Member Survey

US-China Business Council | 2020

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

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

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

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

Top 10 Challenges

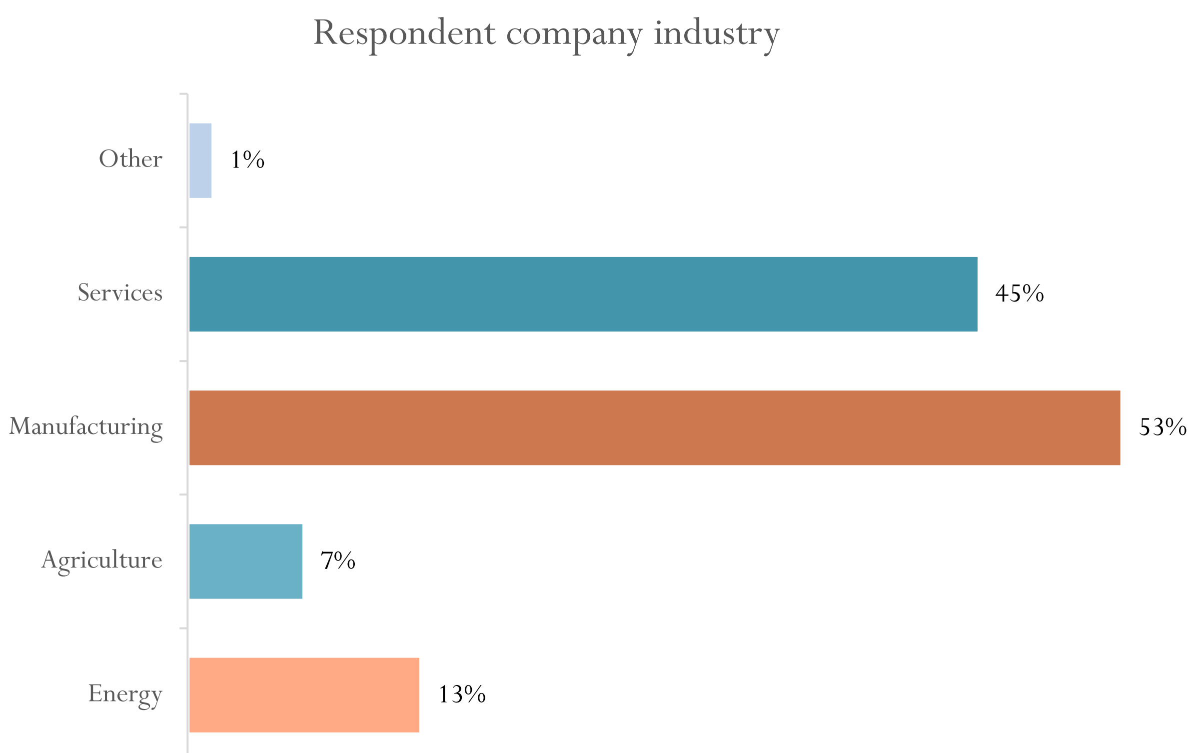
1. US-China relations
2. COVID-19 impacts
3. Competition with Chinese companies
4. Tariffs
5. Cost increases
6. Licenses and approvals
7. IPR enforcement
8. Data flows
9. Innovation policies
10. Investment restrictions on foreign companies

Methodology

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

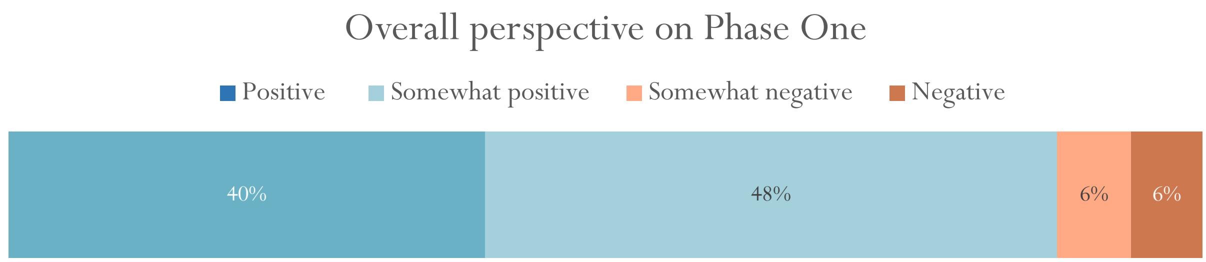
Companies' top 10 challenges were calculated using a weighted system to reflect the most significant issues they encounter while doing business in China. The same methodology has been used in previous years to ensure consistent analysis of the issues over time.

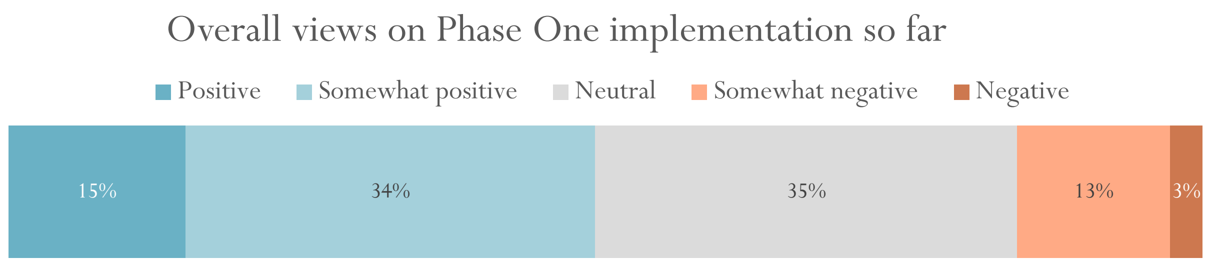
Due to rounding, some chart totals may add up to more or less than 100 percent.



The Phase One Trade Deal

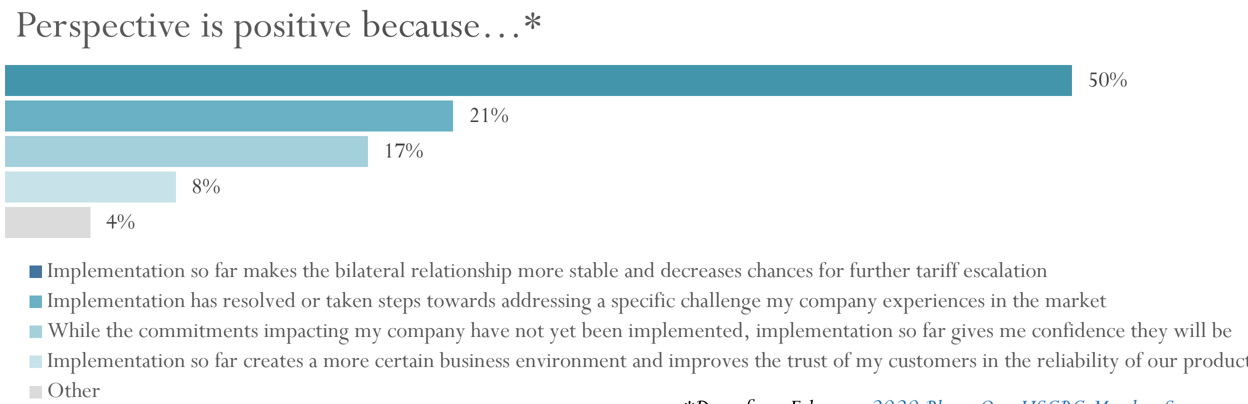
The signing of the Phase One Trade Agreement between the United States and China in mid-January of this year was met with a range of reactions from lawmakers, analysts, and the business community. Seven months after the United States and China signed the Phase One deal, American companies remain overwhelmingly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





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

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



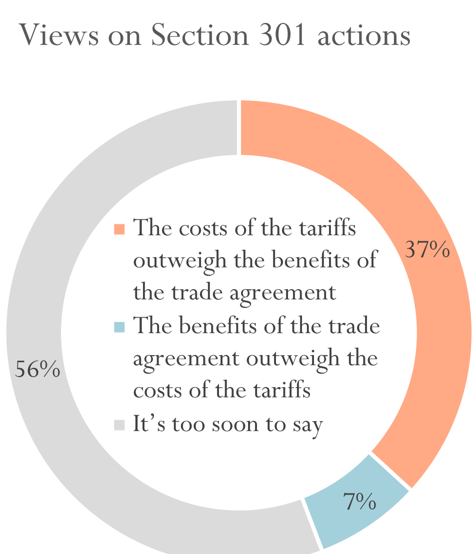
Data from February [2020 Phase One USCBC Member Survey]

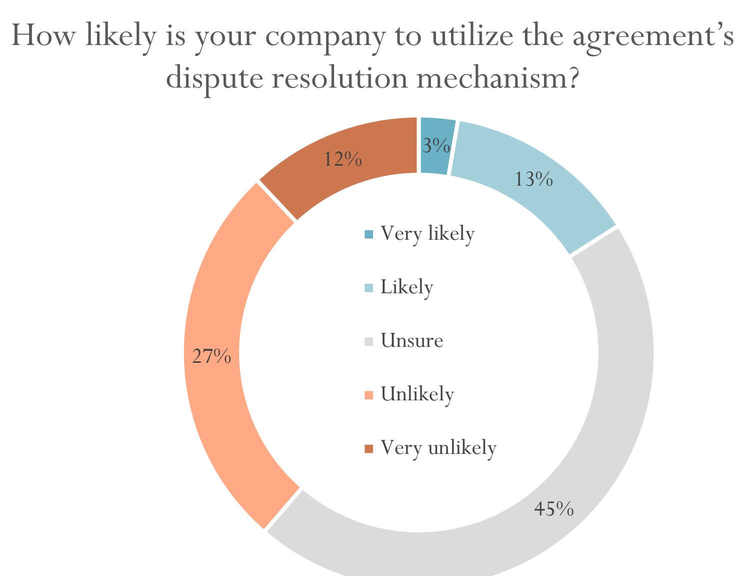
Despite agreeing to halt any further tariff increases, as of the release of this report, tariffs remain on $370 billion of Chinese goods and more than $110 billion of US goods.

