

2015



The AMERICAN CHAMBER of COMMERCE in SHANGHAI

# VIEWPOINT

## U.S. Market Access in China



# Executive Summary



Despite China's economic slowdown, American companies continue to find enormous opportunities in this market. However, their growth is hampered by market access problems ranging from protectionist policies to increased domestic competition to unclear regulations. AmCham Shanghai is committed to helping American companies succeed in this important market and urges the U.S. government to take measures to improve market access in China. These include negotiating a U.S.-China Bilateral Investment Treaty (BIT), pressing President Xi Jinping to improve China's investment climate, and increasing funds to U.S. government agencies in China that support American businesses.

According to the U.S. Department of Commerce, American exports to China grew 260 percent since 2004, topping USD 124 billion in 2014. This makes China the United States' third-largest export market and second-largest trading partner. While the Chinese economy is slowing, with government estimates for GDP growth of about 7 percent

for 2015 (many economists suggest the figure is closer to 5 percent or lower), the Chinese growth story still holds plenty of long term potential for American business.

China's economic growth can be largely observed by its demographic changes. Ernst & Young says that China has about 150 million people in the "global middle class," which it defines as those making USD 10 to 100 per day. Over the next decade, this number should exceed 500 million and by 2030 will reach around a billion people – nearly 70 percent of China's population. This unprecedented expansion of the middle-class will be accompanied by a huge increase in consumption.

According to the Wall Street Journal, China spends about 9 percent of its GDP on infrastructure, vastly improving the connectivity and efficiency of its continent-sized economy and creating new markets for U.S. firms. As China continues its shift from a low-cost manufacturing to a service-based economy,

opportunities for U.S. service industry companies will also expand markedly.

However, market access barriers continue to plague American companies in China and limit growth. Protectionist policies, unclear regulatory requirements, and a growing sense that foreign companies are unwelcome prevent American companies from expanding in the market. The information and communications technology sector, in particular, has seen a raft of proposed legislation that would favor domestic companies over foreign ones, or unfairly place foreign companies in a position of having to surrender their intellectual property in order to participate in important sectors such as financial services.

Furthermore, the extensive domestic publicity given last year to investigations of foreign companies for pricing violations under China's Anti-Monopoly Law, corrupt sales practices of pharmaceutical companies and the record-breaking USD 975 million fine against Qualcomm, have caused concerns that foreign companies are no longer welcome in China. New industrial policies increasingly favor local players. The recently adopted National Security Law establishes a national security review that would evaluate foreign investments for their impact on economic security, cultural security and public morality. Observers worry that the review will be used to prevent foreign companies from operating in key sectors.

American companies also face problems navigating China's opaque regulatory environment. The healthcare sector, which suffers from government agencies with overlapping responsibilities and unreliable domestic approval procedures, has been especially difficult for American companies.

Since AmCham Shanghai's establishment in 1915, we have looked to the U.S. government to support

American companies in China. The growth of the American business community in Shanghai over the past century reflects this support. However, continued support is still needed. To encourage improved market access and U.S. competitiveness in China, AmCham Shanghai recommends that the U.S. government:


**1. Prioritize negotiations on the U.S.-China Bilateral Investment Treaty (BIT).**

A high-standard U.S.-China BIT should further open up the Chinese market to U.S. investments and encourage investment by Chinese companies in the United States, strengthening both economies.

**2. Urge President Xi Jinping to adopt a more positive stance on foreign investment, encourage a more level playing field for foreign firms and accelerate economic reform programs.**

A strong endorsement by Xi Jinping of China's economic reform agenda, including financial sector liberalization, and for the U.S.-China BIT, would bolster economic reform efforts in China and signal to American companies that China is willing to allow foreign companies to succeed in its market.

**3. Increase the capacity of U.S. government agencies to promote and support American businesses in China. Reauthorize funding for Ex-Im Bank.**

U.S. trade promotion and diplomatic personnel have provided American companies with invaluable support and information on the Chinese market. Increased interaction at the working level promotes greater understanding between the two countries and lays the groundwork for finding solutions to market access problems. Reauthorizing Ex-Im funding will also support American businesses by providing them with the credit they need to expand their businesses in China. 

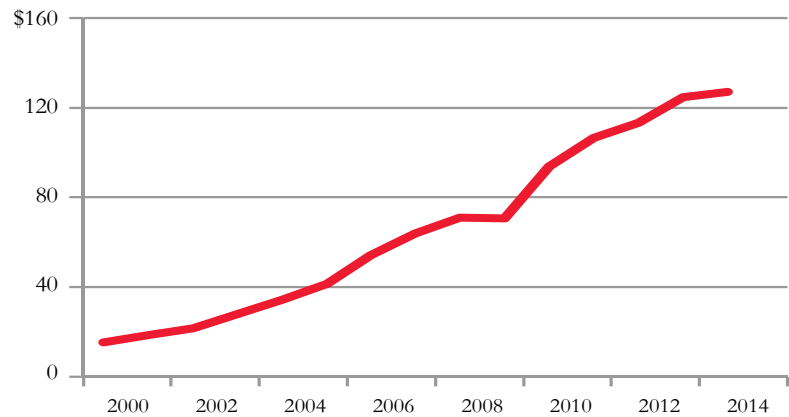


# Market Access

Since China began opening its economy in the 1970s, foreign firms have gradually gained more market access. China's accession into the WTO in 2001 led many pundits to believe that the Chinese economy was on a clear path towards full integration with the global economy. The question was not whether China would liberalize its economy, but when.

Chinese President Xi Jinping's statement at the Third Plenum in 2013 that the market should play a "decisive" and "dominant" role in allocating resources in the world's second-largest economy seemed to support this narrative. Believing that this would mean unprecedented access to the country's 1.3 billion consumers as they moved into the middle class, American businesses were strongly

U.S. Goods Exported to China  
(Billions of Dollars)



Source: U.S. Bureau of Economic Analysis


optimistic. This past year however, China introduced a series of policies that have caused companies to reassess views of their business prospects. In addition to a slowing economy, President Xi's economic liberalization has been implemented at a sluggish pace. In some industry sectors, market access is worsening.



