-standard BIT using the US model on these points, American companies would have explicit new protections from these types of requests and would have recourse through both investor-state and state-state dispute settlement to address violations of those protections.

Joint venture requirements and foreign equity limitations

In sectors where 100 percent foreign ownership is allowed in China, foreign companies are generally not compelled to transfer their technology to a competitor, since any technology used in their China operations remains in the possession of the foreign company. As a consequence, eliminating equity caps in sectors where joint ventures are required, such as cloud computing, would enable American companies to protect their IP in ways that are not currently possible in China. While roughly three-fourths of American and other foreign investment into China is made into 100 percent-owned facilities and subsidiaries, many key sectors in manufacturing, services, energy, and agriculture require a Chinese partner. A list of China's current foreign investment ownership restrictions is attached for reference.

In some industries, China imposes equity restrictions which require foreign companies to not only partner with a domestic company to access the market, but also stipulate that the domestic partner control technologies and processes that many companies consider to be trade secrets. For example, in addition to being subjected to a 50 percent ownership limit, cloud computing companies are unable to get licenses to operate without sharing IP and proprietary processes with a Chinese partner. In cases where joint venture requirements persist, China should not impose requirements to transfer sensitive trade secrets as a prerequisite for market access.

When China joined the World Trade Organization, its negotiators committed in the accession's Working Party Report 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 goes further and 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." In other words, China committed that that technology transfers would not be required to invest or sell products in China, but would be allowed if a foreign and Chinese company agreed to such a transfer as part of a normal business negotiation.

In reality, China's joint venture requirements and foreign equity restrictions create an unbalanced negotiation for foreign companies seeking to enter the Chinese market. While on paper such negotiations might technically be a "normal" business negotiation, Chinese companies have an inherently stronger position over their foreign counterparts since a Chinese company's participation is required to form a joint venture or to provide the remaining equity in restricted sectors. As a consequence, a request for technology transfer made by a Chinese party in a business negotiation can reasonably be interpreted by foreign parties as a requirement for the deal to be successfully be concluded.

The solution to address these concerns is obvious: elimination of joint venture requirements and foreign equity limitations. During the active negotiations of the BIT, reports indicated that progress was made in getting China to agree to eliminate some of these equity caps. Locking those liberalizations, either as part of a BIT or in the interim as a “down payment” on resuming BIT negotiations, would provide meaningful improvements for the affected sectors. In particular, elimination of JV requirements in cloud computing, financial services, and auto manufacturing should be prioritized.

Procurement

China has a variety of procurement-related policies that act as de facto IP or technology transfer requirements. For instance, the China Cybersecurity Law and measures related to it include requirements for the use of “secure and controllable” technology, which in effect mandates the purchase of such technologies by government or state-owned entities. Qualification requires sharing source code or other proprietary information. In addition, some provincial and local innovation policies continue to include preferences for products using “indigenous” innovation -- measures that are frequently interpreted as meaning products made by Chinese companies.

All countries have legitimate concerns over privacy and national security, but China is the principal country addressing these concerns by requiring foreign companies to transfer their technology and, in some instances, to surrender their brand and operating control in order to do business. Requirements that are described by Chinese officials as neutral and non-discriminatory instead have the effect of excluding foreign competitors who cannot meet them if they do not comply with technology transfer, encryption or other requirements.

To address these concerns, it is critical that pending cybersecurity regulations—including those in sector-specific measures that promote or require the use of secure and controllable technologies as well as future implementing regulations and standards for the Cybersecurity Law—comply with China’s WTO commitments on nondiscrimination and national treatment. In addition, China’s central government should continue to actively monitor the implementation at the provincial and local level of its commitments to treat IP owned and developed in other countries on an equal basis as IP owned or developed in China.

More generally, China should finalize the draft Administrative Measures for Government Procurement of Domestic Products, with modifications to ensure that goods and services provided by all legal entities in China are treated equally during procurement processes, regardless of ownership. If appropriately revised, the rules would roughly parallel similar rules applied to Chinese companies in the United States. China should also take the necessary steps to join the WTO’s Government Procurement Agreement in 2017. Doing so under meaningful terms will positively address many concerns with “Buy American” and “Buy Chinese” procurement practices in each country.