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

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

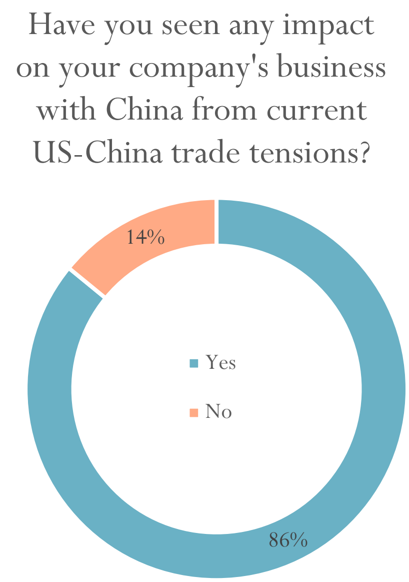
While this mechanism provides more opportunities for the US government and, by proxy, companies, to resolve their problems in the China market, many companies are circumspect about actually utilizing the mechanism, with only 16 percent expecting to do so if issues with Phase One arise. Members indicate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





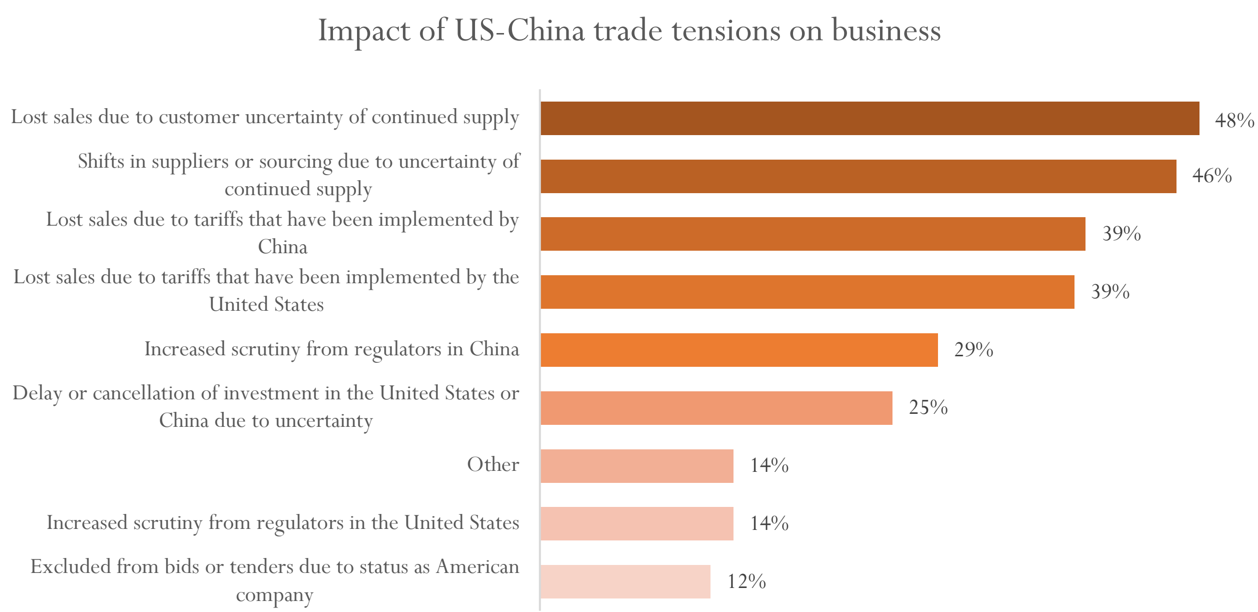
US-China Relations

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



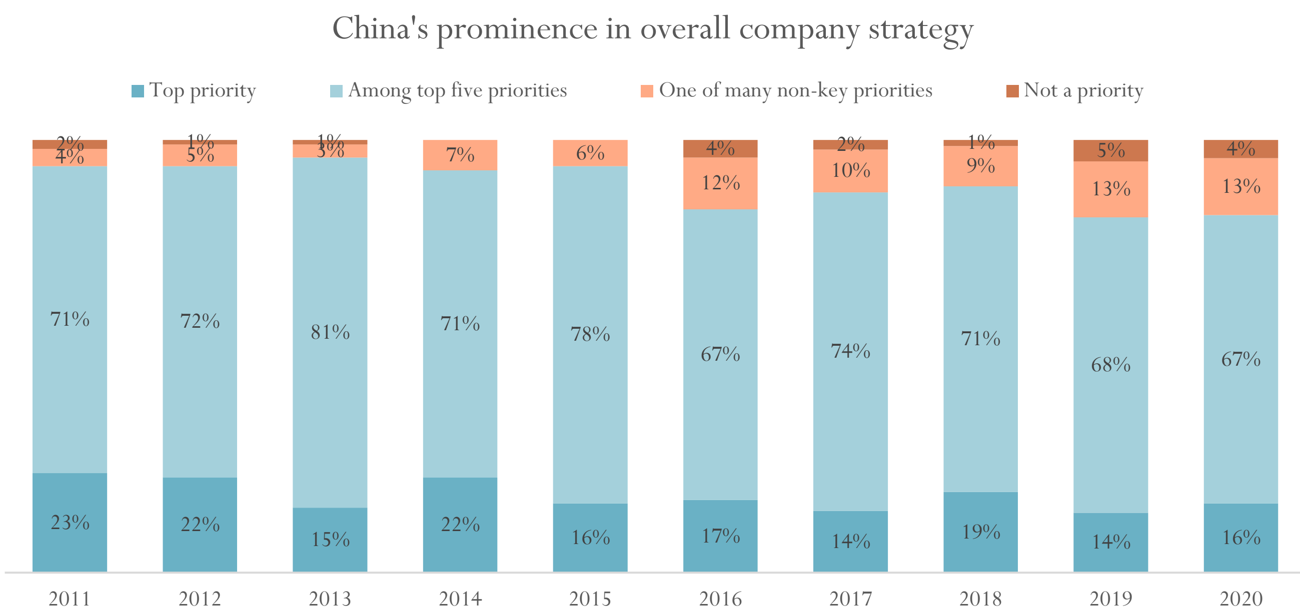
Eighty-six percent of USCBC members report that bilateral trade tensions have impacted their business with China. In 2019, the most significant result of those tensions was lost sales due to retaliatory tariffs enacted by China. While Chinese tariffs continued to impact US company sales to China in 2020,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