## The Shanghai FTZ

Market access limitations appear in every sector of the Chinese market. American companies are spending more time and money to understand and comply with Chinese laws. U.S. companies report that the regulatory environment in China is increasingly opaque, deteriorating, and affecting business. According to AmCham Shanghai's 2015 China Business Report, nearly 78 percent of companies reported that an unclear regulatory environment hinders their China business, 67 percent report difficulty enforcing their contract terms, and 63 percent say that laws or regulations that favor domestic firms are hindering their business. Reflecting this, the U.S. government has brought 16 World Trade Organization (WTO) cases against China, more than twice as many as any other WTO member.

The increased devolution of authority to provincial and municipal governments, although a welcome trend, contributes to variation in the implementation of regulatory reforms. This adds to the confusion and frustration felt by American businesses which are not only held to a higher standard by the Chinese government but also face a market where many local companies receive government support in the form of subsidies or government procurement preferences.

Despite these negative trends, there are still positive developments on the horizon for American companies. The successful negotiation of a U.S.-China BIT has the most potential to influence market access for U.S. companies. At the June 2015 Strategic and Economic Dialogue, the United States and China reaffirmed negotiation of a BIT as their number one priority in bilateral economic relations. Under a U.S.-China BIT, American companies will enjoy national treatment in all industries not on a "negative list." This will provide a more level playing field for American companies in China. 



Opened in September 2013, the China (Shanghai) Pilot Free Trade Zone (FTZ) serves as a testing ground for import/export, financial sector and foreign investment reforms. Although the pace of reforms in the FTZ has been slow, it has piloted some significant changes, including the first use of a "negative list" approach to regulate foreign investment. A negative list approach allows for foreign investment in all areas except for those specified on the list. The government has reduced the FTZ negative list twice from an initial 190 items to the current 122 items, although much of the decrease was cosmetic and consisted of regrouping restrictions rather than their elimination. Regardless, the use of a negative list approach to investment is a step forward as it reduces government interference and bureaucracy. Since its introduction, negative lists have been adopted more widely. In particular, this approach is being used in the U.S.-China BIT negotiations.

Other significant reforms in the Shanghai FTZ include measures to reduce and simplify customs clearance procedures, the creation of Free Trade Accounts (FTA) for cross-border transfers of foreign currency and RMB, and the permission for foreign investors to wholly own e-commerce companies. In April 2015, the Chinese government expanded the geographic scope of the Shanghai FTZ to include most of Pudong as part of an effort to increase the FTZ's significance and impact. It also created three new FTZs in Guangdong, Fujian, and Tianjin.



# China's Investment Climate



AmCham Shanghai's annual China Business Report, one of the longest running surveys of American businesses in China, gives tangible insights on China's business climate. The latest report is based on responses from nearly 400 companies collected at the end of 2014. The full text of the report is available at: [www.amcham-shanghai.org](http://www.amcham-shanghai.org).

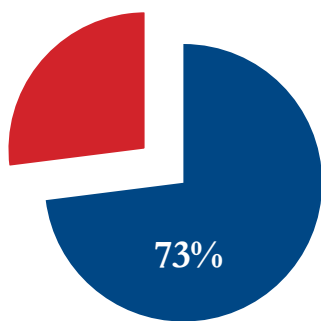
The survey found that U.S. businesses in China continue to do well. Nearly three-fourths of U.S. companies in China are profitable and enjoy revenue growth, and 9 out of 10 boast a growing or stable market share.

The focus of American companies on the Chinese domestic market is stronger than ever. The survey found that a record two-thirds of companies are producing or sourcing goods or services in China for the China market, a strategy we call "in China for China." Another noteworthy trend, which started in 2013 and has continued, is that the percentage of revenue coming from services (45 percent) has surpassed that from manufacturing (42 percent).

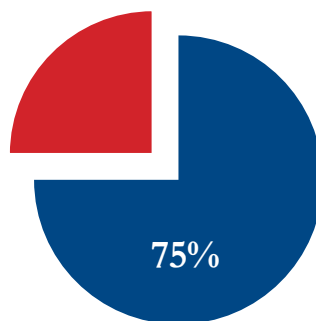
With so many moving pieces in the Chinese economy – a growing middle class, a slowing economy, and a variety of reforms loosening or tightening restrictions on foreign businesses – it is more difficult to provide simple and short characterizations of the outlook for American business in China.

The overwhelming majority of U.S. companies (85 percent) have a five-year optimistic outlook, as has been the case now for many years. This