Other mechanisms to regulate or intervene in U.S. companies' operations in China

Domestic Preferences

In China's pursuit of creating domestic innovation, it has regularly used approaches that have implied or required ownership of IP in China to qualify for sale in its domestic market. The linkage of these policies to network security requirements create a market disadvantage for companies that do not comply, since their products cannot be sold in China without the necessary approvals. They also creates security risks for China's ICT systems, since the effect of the policies is to force companies to use local encryption standards and other technologies that have not been fully tested to ensure the protection of networks and data. China's indigenous innovation policies have included IP ownership requirements as well that have disadvantaged American companies. Made in China 2025 also includes provisions that suggests foreign and domestic companies will not be treated equally. While there has been some improvement on these issues due to robust advocacy by the US government, American companies and our trading partners, issues remain that need to be addressed. As noted above, all government policies should comply with China's WTO commitments on nondiscrimination and national treatment and the central government should actively monitor the implementation at the provincial and local level of its commitments to treat IP owned and developed in other countries on an equal basis as IP owned or developed in China.

Innovation incentives

One of China's core innovation tax policies, the High- and New-Technology Enterprise (HNTE) program, offers qualified applicants a 15 percent income tax rate. HNTE status is granted by provincial tax authorities for company facilities located within their jurisdictions. In order to receive the tax break, the applying entity is required to own the proprietary IPR of the core technology used in their products and services in China. This criterion requires an American company to transfer ownership of technology to the subsidiary entity in China in order to qualify for the tax break.

While on paper China's current HNTE program allows both domestic and foreign companies to apply for HNTE status, the structure of the HNTE program presents a de-facto bias against foreign companies that manage their global corporate IP structure based on commercial considerations and international best practices, as it forces them to readjust these structures to fit Chinese policy goals. To address these concerns, China should adopt tax policies, incentives, and IP protection programs to promote innovation that align with international best practices: eliminating requirements for ownership of core proprietary IP in China or expanding the criteria to includes legally acquired, non-exclusive licensee or usage rights.

Import Restrictions

Import restrictions on legitimate products, such as high import duties and taxes, import quotas, or onerous product approval requirements, serve to promote the sale of counterfeit products in the domestic market. Reducing import and distribution barriers of IP-intensive products would reduce counterfeits and ensure Chinese consumers have access to legitimate products.

Rulemaking transparency
China's central government has made some progress on improving rule-making transparency over the past several years, but further improvements are needed to ensure that laws and regulations, such as those noted throughout this submission, are consistent with China's commitments to nondiscrimination and national treatment. 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 comment 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.

Data flows
China's controls over the Internet are creating barriers to the cross-border flow of data and the ability of companies to operate in China. In a globalized economy, companies across all sectors rely on the Internet to transmit and receive data to operate and serve their customers. A spate of recent regulatory rules in China are clamping down on internet flows, making it difficult and unpredictable for companies that operate in the Chinese market.

At a minimum, China should promote a reliable and open internet to allow the flow of information necessary for companies to engage in innovation and international commerce. Chinese regulators should work with companies that operate internet-based businesses to develop solutions that will allow them to bring their services to Chinese users.

In addition, China should conduct a detailed analysis of the costs associated with restricting the efficient flow of data in an innovative and global digital economy, taking into account the associated costs for domestic industry, global commerce, research and development, and cyber-threat management. Based on that analysis, China should remove unnecessary security review regimes and data security licensing in order to allow its transfer across national borders. Chinese regulators should align data flow policies with internationally-proven cybersecurity best practices. This includes revising provisions in the Cybersecurity Law that unnecessarily restrict the efficient flow of information.

China should also allow copies of data to be sent abroad for analysis and processing in order to ensure operational efficiency and encourage innovation by using big data. This would preserve territorial jurisdiction on the data while still allowing important business functions to be conducted. In addition, Chinese policymakers should consult with international industry on global best practices for secure data management. Such policies should be developed in a clear and transparent manner, pursuant to China's international obligations on regulatory transparency.

China should also become a party to the APEC Cross Border Privacy Rules System (CBPRS), which was developed to build consumer, business and regulator trust in cross border flows of personal information. Under CBPRS's framework, independent third-party accountability agents ensure that countries' and companies' data protection mechanisms are in line with the APEC Privacy Framework and meet a suitable and enforceable standard for citizens' privacy protection.