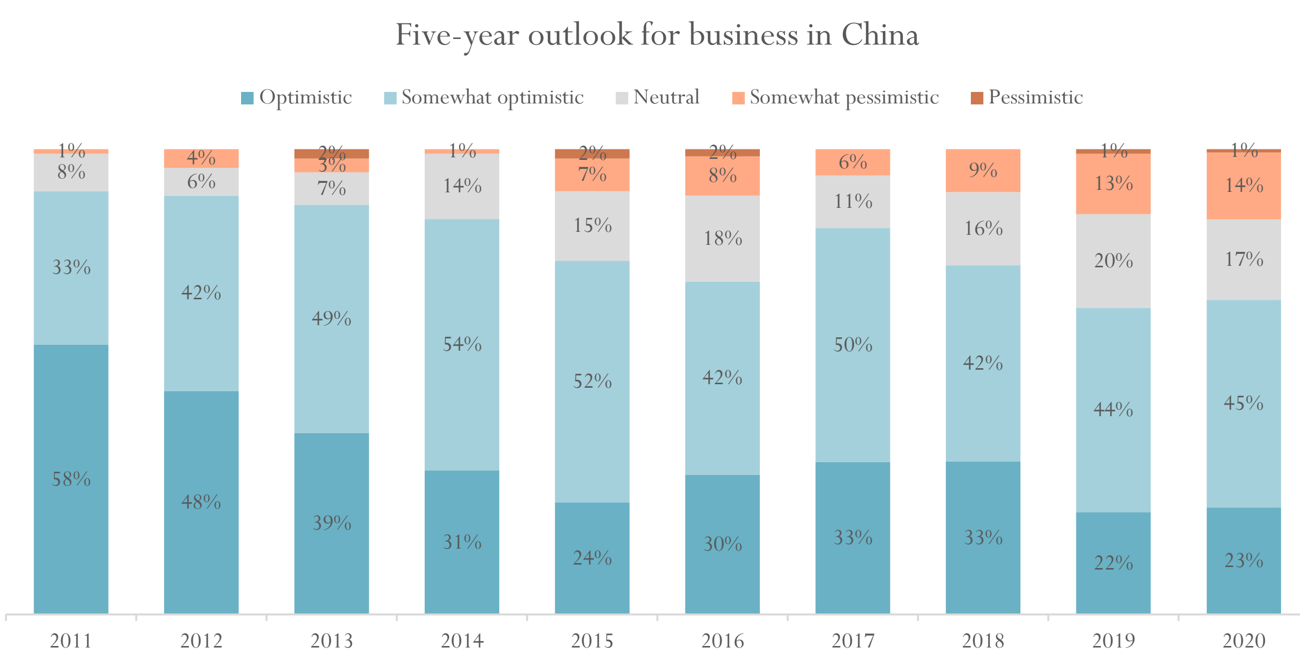
In 2020, the most perverse impact of bilateral trade tensions—reported by half of respondents—was lost sales due to customer uncertainty about continued supply. Members were similarly concerned about sourcing products as a result of tariffs. Recent US policies restricting the sales of certain products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



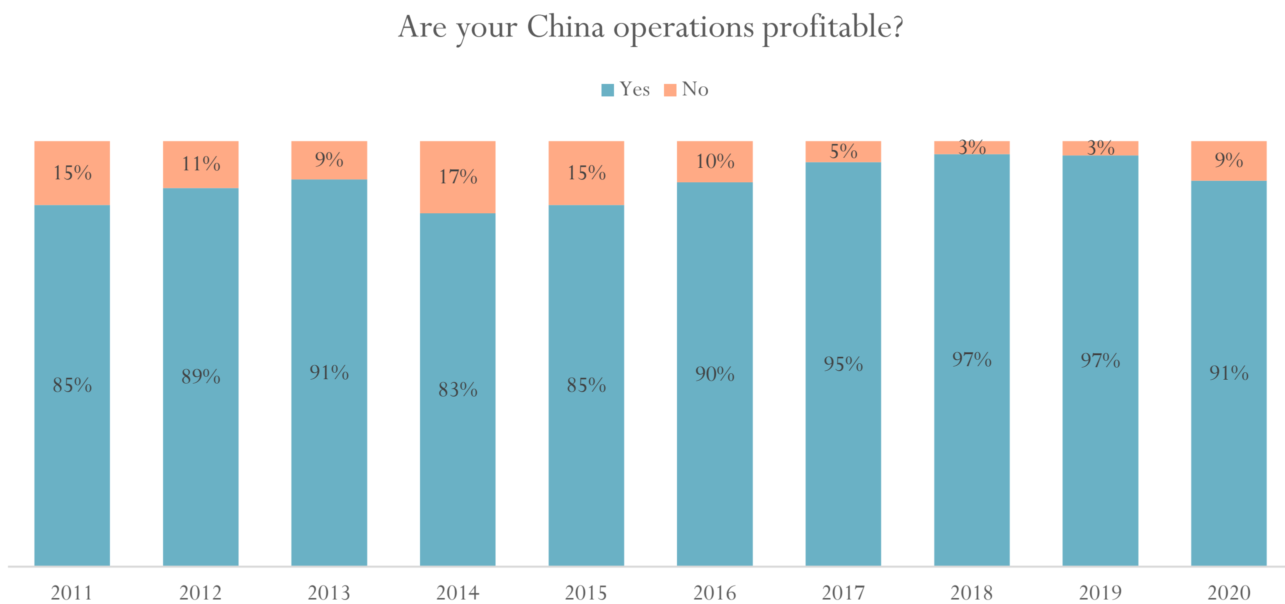
The Investment Environment

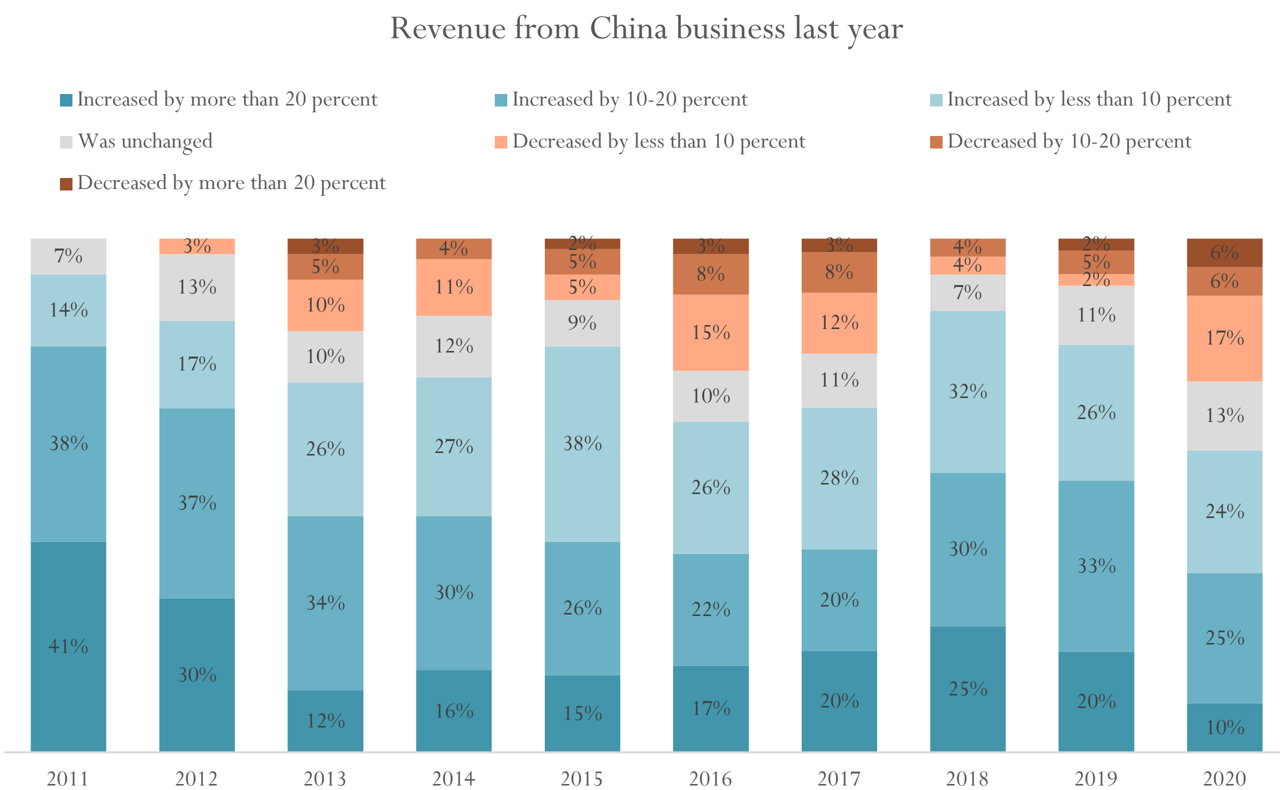
Despite years of trade friction and swelling calls for economic disengagement by hawks in the United States and China, both our data as well as conversations with member companies indicate that American companies remain committed to the China market over the long term. Eighty-three percent of companies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