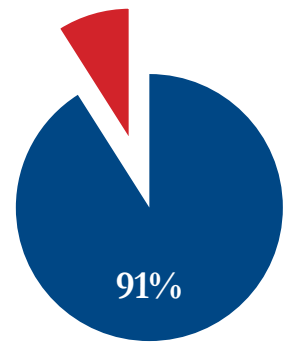
## U.S. Firms in China



Profitable

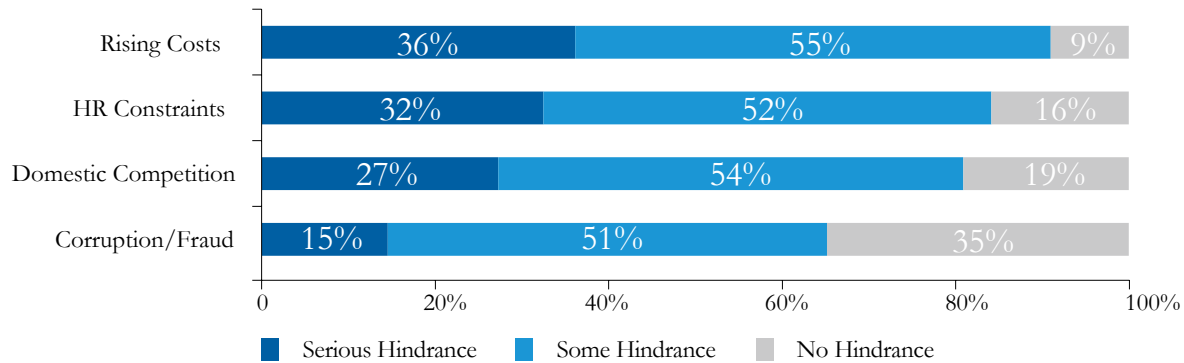


Growing Revenue



Growing/Stable Market Share


## Business Challenges



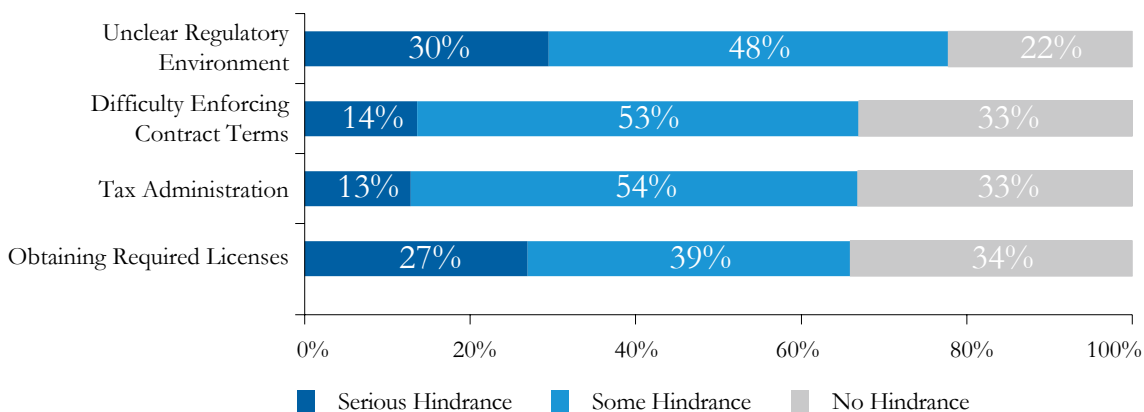
past year, however, there was a notable shift in the degree of optimism, with a 10 percent drop of those in the “optimistic” category and a 9 percent increase in the less exuberant “slightly optimistic” category. Investment levels also reflect this shift. While 96 percent reported that they had maintained or increased investment levels in China for 2014, projected investment increases for this year are lower than in the past. 21 percent reported plans to increase investment by 16-50 percent compared to 23 percent in last year’s report. 41 percent planned investment increases of 1-15 percent.

This tempering of long-term optimism can be attributed to a number of factors. In terms

of operational challenges, 91 percent say that rising costs continue to hinder their business and 81 percent say that domestic competition is challenging their business with 34 percent saying that it is getting worse.

In terms of regulatory challenges, China’s opaque regulatory environment remains a major issue, with 78 percent saying it hinders business. In the category of business risks, the biggest concern for American business appears to be the direction of China’s economic reform with over half of respondents (52 percent) saying it is their number one business risk. 

## Regulatory Challenges





# Industry Update: Agriculture



**China relies heavily on imports to feed its population, but multinationals still face significant restrictions.**

China is the number one destination for U.S. agricultural exports. It accounted for 20 percent of all U.S. farm exports and reached a record USD 29.9 billion in 2014, according to the U.S. Department of Agriculture (USDA). Major U.S. exports to China include soybeans, grains, hides, tree nuts, and cotton. These figures are set to grow as China demands more U.S. goods to help feed its 1.3 billion people.

Home to one-fifth of the world's population, China has only 7 percent of the world's arable land. Northern China faces acute water shortages, while farmland in China's south suffers from acidification. According to Xinhua, China's official press agency, more than 40 percent of China's arable land suffers from degradation, leading to

further strain on domestic crop production and an increased demand for imported products.

The growing affluence of Chinese consumers and changing diets offer large growth opportunities for American agricultural companies. As the disposable income of the average Chinese increases so too does their desire to consume foreign products. Foreign food brands have gained the trust of Chinese consumers in quality and safety standards, especially in organic or premium products.

In China's gigantic e-commerce market, food and drink sales are one of the fastest growing categories. According to a McKinsey report, 40 percent of Chinese consumers buy food online, four times more than in the United States. Young tech-savvy buyers are driving the market for specialty foods such as North American cherries, avocados, and lobster. Although this trend creates business opportunities, ensuring the safety and quality of products sold online is a huge concern for foreign food companies.

American companies are eager to expand their sales and offer Chinese consumers quality agricultural products. However, market access is limited by protectionist policies and an unclear regulatory framework.

China's market remains restricted or closed to the export of certain key U.S. crops. This includes a ban on American beef and restrictions on rice imports. Non-tariff measures also hurt U.S. competitiveness by making it more difficult for exports to enter China, increasing risks and therefore adding costs to traders.

For example, American exporters face lengthy approval processes for Genetically Modified Organisms (GMO) which potentially limits

the volume and type of crop exported by the U.S. companies. Although China has recently approved strands of genetically modified corn and soybeans and is generally welcoming of GMOs, it has a zero tolerance policy for certain crops. The Chinese government approval process for new strains of GMO crops is also time-consuming. Meanwhile, public confidence in GMOs is withering due to a paucity of clear and correct information from the government.

The Chinese government has made significant reforms to the country's food safety regulatory framework. However, implementation and enforcement of rules at the local level is often inconsistent. Foreign companies face greater scrutiny from the public and oftentimes invest more resources than local companies on compliance issues.

Increased training and capacity building of local officials' understanding of food safety standards, as well as testing regimes and standards continue to be key issues. As a result, many food safety regulations are implemented at the place of import, putting heavier compliance responsibility on foreign import companies.

To improve market access in the Agricultural Industry, AmCham Shanghai recommends that:


**1) The U.S. Government continues to press China to lift bans on American agricultural products including beef and rice, and approve more strands of GMOs for import.**

**2) The U.S. Government increases cooperation and coordination with relevant Chinese government agencies on food safety and food import policies.**

Better coordination between technical agencies such as the USDA and the Chinese General

Administration of Quality Supervision, Inspection and Quarantine (AQSIQ) can alleviate misunderstandings and help American companies to improve their position in this rapidly expanding market.

**3) The U.S. Government encourages China to engage more with American agricultural companies and seek industry input on draft laws and regulations.**

American agricultural companies have extensive experience and knowledge on food safety issues. We applaud the Chinese government for its efforts to solicit industry opinions on relevant laws and regulations in 2014 and encourage the government to continue to find ways to engage with industry on these issues. 

## The 2015 Food Safety Law

In April, China introduced newer and tougher amendments to its Food Safety Law which go into effect on October 1, 2015. The amendments increase the law's scope to regulate not only food production and trading, but also food storage and transportation. Criminal charges have been made more punitive for deterrence purposes. The amendments also shorten approval processes for vitamins, health supplements, and minerals, although these processes remain ambiguous at this time.