Technology Import and Export Regulations (TIERs)
China's technology regulations include contradictions related to IP infringement that should be

addressed. In particular, Article 24 of the Technology Import and Export Regulations (TIER) mandates that technology importers indemnify their customers and bear the liability for infringement. In contrast, Article 353 of China's Contract Law permits parties to negotiate who will bear liability for infringement, but Article 355 of the same law says that, for a technology import and export contract, TIER shall apply. This lack of freedom of contract discriminates against overseas licensors and could be viewed as a non-tariff technical barrier. To address this disparity, changes are needed to both TIER and the Contract law to clarify that parties may negotiate who will bear the responsibility for infringement. We would be happy to provide specific recommended changes to the text of measures to achieve that goal.

Inability to set market-based terms in licensing and other technology-related negotiations
As noted previously, China's JV requirements and foreign equity limitations creates an unequal negotiation for companies that are required to have Chinese partners to participate in China's market. Also noted previously, not all companies face technology transfer requests to do business in China, but the issue is of significant concern for those that do. Elimination of these policies would create a meaningful change in companies' ability to negotiate market-based terms for their IP and technology in China.

Even for companies that are able to come to reasonable terms on licensing and other technology-related negotiations, it can be difficult to ensure that licensing fees and royalties are paid in full. Two issues are factors in this challenge.

First, China's controls over the movement of capital across its borders have sometimes been inappropriately interpreted to cover current account transactions such as the payment of dividends, royalties, and even routine trade payments overseas. As a member of the International Monetary Fund (IMF), China accepted the IMF's Articles of Agreement, which include commitments by member countries to avoid restrictions on current account payments. Those transactions include payments for business services, and imports and exports of goods and services. IMF rules allow member countries to control capital transfers, which relate to the purchase and sale of foreign assets and liabilities, such as investments, loans, and exchange rate transactions. Some progress was made on this issue in 2017, in part due to USCBC's advocacy efforts directly with China's financial regulators, to provide guidance to local People's Bank of China and State Administration of Foreign Exchange officials clarifying that normal business transactions were not covered by China's capital account restrictions. Some companies continue to experience problems, however, so further policy clarifications would be appropriate to ensure consistent application of the rules.

Second, accounting procedures at some Chinese companies make it difficult for licensors to know if royalties have been paid in full. Better compliance with generally accepted accounting procedures (GAAP) or GAAP-like controls in China would improve companies' ability to ensure that they have been fully compensated, and would improve the general confidence that foreign companies have in China's commercial market.

Acquisition of US companies and assets

Foreign investment is a critical part of the US economy. It recycles the money we pay out for purchases abroad back into our economy in the form of investments that make us richer, stronger and better positioned to compete more aggressively in trade markets. Not all investment is created equal, however -- the national security of the United States is critical -- but national security considerations must not be used as a means of protectionism. To that end, USCBC members support the use of US laws and regulations to address legitimate national security concerns, such as through the Committee on Foreign Investment in the United States (CFIUS) review process. CFIUS reviews ensure that foreign direct investments in the US do not threaten our broader national security interests.

There has been a robust discussion about potentially expanding the United States' existing investment reviews to cover specific types of investment structures or business arrangements that go well beyond CFIUS's current scope. We urge policymakers to proceed cautiously in considering such changes.

While joint venture requirements and technology transfer requirements are important business issues, not all business arrangements have national security implications. As a consequence, it would be inappropriate to use CFIUS as the vehicle to try to address all US concerns in those areas. Additionally, making such a change would mean giving China the green light to not only maintain its broad use of national security to exclude foreign companies, but encourage it to expand it even further. This would be a race to the bottom, as the United States starts to copy or encourage China's worst practices.

As USCBC's board of directors has noted regularly in its annual priorities statements, national security exceptions should be used only when essential and narrowly targeted. They should not be used for economic or commercial objectives or to protect or promote domestic companies versus foreign ones.

Cyber theft for commercial gain

USCBC's board of directors has regularly stated that cybersecurity concerns threaten to undermine a constructive US-China commercial relationship. Individual companies can only do so much to combat these types of intrusions on their own. The US and Chinese governments need to take appropriate actions to curtail cyber activity targeting company networks.