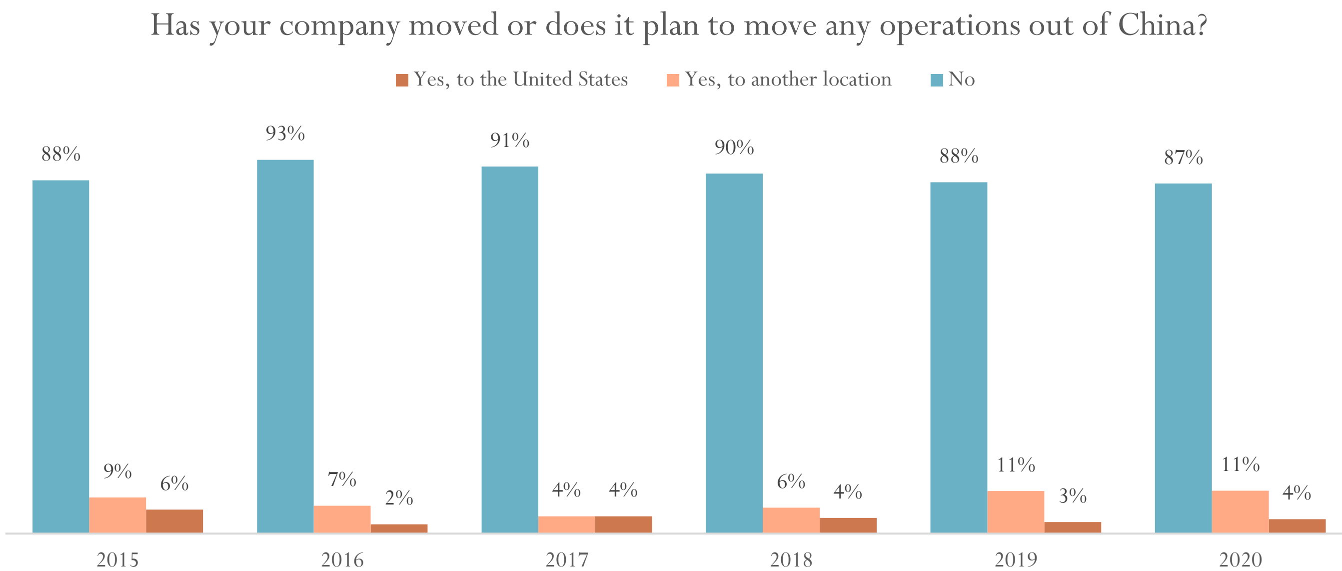


Profitability is also a key component of long-term confidence in the China market. Ninety-one percent of companies indicate their China operations are profitable, albeit at a lower margin than in years past. According to our data, the primary restraint on profitability is COVID-19 and its impact on the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

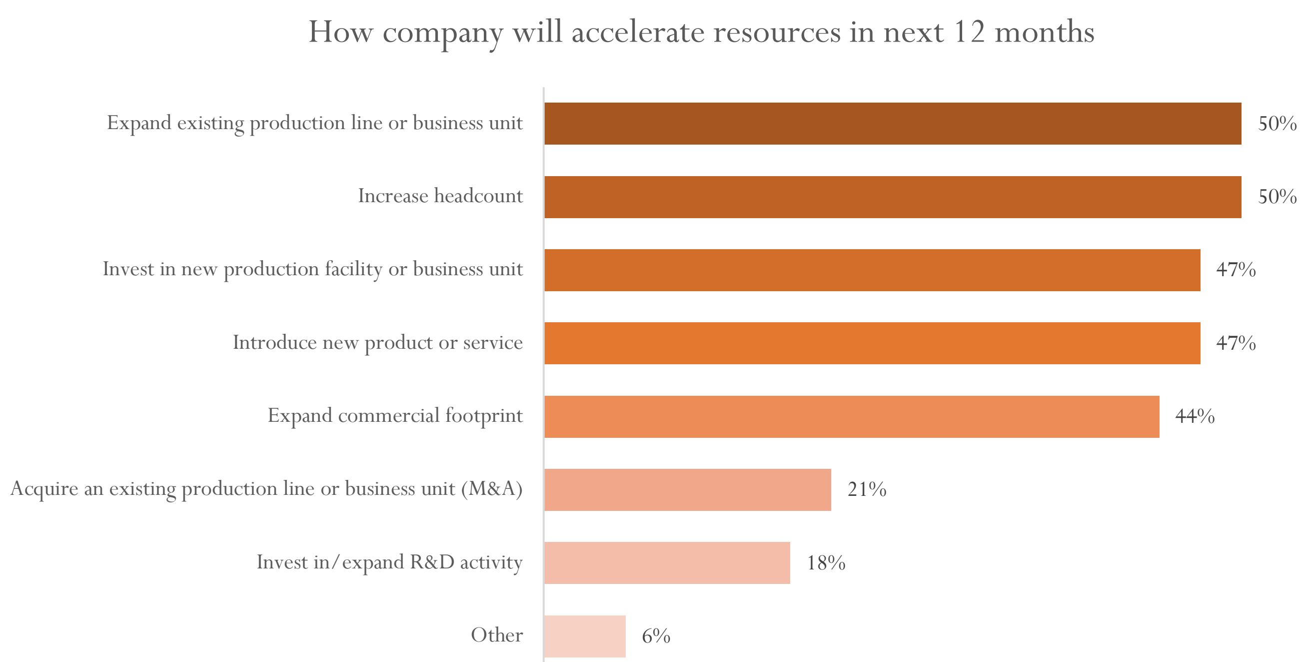




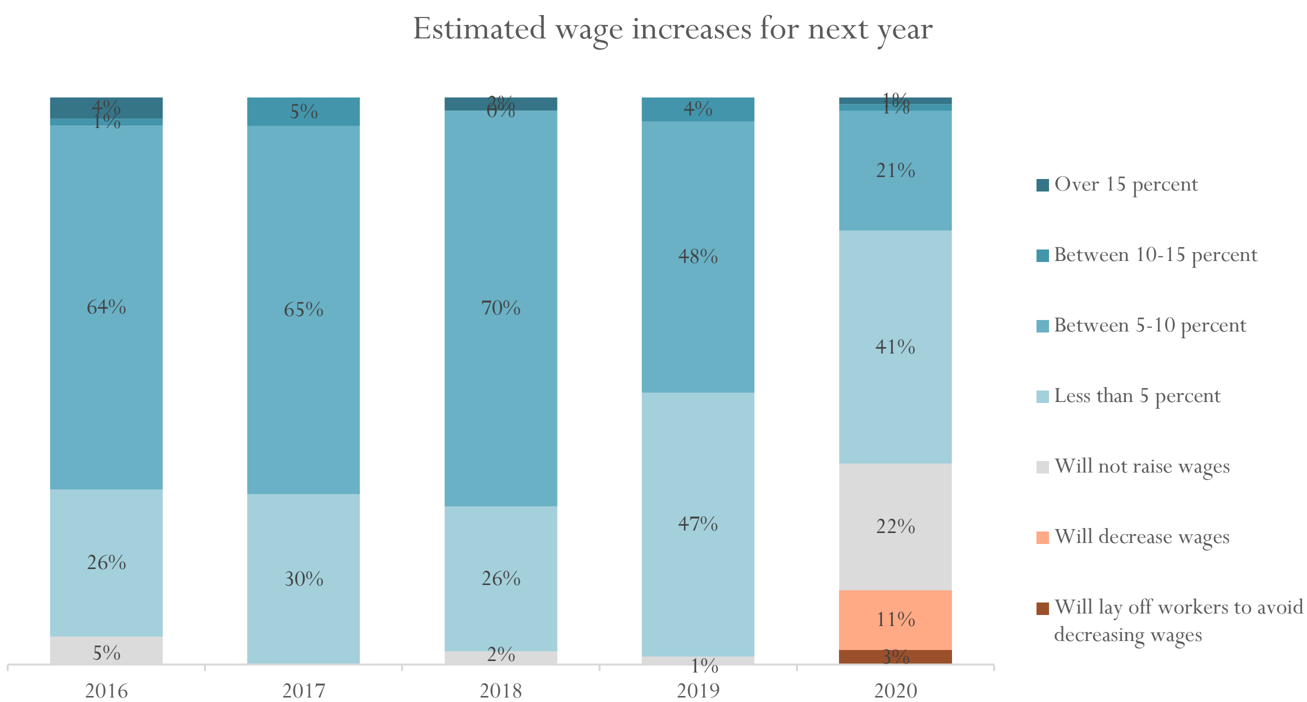
As a result of this long-term confidence in the China market, 87 percent of companies reported no plans to shift production out of China. Only four percent have shifted or plan to shift operations to the United States, and this is largely due to lagging consumer demand in China. The other 11 percent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