U.S. firms welcome these changes as they should force domestic competitors to catch up to foreign companies that are already operating at international standards. However, the disjointed makeup of production, processing and distribution of food in China, means authorities will still not have the resources to enforce safety standards equally. In addition, foreign companies are frequent scapegoats for food safety and regulatory enforcement which makes them more vulnerable to regulatory scrutiny.



## **Lackluster financial service reforms and stock market interference call into question China's commitment to financial service reforms.**

China has long held ambitions for Shanghai to be a global financial center by 2020. Yet by most measures the city has a long way to go. Lack of transparency, weak rule of law and, most recently, massive government intervention in the stock market, all indicate that China's financial sector is far from mature. While the skyline of Lujiazui, the city's financial district, is dotted with the names of American and European financial institutions, foreign banks control less than 2 percent of the country's total banking assets.

According to AmCham Shanghai members, American banks face several barriers in China. Foreign banks have a low ceiling on the amount of foreign debt allowed for locally incorporated units, limiting the funding they can obtain from offshore parents. Prohibitory licensing requirements also limit the number of branches foreign banks can open. Moreover, foreign banks can own only a 20 percent stake in domestic banks, thereby preventing acquisitions of local banks. Similarly, foreign banks or brokerages can set up joint ventures with local securities brokerages, but their stakes remain limited to 49 percent, thereby meaning that they are minority shareholders.

American financial institutions have expanded their credit and debit card operations globally but have faced obstacles in China because of the monopoly position of state-owned UnionPay, the Chinese bank card association. In 2012, the WTO ruled this to be unfair and gave China until 2015 to change. In April 2015, China's State Council issued a decision to open up the bankcard clearing market, providing opportunities for both Chinese and foreign card schemes to provide domestic renminbi (RMB) transaction processing services. However, the opening

remains an in-principle decision only. Continued foot-dragging means that U.S. card payment companies remain shut out of this market.

On the positive side, China is making efforts to integrate its financial system with the rest of the developed world. Leading the charge is its effort to internationalize the RMB, now the second most used currency in trade finance. As RMB usage expands overseas, it will be easier for Chinese firms to operate internationally. Although there are regulatory restrictions on what kind of RMB products foreign banks can offer, these banks can use their global reach to assist Chinese firms overseas and provide some RMB financing.

China wants the IMF to adopt the RMB as one of its reserve currencies, a notable soft power victory when it occurs. However the RMB does not yet meet all the metrics necessary for inclusion. One requirement is greater exchange rate flexibility, and the Chinese government's recent devaluations of the RMB suggest they have acknowledged this. It is likely though that the devaluations serve a double purpose: satisfying the IMF while also making Chinese exports cheaper and more competitive.

Another measure the IMF uses is capital account convertibility. Chinese officials have made it clear that their idea of capital account convertibility is very different from that held by western countries. While the advent of the Shanghai-Hong Kong Connect stock trading program now allows foreigners to buy Shanghai-listed shares and Chinese households to buy shares in Hong Kong (all within certain limits), Chinese households do not yet have unfettered access to American equity, bond and property markets. Even with China's present capital account restrictions, capital flight in 2015 has already surpassed previous records. However, if limits on ownership of foreign assets are loosened, American banks and fund managers will benefit.

## Chinese Overseas Direct Investment – An Opportunity

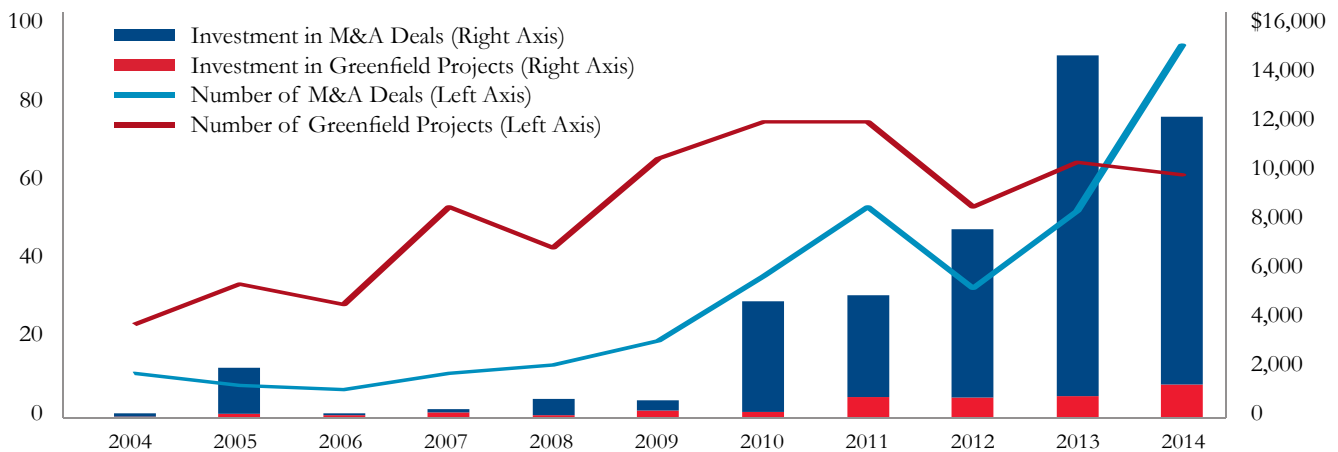
Over the past six years, large Chinese companies have quadrupled their overseas direct investment (ODI) in the United States, surpassing for the first time the annual flow of new American investment in China.

In 2014, China's global ODI amounted to USD 103 billion, a 14 percent rise from the previous year. Of that, USD 12 billion went to the United States. By 2020, China is expected to become the world's largest global investor with offshore assets tripling from USD 6.4 trillion to more than USD 20 trillion. The Chinese government's encouragement of outbound investment presents business opportunities for U.S. banks, insurance companies, and consultancies.

While Chinese banks are trying to develop overseas capabilities, it will be decades before they amass the experience of U.S. banks, particularly in areas like trade finance, foreign exchange, cross-border cash management, and mergers and acquisitions. Chinese banks have limited experience in overseas retail operations, making it difficult for them to compete with international banks in developed economies.

In consulting and other advisory services, the story is similar. With their broad international experience and extensive global networks, U.S. advisory firms are well placed to offer outbound Chinese investors the advice necessary to navigate new markets outside China's borders.