USCBC's understanding is that the agreement reached between the United States and China in 2015 on halting cyber theft for commercial gain, along with other efforts to address global cyber theft concerns, were largely successful, with a notable decrease in reports by American companies of intrusions from suspected Chinese hackers – a point made by computer security firm FireEye in a June 2016 report on the issue. If that assessment is inaccurate and such intrusions have continued, we encourage the US government to work with China on full implementation of previous commitments in this area. In the meantime, companies should ensure they have the best protections of their networks in place, but governments need to work on stopping the attempted intrusions, regardless of the source.

Identifying appropriate solutions
As noted previously, intellectual property protection and technology transfer requirements are important issues that need to be addressed. To achieve that goal, the United States needs a clear plan of what constitutes success. Imposing wide-ranging tariffs or other broad restrictions on Chinese products or exports to the United States may provide monetary compensation for the lost opportunities that American companies should have in China, but such actions are unlikely to address the underlying policies that created the problems for companies or result in enduring solutions. Tailored and more focused solutions enforceable by international trade rules are the best way to avoid a potential race-to-the-bottom of domestic enforcement actions that would be damaging to American economic interests.

Several such solutions are noted above. While these issues are difficult, the United States has allies among its trading partners, all of whose domestic industries face the same challenges as American companies in China. The administration has the opportunity to lead like-minded countries in an effort to address China's policies that are inconsistent with both the letter and the spirit of the WTO's rules on national treatment, non-discrimination, IP protection and technology transfer. Coordinated action will be stronger than unilateral action.

We look forward to working with you on achieving successful resolution of these issues, to the benefit of American companies doing business with China.

<u>Attachment</u>
List of Chinese investment restrictions

China's Ownership Caps on Foreign Investment

July 2017

China's entry into the World Trade Organization in 2001 opened many sectors to foreign investment, and subsequent reforms have opened additional sectors, but significant ownership restrictions remain in place for numerous industries. The list below covers all 35 areas where China's Catalogue Guiding Foreign Investment (the Catalogue), most recently revised in June 2017, specifies investment restrictions. China's Catalogue places industries into three categories – "encouraged", "restricted", and "prohibited" – based on how open those sectors are to foreign investment. The prohibited category, in which foreign investment is not permitted in any form, includes 28 sectors such as mining of rare-earth minerals, production of weapons and ammunition, and air traffic control.

The 35 sectors that fall into the restricted categories are at least partially open to foreign investment, but in most cases this investment is limited to joint ventures (JV) with Chinese companies, sometimes with additional stipulations that the Chinese partner or partners must hold a controlling stake in the JV, as well as specific foreign ownership caps. This chart lists all 35 sectors where the Catalogue restricts foreign investment, and indicates where JVs are required, where Chinese control of a JV is required, and where specific foreign ownership caps exist.

In several places in the new Catalogue, certain investments are listed both in the encouraged section (without any JV or ownership cap requirements), as well as in the restricted section (with JV or ownership cap requirements). A note in the preface to the restricted section of the Catalogue acknowledges these overlaps, but does not fully clarify how investments in these sectors will be treated. The far right column of this list indicates where such overlaps exist.

Note: All items are from the June 2017 Catalogue Guiding Foreign Investment

	Sector	JV with Chinese company required	JV required, foreign share limited to minority	Specific foreign ownership caps, if specified	Catalogue also lists as encouraged without specifying ownership restrictions
Agriculture, Forestry, Animal Husbandry, Fishery and Related Industries					
1	Selection and breeding of new types of agricultural goods, and production of seeds		X		

	Sector	JV with Chinese company required	JV required, foreign share limited to minority	Specific foreign ownership caps, if specified	Catalogue also lists as encouraged without specifying ownership restrictions
Mining					
2	Exploration and development of oil and natural gas (including coalbed methane, oil shale, oil sands and shale gas)	x			x
3	Surveying and mining of special and rare coal		x		
4	Surveying and mining of graphite				
Manufacturing					
5	Publications printing		x		
6	Rare earth smelting, separation, and tungsten smelting	x			
7	Manufacture of whole vehicles, special purpose automobiles, and motorcycles	x		Chinese parties shall hold no less than 50% of shares, and any one foreign party is permitted to establish in China no more than two JVs manufacturing the same type of vehicles (passenger vehicles, commercial vehicles, or motorcycles); if a foreign company's Chinese partner merges with another domestic auto manufacturer, the foreign company is not bound by the "two JV" limit	
8	Design, manufacture and repair of ships (including subparts)		x		