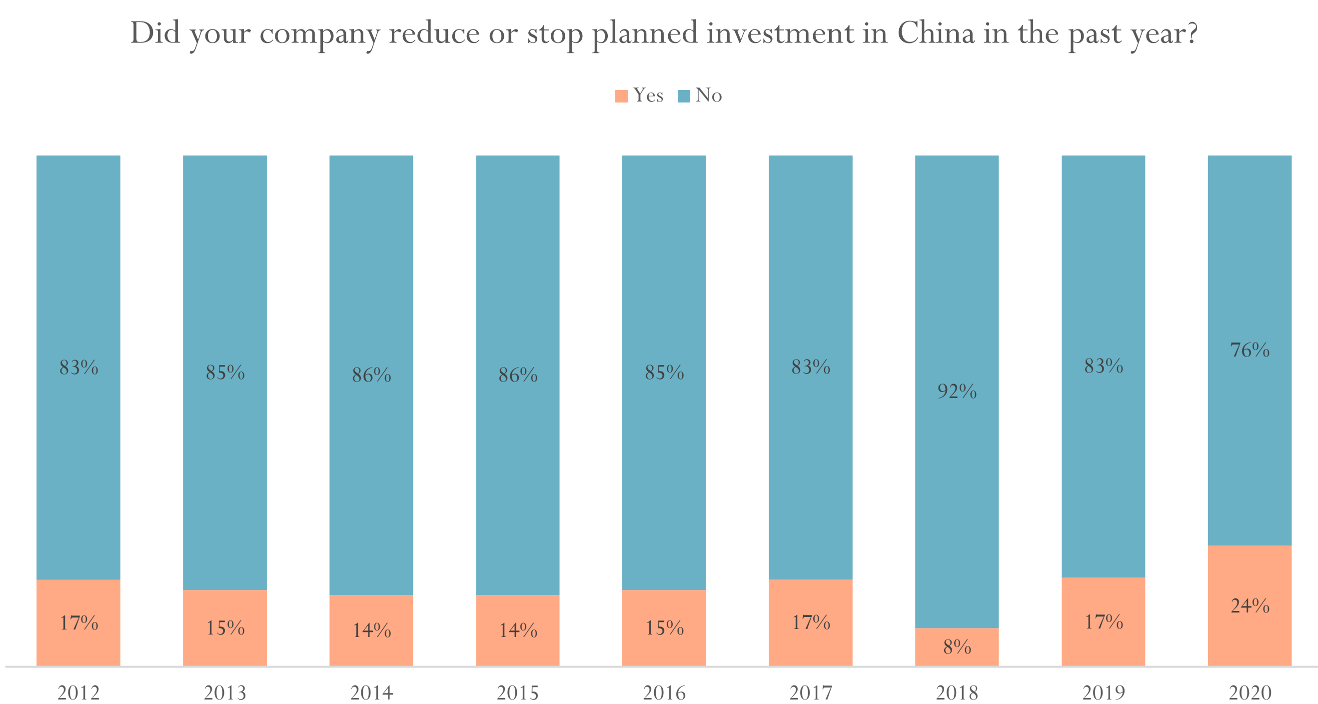
Of the 75 percent of companies reporting that their resource commitments to China operations will remain static or accelerate in the coming year, the most common reasons were to expand their existing commercial footprint and production, increase their headcount, and launch new products.



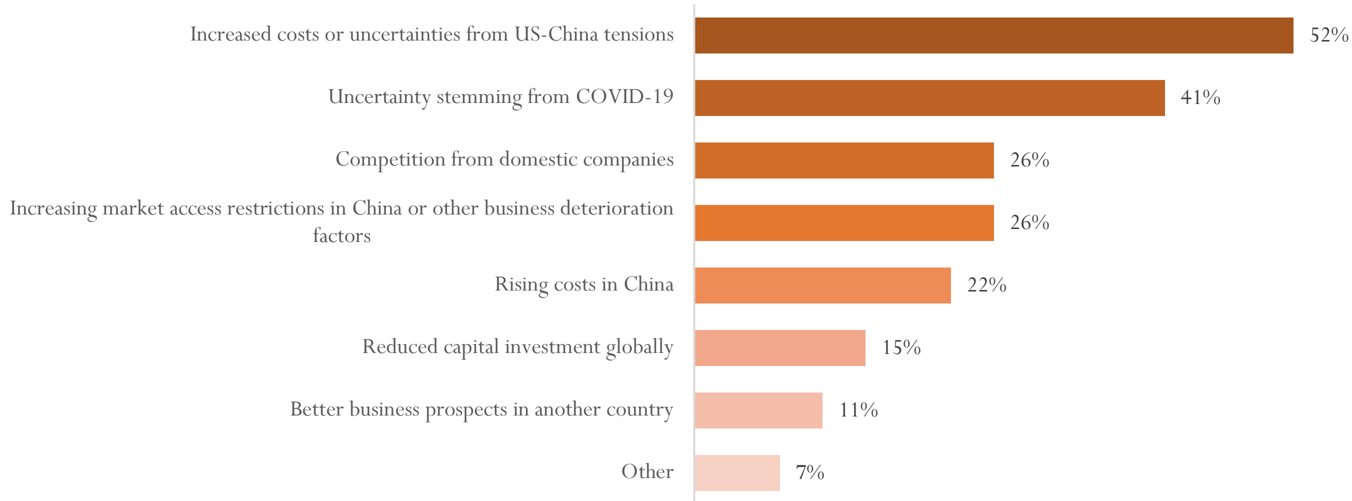
But despite long-term optimism, bilateral trade friction and especially the outbreak of COVID-19 are weighing on the investment decisions and near-term economic prospects of American companies in China.



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



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

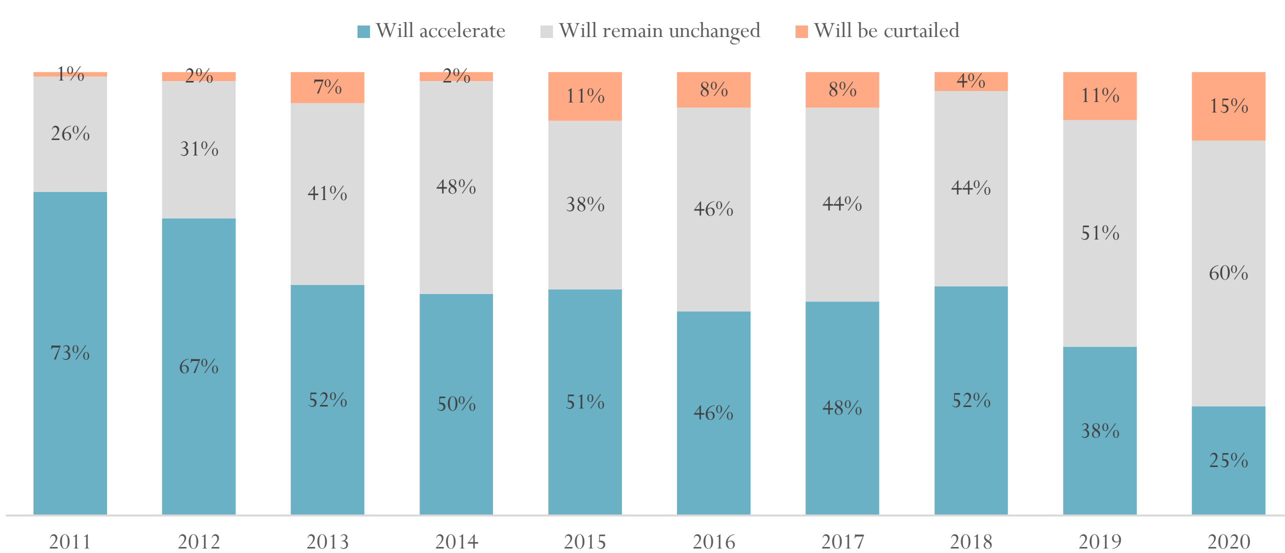


The trend of reduced investment is particularly apparent in research and development (R&D). In 2020, for those increasing investment in China, only 18 percent indicated that investment would go to R&D spending. This compares to 33 percent in 2019, and 47 percent in 2018. Part of this decrease might be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