Chinese FDI Transactions in the United States, 2000-2014\*  
Number of deals, USD million




Source: Rhodium Group

U.S. firms in the financial services sector, perhaps more than any other sector, are on edge over China's proposed technology restrictions. The China Banking Regulatory Commission has called for, and then suspended, a requirement for all banks to use "secure and controllable" Chinese made technology and showed an intention to require foreign banks to bring their transaction servers to the mainland. For some U.S. financial firms, this would effectively close the doors not only due to backdoor concerns, but also to costs.

For Shanghai to become a world-class international financial center, the Chinese

**government needs to further liberalize the financial services sector, lower market access barriers, and allow the market to determine asset allocation. AmCham Shanghai recommends that:**

**1) The U.S. government continues to encourage China to open the capital account, strengthen legal institutions, and eliminate restrictions on the free flow of information.**

**2) The U.S. government advocates for a more equitable playing field for U.S. commercial banks, brokerages and insurance companies in China.** 



# Industry Update: Healthcare

**China is counting on foreign healthcare firms to help take care of its 1.3 billion people. Still, a challenging regulatory environment prevents access to certain markets.**

China should become the world's second largest healthcare market by 2017 and the second largest pharmaceutical market by 2020, trailing only the United States. Known for being safe and high-tech, American medical companies and their products will continue to be in high demand as the China market grows.

China spends about 5 percent of GDP on healthcare, substantially less than some of its neighbors and the United States, and growth potential remains strong. According to a goal set by China's National Health & Family Planning Commission, China plans to spend 6.5 percent of GDP on healthcare by 2020, an estimated total of USD 1.1 trillion. By this time, Chinese pharmaceutical sales alone could reach USD 310 billion, according to a report by McKinsey.

This is encouraging data for American healthcare firms operating in China. According to AmCham Shanghai's 2015 China Business Report, companies in the healthcare sector are among the most optimistic, second only to retail.

The fundamentals of the market are strong. Chinese urbanization is creating a larger, more accessible market while in China's rural areas people are increasingly covered by public insurance, although the amount of coverage remains small. The future size of China's growing middle class (projected by Ernst and Young to reach 500 million in the next decade) will be crucial to growth in the healthcare sector. These growing numbers and increased purchasing power also bring a heightened awareness of health and well-being. Chinese citizens expect an improvement in the attention and level of care they receive

from healthcare providers. Likewise, with China's aging population, environmental degradation, and lifestyle changes, there is an alarming growth in chronic diseases such as lung cancer, obesity, and diabetes. While there were virtually no cases of diabetes in China in the 1980s, nearly one-ninth of its population is affected by the disease today, a higher rate than in the United States.

This need for an immediate supply of healthcare providers has made the Chinese government more willing to work with private foreign hospitals to cater to its own more affluent patients. China's 13,000 government-owned hospitals provide about 90 percent of all health services, and China is looking for foreign firms to help serve those segments that it cannot prioritize. An example of this is the encouragement of private foreign hospitals to take over the VIP wards of some public hospitals.

China's adoption of public-private-partnerships is gradually opening doors for foreign companies. This is good news for foreign investors and should improve the accessibility and affordability of an under-resourced healthcare system.

Moreover, relative to the U.S. FDA, China's Food and Drug Administration (CFDA) is under-staffed and inadequately trained. American industry is ready to help CFDA build capacity and set standards. This engagement by U.S. firms with China's healthcare agencies at the local, provincial, and national level is critical to helping China achieve its healthcare reform goals. Another objective is to create a more welcoming environment for American firms.

Despite a strong demand, market access barriers still remain. Insufficient regulatory transparency, high costs and an unequal playing field are significant challenges to American firms already involved in or seeking to enter the Chinese healthcare market.

China's healthcare sector has been racked by scandals and strong public criticism. Patients have lashed out violently at doctors and hospital staff for not providing adequate treatment. Foreign and domestic pharmaceutical and medical devices companies have been accused of corruption. Foreign companies have dedicated more resources to complying with local regulations and cooperating with investigations. Although many firms feel they are being unfairly targeted, American companies still welcome this increased scrutiny on the sector in the hope it will ultimately create a more transparent healthcare system.

American healthcare providers are disadvantaged by preferential policies for domestic competitors. For example, domestic medical device companies are able to register their products faster and at lower costs than foreign companies. Medical device companies also face an unreliable domestic approval process, making it difficult for foreign firms to strategically plan and forecast.


On the pharmaceutical side, foreign companies face overlapping jurisdiction issues between CFDA, which oversees the approval of pharmaceutical products, and the State Administration of Commodity Prices, which regulates antitrust issues and pricing. Moreover, CFDA has a severe approval backlog due to lack of capacity and expertise, leading to a lengthy approval process in China. Not knowing when a product will be approved leads to uncertainty about when it can reach the market.

Following the perceived success and expansion of joint ventures between private foreign hospitals and Chinese hospitals, in August 2014, the Chinese government announced a pilot program to allow the establishment of wholly foreign-owned hospitals in the cities of Shanghai, Beijing, and Tianjin and the provinces of Jiangsu, Fujian, Guangdong, and Hainan.

Even before the announcement, private foreign hospitals through joint ventures were beginning to