	Sector	JV with Chinese company required	JV required, foreign share limited to minority	Specific foreign ownership caps, if specified	Catalogue also lists as encouraged without specifying ownership restrictions
9	Trunk, regional aircraft design,manufacturing and maintenance, 3-ton and above helicopter design and manufacturing, ground, surface effect of aircraft manufacturing and unmanned aerial vehicles, manufacture of aircraft for ground or water surface effects; design and manufacture of unmanned aerial vehicle and aerostatics		**X**		**X**
10	General aircraft design, manufacture and maintenance	**X**			**X**
11	Production of satellite television receiving and broadcasting equipment and key parts				
Electricity, Gas, and Water Production and Supplies					
12	Construction and operation of nuclear power plants		**X**		**X**
13	Construction and operation of electricity grids		**X**		**X**
14	Construction and operation of gas, heat supply, and water drainage networks in cities with a population of more than 500,000		**X**		
Transportation, Shipping, Storage, and Postal Industries					
15	Construction and operation of main line railroad networks		**X**		**X**

	Sector	JV with Chinese company required	JV required, foreign share limited to minority	Specific foreign ownership caps, if specified	Catalogue also lists as encouraged without specifying ownership restrictions
16	Passenger train transportation companies		x		
17	Domestic water transport companies (Chinese majority control); international maritime transport companies (JV required)	x	x		x
18	Construction and operation of civil airports		x		x
19	Public air carrier shipping company		x	The investment of a foreign investor and its affiliated enterprises shall not exceed 25% and the legal representative shall have Chinese nationality.	
20	General aviation companies--agricultural, forestry, and fisheries-related general aviation companies limited to joint ventures and cooperative joint ventures. For other general aviation companies the Chinese side must hold the controlling share. The legal representative must have Chinese nationality.	x	x		x
Information Transmission, Software, and IT Services					
21	Telecommunications companies	x	x	Value-added telecommunications services (foreign investment ratio of not more than 50%, except e-commerce); basic telecommunications business (Chinese majority control)	

	Sector	JV with Chinese company required	JV required, foreign share limited to minority	Specific foreign ownership caps, if specified	Catalogue also lists as encouraged without specifying ownership restrictions
Wholesale and Retail Trade					
22	Procurement of rice, wheat, and corn				
23	Shipping agents		X		
24	Construction and operation of gas stations		X	Retail operations of more than 30 chain stores established by the same foreign investor that sell different types and brands from multiple suppliers must have majority Chinese control	
Finance and Insurance					
25	Banks		X	For investment in individual Chinese commercial banks, no one foreign financial institution or the affiliates it controls or jointly controls as a founder or a strategic investor shall own more than 20%; no combination of foreign financial institutions or the affiliates they control or jointly control as a founder or strategic investor shall own more than 25%.	
26	Insurance companies	X		The foreign stake in life insurance companies must not exceed 50%	
27	Securities companies		X		
Leasing and Business Services					
28	Market research--Market research generally is limited to EJVs and CJVs; radio and television listenership and viewership rating market research must have Chinese majority control	X	X		

Sector		JV with Chinese company required	JV required, foreign share limited to minority	Specific foreign ownership caps, if specified	Catalogue also lists as encouraged without specifying ownership restrictions
Scientific Research, Technology Services and Geological Survey Industries					
30	Surveying and mapping companies		X		
Education					
31	Pre-school, general, high school, and higher education institutions--limited to Chinese-foreign cooperation in running schools, with Chinese leadership. The principal or the principal administrative person in charge shall have Chinese nationality, and Chinese nationals shall comprise no less than half of the board of directors or the joint management committee of the Chinese foreign cooperative education institution.	X			
Healthcare and Social Work Services					
32	Medical institutions	X			
Cultural, Sports, and Entertainment Companies					
33	Radio and television program production and film production	X			
34	Construction and management of movie theaters		X		
35	Performance agency companies		X		