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

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

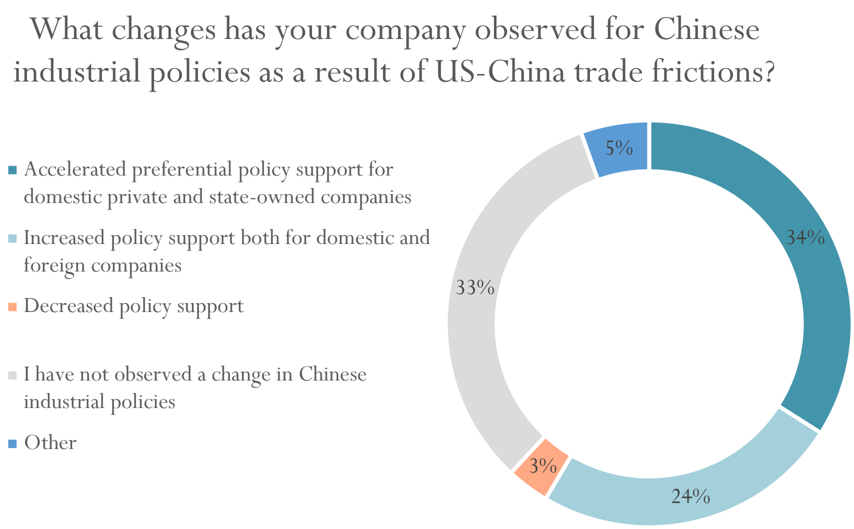
Resource commitment for next 12 months

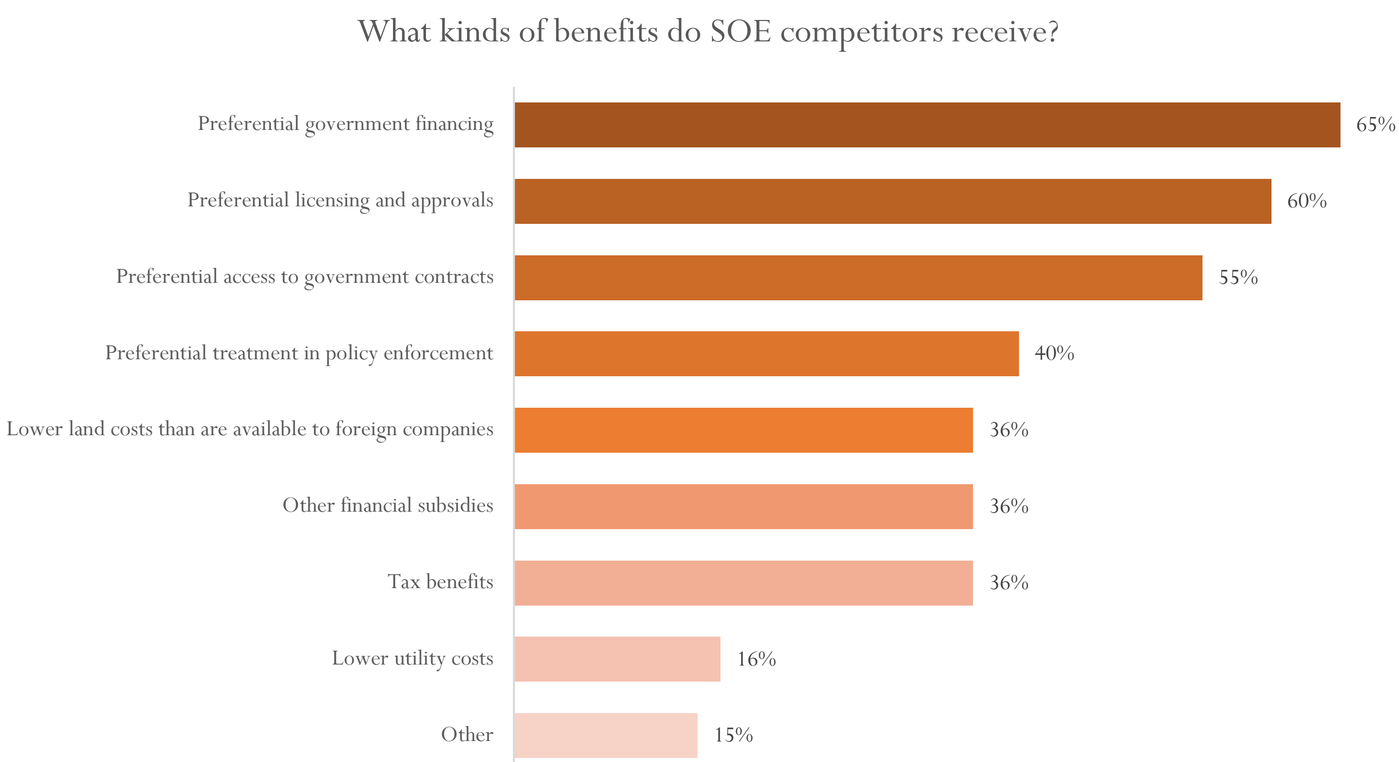


Competition

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

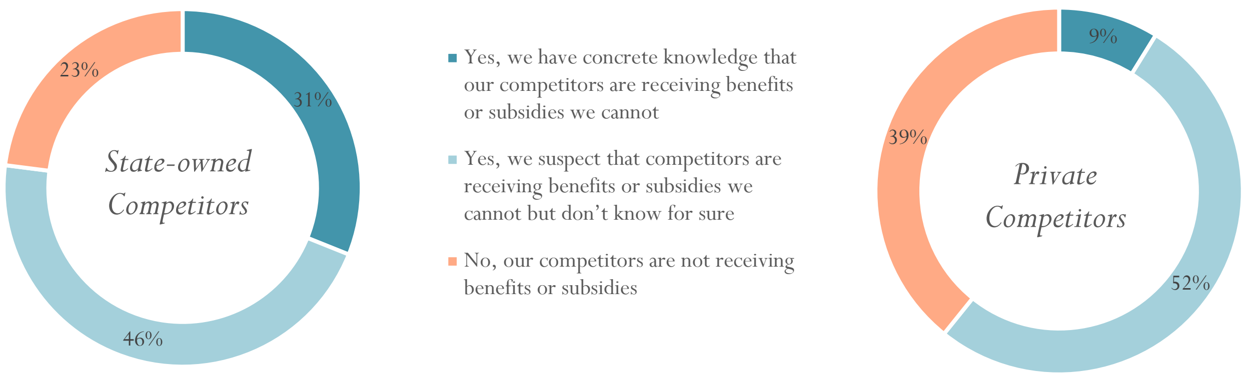
But in other areas, particularly when it comes to the state sector, the picture is less straightforward. While the majority—77 percent—either have concrete knowledge of or suspect state-owned competitors are receiving subsidies or benefits from the Chinese government, twenty-three percent report that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

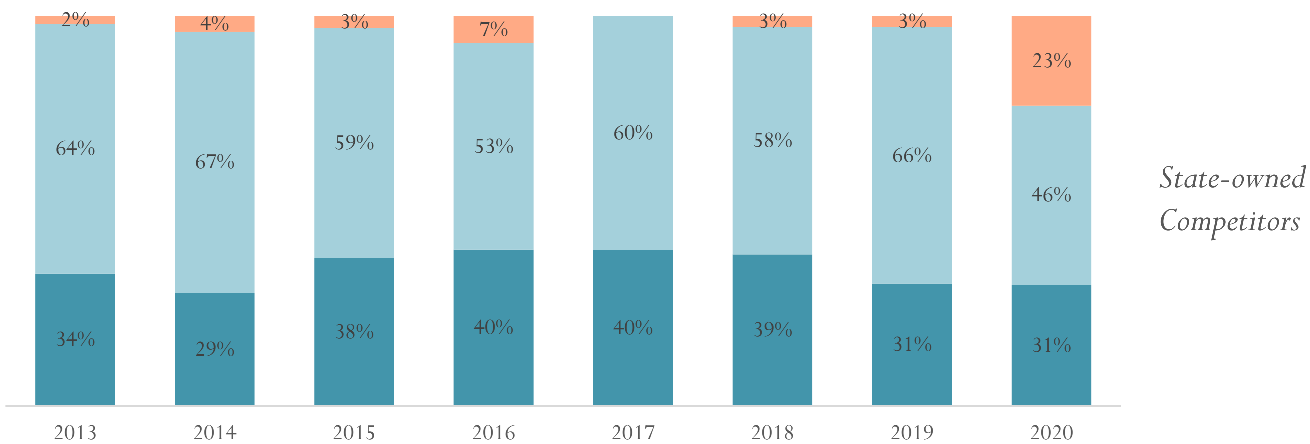


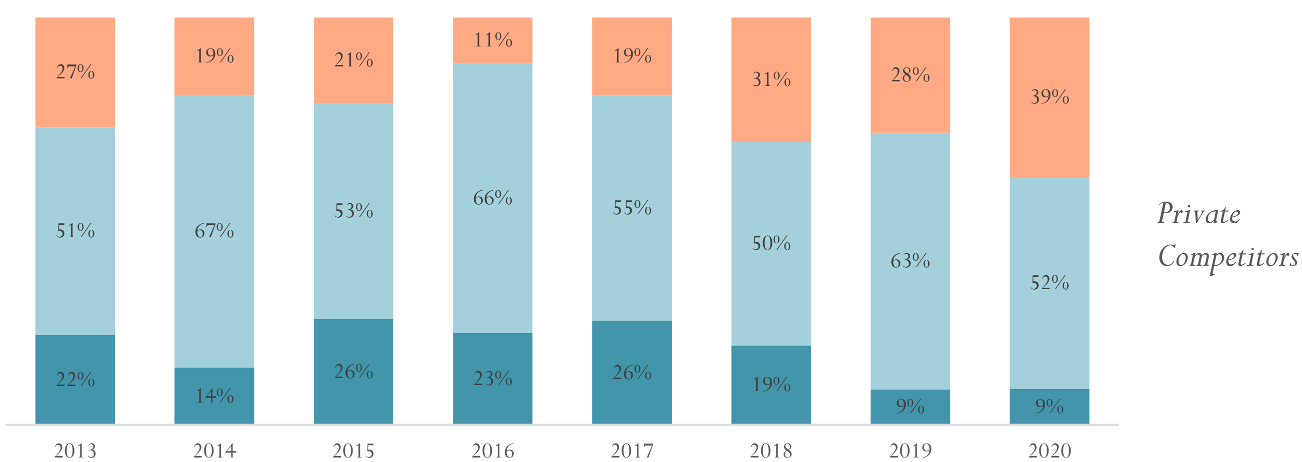


Likewise, 61 percent of respondents either have concrete evidence or suspect that their privately-owned competitors in China are receiving similar benefits. While this is an improvement from years past, competition with Chinese companies still ranks as the third most common challenge for respondents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