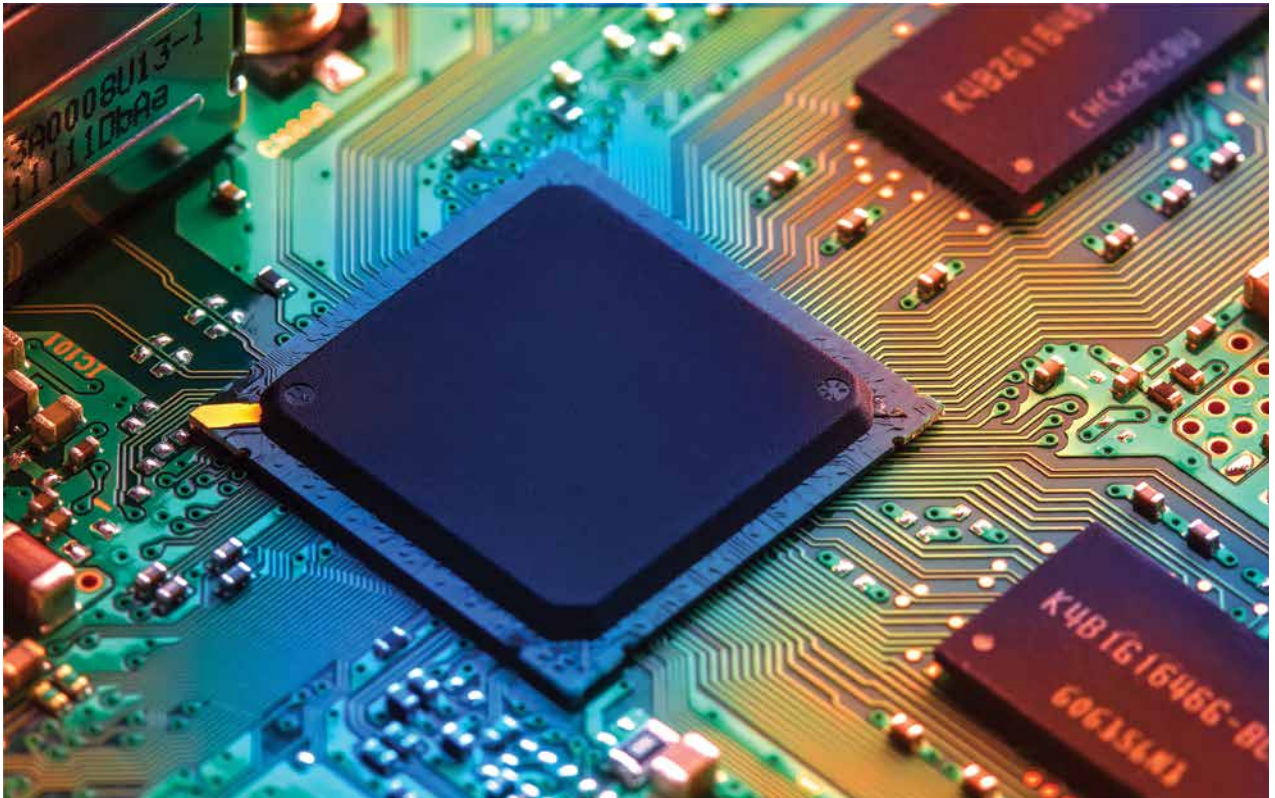
expand in China and find success in many markets. These hospitals face a number of challenges, however. According to Reuters, foreign private hospitals have a difficult time finding qualified doctors. In most of China, doctors need to obtain permission from their state-owned hospitals before they can work in the private sector. Public hospitals, many of which are short staffed, are reluctant to let go of their best doctors. In August 2014, Beijing was the first municipality to allow doctors to work in more than one place without the permission of their bosses. Acquiring an attractive real estate location and a healthcare license is still challenging. Attracting paying customers remains difficult in a market with few private health insurance programs and a public health insurance that only covers a portion of medical care.

**American companies anticipate an enormous growth of opportunities in the healthcare industry. To support American healthcare companies, AmCham Shanghai recommends:**

- 1) The Chinese government continues to streamline the review and approval processes for medical devices and pharmaceutical products as a way to prevent unnecessary duplication and ease the administrative burden on companies.**
- 2) The Chinese government invites and incentivizes foreign medical insurance companies to assist in the building of China's supplemental medical insurance system and capabilities.**
- 3) The Chinese government, in order to reduce public safety hazards, bolsters the enforcement of legal and administrative measures that prohibit counterfeit pharmaceutical products and devices from reaching the market.**
- 4) The U.S. government provides more avenues for CFDA officers to obtain training to improve the agency's capacity and alleviate the backlog of approvals.** 



# Industry Update: ICT



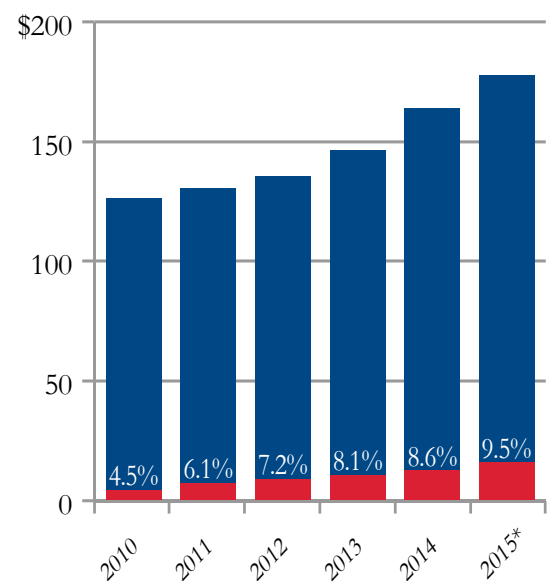
**P**rotectionist policies and innovative competitors threaten American success in this market.

An industry once dominated by foreign multinationals, the information and communications technology (ICT) sector has come under increasing scrutiny by a Chinese government concerned that reliance on foreign-made software and technology products creates national security vulnerabilities. This past year, China has introduced a number of regulations requiring companies to use only “secure and controllable” products and to provide the government with “backdoors” to access data. The latest draft of the Cybersecurity Law issued in July 2015 requires internet service providers to store all data collected within China on Chinese territory. While the Chinese government has modified some of these conditions, the overall nationalistic approach to the industry remains.

Foreign firms also face increasingly agile and innovative local competitors. While foreign

## Chinese chip consumption vs. domestic supply

(Billions of Dollars)



■ Total value of chips used in China  
■ Percentage of value supplied by domestic companies

\*Estimate  
Source: IBS Inc.

## Secure and controllable technology

Over the past year China has placed an unprecedented focus on controlling its own cyber-security, introducing the phrase “secure and controllable” technology into a number of laws and putting foreign brands in an untenable position.

Concerned about cyber-security, the China Banking and Regulatory Commission released draft guidelines in September 2014 that introduced the phrase “secure and controllable” technology. The guidelines require banks in China, both Chinese and foreign, to use domestically made computer chips and other electronic equipment. The guidelines caused uproar among the ICT and banking communities. For ICT companies, it would cut out American companies from an important market. For foreign and domestic banks, there was concern that the guidelines would force them to use inferior technology incompatible with their worldwide systems. After high-level lobbying by U.S. officials, as well as strongly worded

statements by business groups, the rules were suspended in April 2015.