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





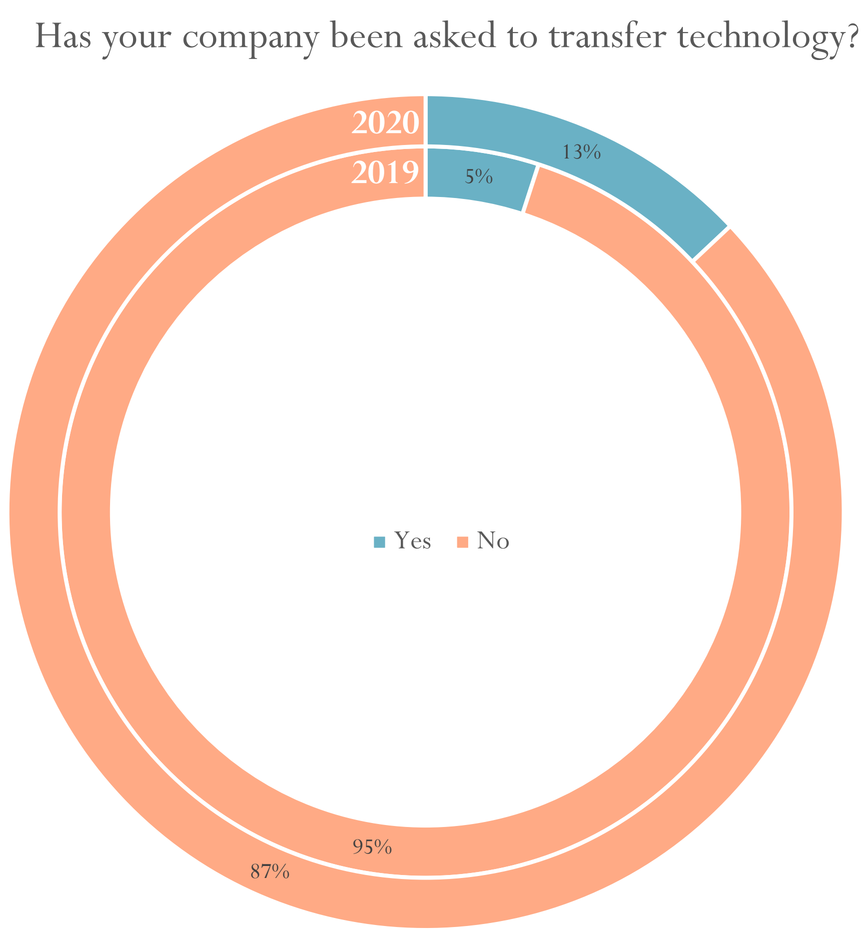


Technology Transfer

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

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

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

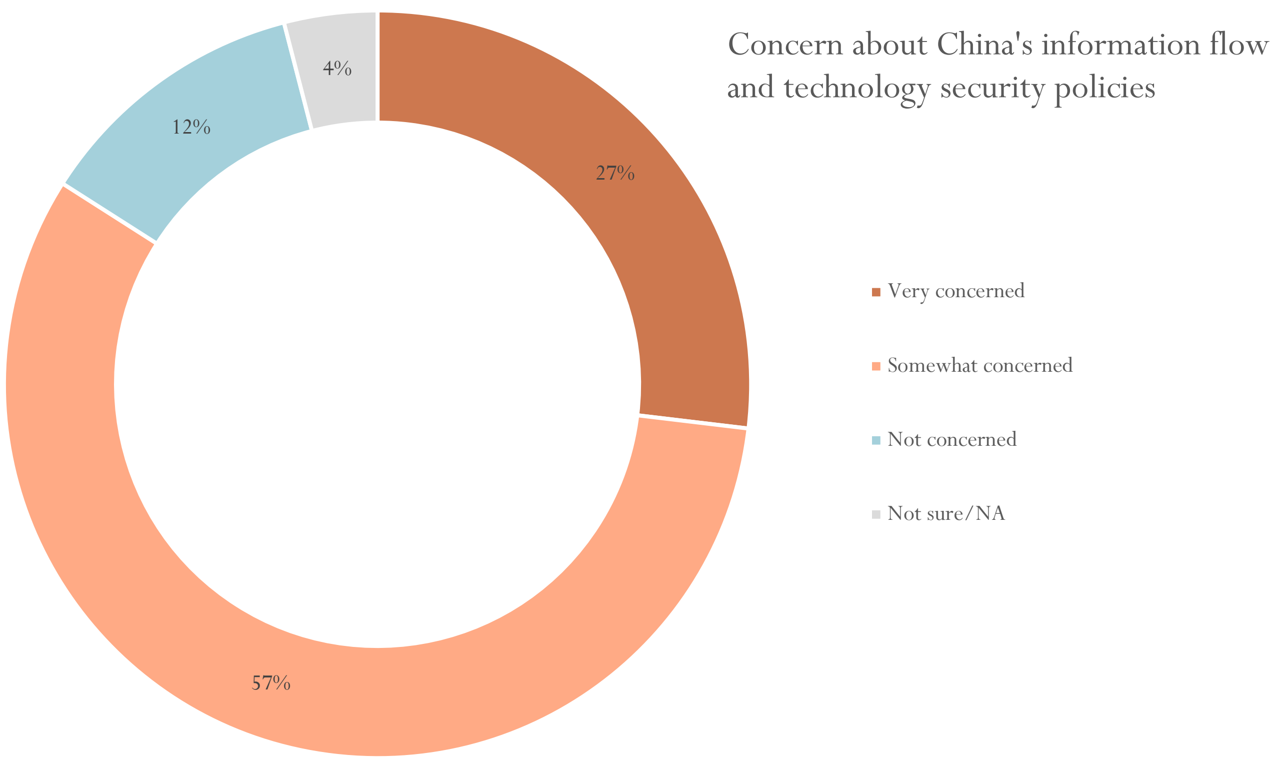


Data Flows and Cybersecurity

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

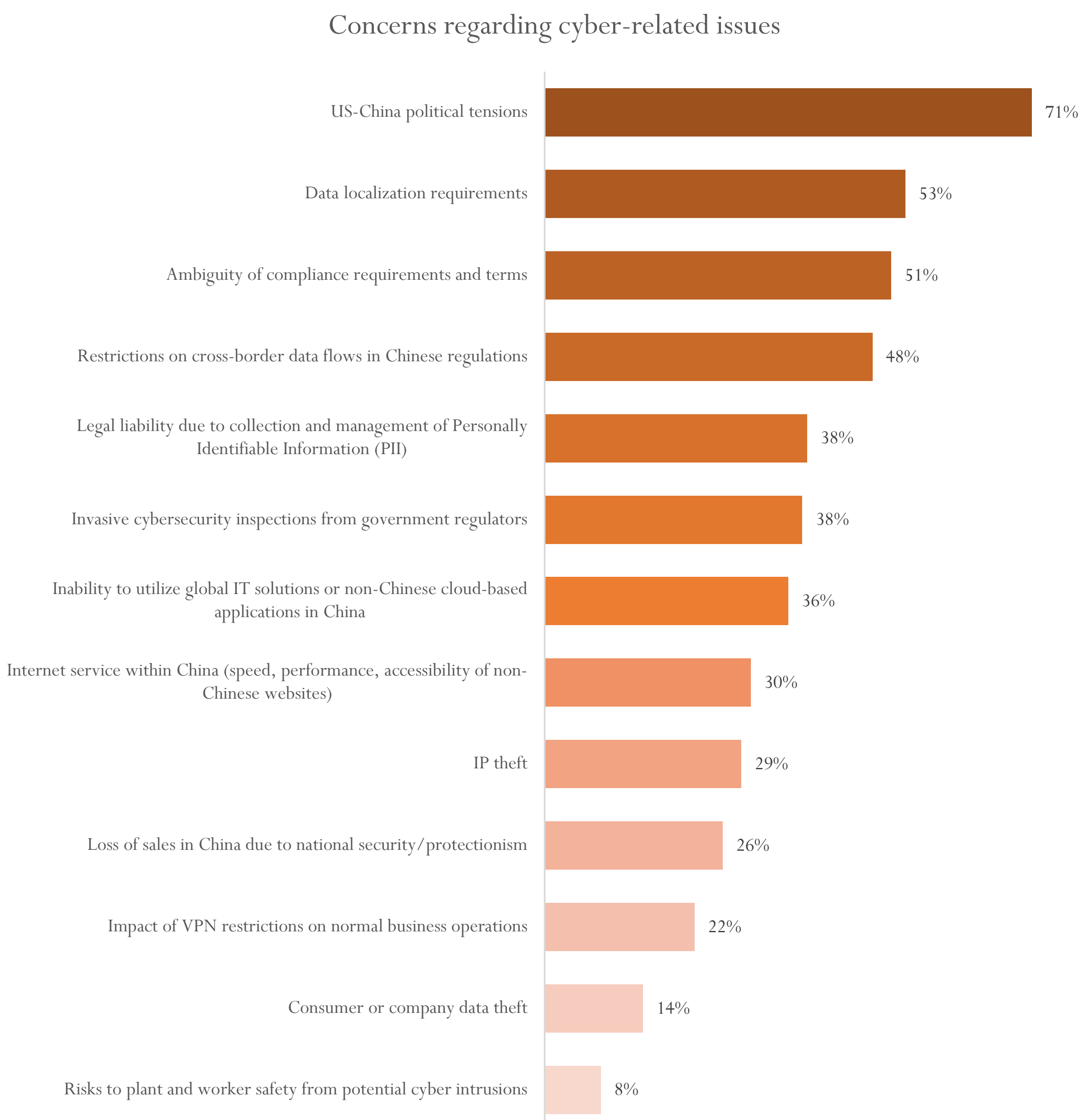
According to companies, these concerns are driven by the negative trajectory of the US-China relationship. Bilateral tensions are likely to remain at the center of concerns around data and cybersecurity issues moving forward. Although foreign technologies provide more options for users in the China market,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