The term “secure and controllable,” however, continues to appear in Chinese legislation. In March 2015, the National People’s Congress published a draft counter-terrorism law which included the phrase. The law would require foreign firms to hand over encryption keys, source code, and install backdoors for Chinese authorities. Implementation of the law was put on hold. It reappeared again in the National Security Law that was passed in June 2015.

Despite the phrase’s vague meaning, it holds the potential to put American technology companies in a difficult position. Whether motivated by security concerns or not, China may interpret the law in ways that favor local companies and forces multinationals to choose between protection of proprietary technology and access to one of the world’s largest markets.

firms continue to be the vanguards of cutting-edge technology, Chinese firms’ technologies are improving and challenging the notion that they are simply cheaper alternatives.

The semiconductor industry is an example where national security concerns and economic potential have limited the ability of American companies to expand. In 2013, China spent USD 230 billion importing computer chips, more than it did importing oil. According to International Business Strategies, Chinese semiconductor companies supply less than 8.6 percent of domestic demand. In September 2013, Chinese Vice Premier Ma Kai declared that the semiconductor industry was a key sector since chips play an important role in controlling computers, smartphones, and other electronic equipment. That same year, China announced plans to direct more than USD 25 billion into a series of chip-related initiatives and to build up the capacity of domestic companies. In chorus with its investment in domestic chip makers, the Chinese government has increased its scrutiny of foreign chipmakers, fining Qualcomm USD 975 million in February 2015 for monopolistic behavior.

Today, China continues to transition away from foreign made chips, importing 5.9 percent fewer

semiconductors in 2014 than the year before. Some American companies are adopting new approaches to remain active in the market. Intel invested USD 1.5 billion in Tsinghua Unigroup, a Chinese state-owned firm that owns two of China’s largest chipmakers. In June 2015, Qualcomm partnered with SMIC, China’s largest chipmaker, to develop a new generation of semiconductors.

**China spent  
USD 230 billion  
importing computer  
chips, more than it  
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The size and growth potential of the ICT market continues to attract American companies to the market. The International Data Corporation predicts that the China ICT market will reach USD 465.6 billion in 2015, up 11.4 percent over 2014. Of that total, IT will make up USD 211.8 billion. In the world’s second largest market for ICT products, American companies are still the most innovative and competitive. But to prosper in a market that is seeing the arrival of strong

# By 2020 China's e-commerce market will be larger than the U.S., U.K., Japan, Germany, and France combined.

local players, American companies must continue to offer unique technologies as well as differentiated end-user experiences.

This differentiation is evident in the world's largest mobile phone market. In 2014, China had 1.26 billion registered mobile phone users according to the Ministry of Information and Industry Technology. The sheer size of the market helps explain how in early 2015, for the first time ever, Apple sold more iPhones in China than in the United States. But local enterprises are rising to the

occasion, replacing international firms in middle or lower-end markets. ZTE, Huawei, Lenovo, Xiaomi, and Tencent are impacting not only the market in China, but also worldwide.

The proliferation of mobile technology and the expansion of big data will continue to drive the ICT market. E-commerce has been one of the most impressive sectors in the Chinese economy. According to Forrester, a research firm, China's e-commerce market reached USD 440 billion in 2014 and is predicted to grow at a compounded annual rate of 20 percent before surpassing USD 1 trillion in 2019. Even more staggering, McKinsey estimates that by 2020 China's e-commerce market will be larger than the U.S., U.K., Japan, Germany, and France combined.

Although foreign companies are allowed to wholly own e-commerce companies in the free trade zones and China is experiencing an online retail boom, many worry that this will be of little benefit to U.S. e-commerce companies. While China's e-commerce giants operate in the U.S. market with few restrictions, U.S. e-commerce firms face an unwelcoming environment in China with legal restrictions and slow or blocked access to their online stores.



The Chinese internet is rife with operational inefficiencies, becoming more restricted and slower by the day. Even with virtual private networks (VPN) foreign and domestic companies alike are increasingly limited in their ability to access information from websites that are located outside of China, putting them at a major disadvantage.

Still, China looks to greatly expand its use of digital cloud technologies. According to a July 2014 report by McKinsey, the internet could provide between 7 and 22 percent of GDP growth expected through 2025. In early 2015, China announced a grand plan to harness this growth and use it to transform its economy. “Internet Plus,” as announced by Premier Li Keqiang, will leverage the country’s booming mobile commerce and big data, and integrate into industries like modern manufacturing. China plans to use Internet Plus to juice its slowing economy and leapfrog others.

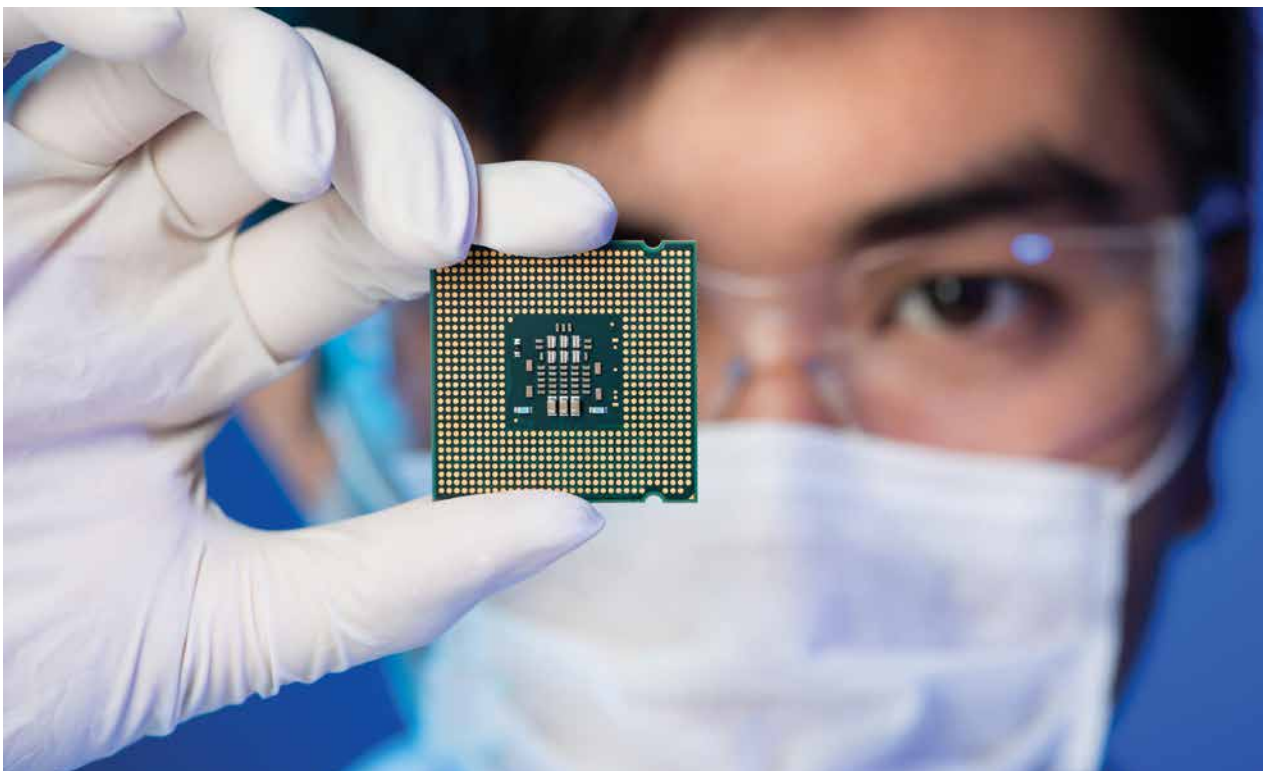
**American ICT companies continue to see China as a market with vast potential, but face pressure from an unprecedented**