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



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

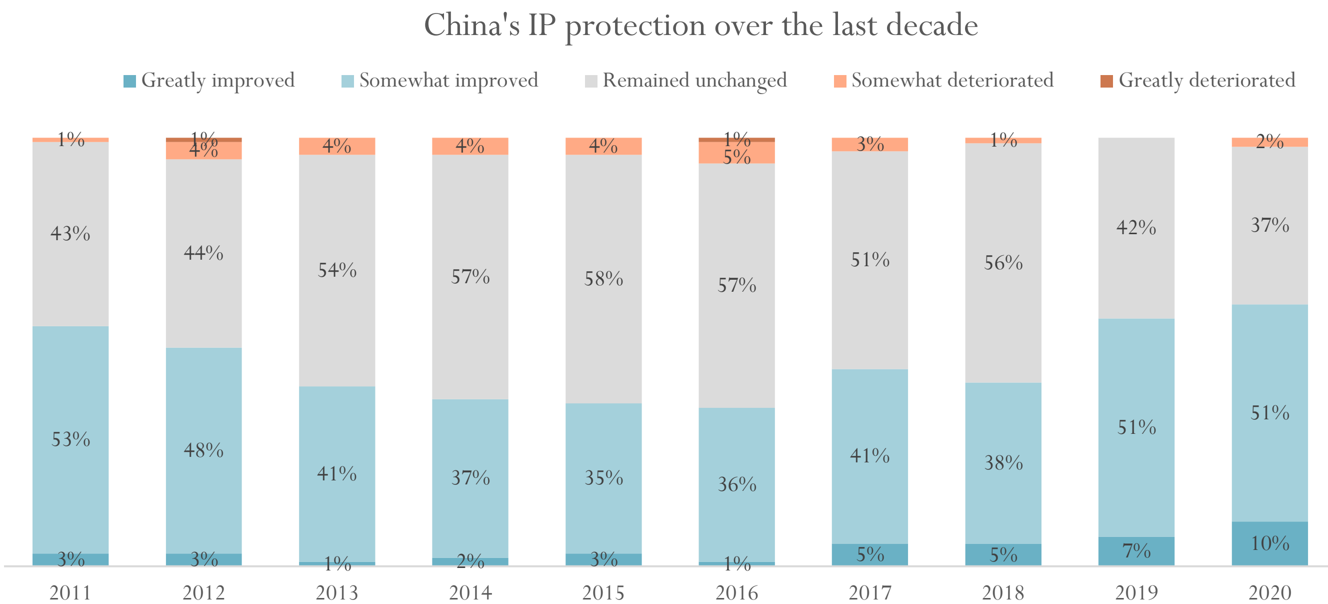
Likewise, concern around data theft has seen a marked decline in the last few years, with only 14 percent of companies identifying it as a problem compared to a peak of 53 percent in 2017.

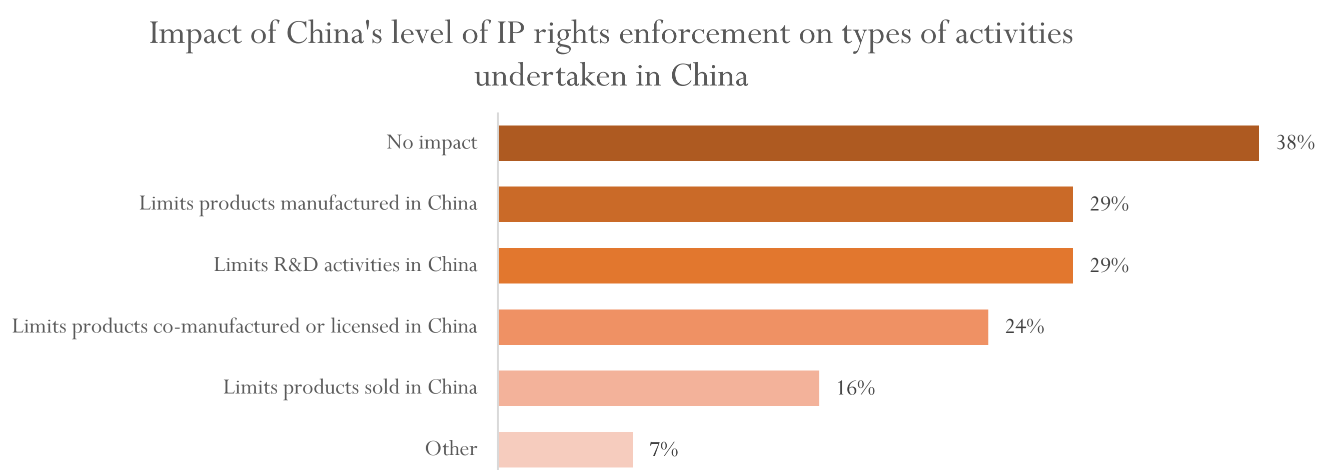


Intellectual Property Protection

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

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



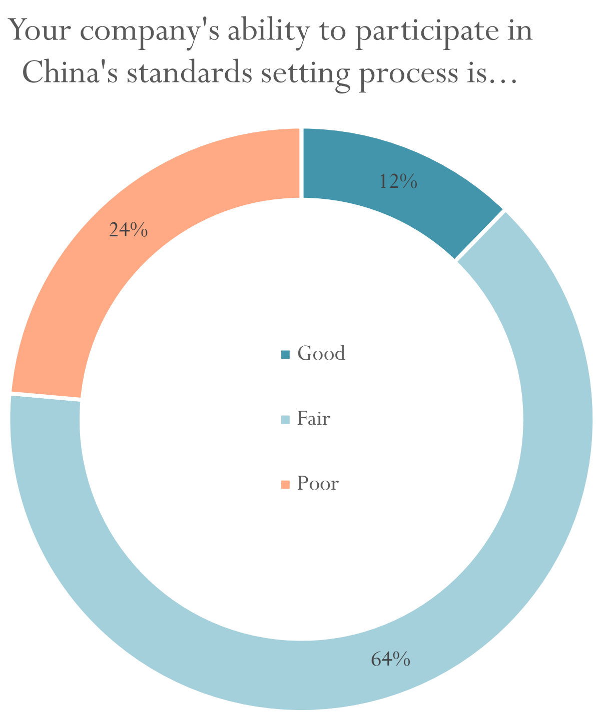


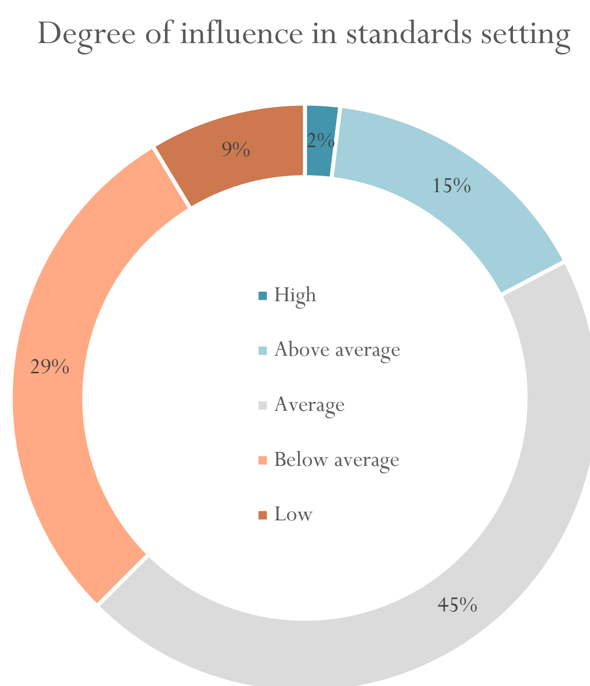
Participation in Standards Setting

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

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

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





Visa and Travel Restrictions

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