**number of challenges. To address market access challenges, AmCham Shanghai recommends:**

**1) The U.S. Government continues to push the Chinese government to rescind nationalistic and protectionist internet policies, including regulations that require companies to purchase “secure and controllable” domestic products and provide “backdoors.”**

**2) The U.S. government seeks out opportunities to engage the Chinese government on cyber-security issues to establish international standards and rule of the roads.**

Many countries face the same challenge of protecting national security while maintaining a healthy internet ecosphere. Policies developed in isolation are not very effective. Developing international standards and rules of the road on the internet will help countries meet their security and economic needs. Companies need to feel confident that their intellectual property and key data will be protected. 🇺🇸





# Recommendations



AmCham Shanghai members are optimistic about their prospects in China, but they face market access obstacles that limit their growth in this key market. They are eager to work with the U.S. government to eliminate market barriers and offer the following recommendations.

## 1) Prioritize negotiations on the Bilateral Investment Treaty (BIT).

At the 2015 Strategic and Economic Dialogue (S&ED), the United States and China emphasized conclusion of a BIT as their number one economic priority. We support that objective. A successful BIT would further open up the Chinese market to U.S. investment, including sectors currently subject to restrictions under Chinese regulations, such as automotive, banking, chemical, telecommunications, and energy.

AmCham Shanghai strongly supports the successful negotiation of a high-standard BIT to protect and encourage investment by American companies in China and Chinese companies in the United States. A high-standard BIT would encourage market-oriented policies and transparent investment environments. It would strengthen China's market reforms, and by enhancing bilateral economic interaction, would also strengthen our respective economies.

## 2) Use President Xi Jinping's U.S. visit to urge China to improve its investment climate and accelerate economic reforms. AmCham Shanghai suggests that U.S. Government officials emphasize the following points in its meetings with President Xi:

(A) American businesses and consumers are important contributors to China's economy.

However, recent developments have created a less than welcoming atmosphere for foreign companies:

**Anti-Monopoly Law (AML) Investigations:** investigations of foreign companies in the auto, ICT, food, and pharmaceutical industry suggest that foreign companies are under close scrutiny by the Chinese government. While Chinese companies have also been investigated, the heavy media focus on foreign firms creates the impression that China is suspicious of foreign companies.


**ICT Market Barriers:** recent draft guidelines from China's Banking and Regulatory Commission call on banks to only use "secure and controllable" technology. This would require banks to purchase only domestic made technology. While the guidelines have since been suspended and the Chinese government has made assurances that "secure and controllable" products do not preclude foreign made products, many American technology companies have seen a drop in sales.

**Economic Security:** We recognize a country's right to determine its national security needs, however, in late May China adopted a National Security Law that provides for reviews of foreign investment that would consider the impact on economic security, cultural security and even public morality. We are concerned that the law could be used for protectionist reasons and prevent U.S. companies from operating in key sectors including technology, agriculture and entertainment.

(B) The Chinese government should accelerate economic reforms, especially in the financial sector and to state-owned enterprises, which still dominate key sectors. This would send a positive signal to American businesses that China welcomes foreign investment.

### **3) Increase the capacity of U.S. government agencies to promote and support American businesses in China.**

The American Embassy, U.S. Foreign Commercial Service, and Agricultural Trade Offices play an important role in promoting U.S. products and business interests. They interact with the Chinese government on a daily basis and provide American companies with invaluable support and information on the Chinese market. While high-level dialogues such as the S&ED and JCCT receive the most attention, daily interaction and working-level meetings carried out by USG agencies play an important role in resolving market access problems and ameliorating difficult issues. AmCham Shanghai believes that more funding for these agencies will help them expand their capacities and make them even more effective advocates for American businesses in China.

AmCham Shanghai also supports reauthorization of the Export-Import (Ex-Im) Bank, given its vital role in supporting American exports. In 2014, Ex-Im Bank financing supported USD 27.5 billion worth of U.S. exports and supported 164,000 jobs in America. The global market is filled with nearly 60 other export credit agencies that provide their citizens with credit to support their businesses. Ex-Im Bank funding helps level the playing field for American companies and bolsters their competitiveness. 

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The AMERICAN CHAMBER of COMMERCE in SHANGHAI

## VIEWPOINT

### **About The American Chamber of Commerce in Shanghai**

The American Chamber of Commerce in Shanghai (AmCham Shanghai), known as the “Voice of American Business in China,” is one of the largest and fastest growing American Chambers in the Asia Pacific region. Founded in 1915, AmCham Shanghai was the third American Chamber established outside the United States. As a non-profit, non-partisan business organization, AmCham Shanghai is committed to the principles of free trade, open markets, private enterprise and the unrestricted flow of information.

For more information, please visit:  
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