Market Access Challenges in China

THE AMERICAN CHAMBER OF COMMERCE IN SHANGHAI

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Improved market access for foreign companies in China is essential for the U.S. economy to benefit from the China market. China today still has many explicit and implicit market access barriers that disadvantage foreign companies. This paper highlights some of those barriers in five key industries: financial services, information and communications technology (ICT), healthcare, automotive, and agriculture.

Market Access Reforms Still Too Slow

The Chinese government has expressed its rhetorical commitment to further market liberalization, yet continues to open its markets at a snail's pace. While the recent reduction of restrictions in the National Foreign Investment Catalogue and Free Trade Zone Negative List for 2017 may appear positive, most reductions provide only marginal improvements in market access. In some cases, the newly opened areas are already dominated by well-established domestic companies. For example, approvals of bond underwriting and electronic payments licenses for U.S. financial service companies in summer 2017 came intentionally late, and the long effort required to remove the ban on American beef exports allowed other suppliers to fill the gap. Other important investment areas such as cloud computing, hospitals, and fintech remain highly restricted.

The Playing Field Remains Uneven

Government foot dragging on market reforms has allowed domestic companies to gain both experience and market share. For example, investment restrictions in the financial services industry limit foreign banks to certain business channels such as cross-border services and restrict them to an anemic total market share of 1.3%. The government also has broad industrial policies, such as *Made in China 2025*, that aim to create domestic champions in important industries for the future. Foreign companies in these industries can face pressure to transfer technology, in some cases via mandated joint venture arrangements, in order to gain market access.

A lack of regulatory transparency also disadvantages U.S. companies relative to their domestic competitors. The exclusion of foreign companies from certain phases of the standards formation process in industries ranging from automotive to healthcare to agriculture results in standards that are created principally with domestic companies in mind. Moreover, uncertainty over how certain policies will be implemented, such as data localization requirements under China's new Cybersecurity Law, could result in sudden cost increases for U.S. companies without much explanation or advance notice.

Explicit and Implicit Barriers Exist

Explicit barriers such as long-held equity caps and licensing restrictions in the automotive and financial services industries are irrefutable restrictions that handicap foreign companies as they seek to build market share. There are also many implicit barriers, from the frequent use of informal notifications of sensitive policy changes ("window guidance" in banking, for example) and insufficient lead time before new policies take effect. These practices create uncertainty about regulatory compliance and drive up costs for U.S. companies.

We list in the following pages some of the main market access barriers U.S companies face in China, looking at financial services, ICT, healthcare, automotive, and agriculture. We hope that policymakers in Washington focus on ways to eliminate these barriers in their discussions with the Chinese government on bilateral trade and investment issues.

Market Access Challenges in China

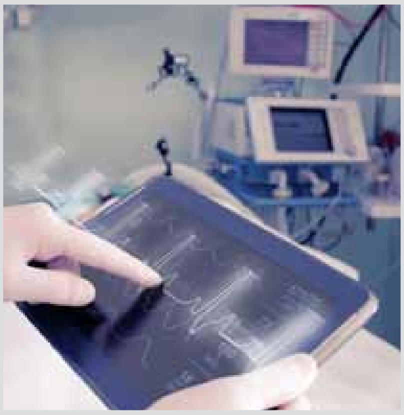
Financial Services

- **Excessive Window Guidance:** U.S. banks frequently receive informal, last-minute notification of policy changes by Chinese regulators, such as new foreign exchange controls. The informality and suddenness of these notifications disadvantages U.S. banks relative to their domestic peers, who are often better informed on policy changes.
- **Cross-Border Capital Controls:** Ad hoc restrictions on cross-border capital flows by Chinese regulators create operational challenges for U.S. banks in China and the United States that specialize in cross-border financial services. Capital controls also pose significant challenges to U.S. companies seeking to repatriate profits.
- **Licensing and Investment Restrictions:** Long-held licensing and investment restrictions in securities and banking restrain U.S. companies and investors from benefiting from China's high growth markets.

Information and Communications Technology (ICT)

- **Mandatory Cyber Security Review:** Under China's new Cybersecurity Law, products and services defined as being critical information infrastructure (CII) or related to national security are subject to mandatory cyber security reviews. Although the law has already taken effect, the scope of products and services as well as the review requirements have yet to be clearly defined. This creates operational challenges for foreign companies and raises concerns over the security of their IPR.
- **Data Localization Requirements and Cross-Border Data Controls:** CII companies are required to locally store personal information and important data that is collected and produced in the course of business operations in China. These requirements mean companies must establish new data servers in China, while cross-border data controls may slow down or stop transfer of information. This requirement has a special impact on foreign companies, who should have the flexibility to host data where it makes business sense.
- **Strict Content Guidelines:** U.S. media and gaming companies are required to adjust their products and services to meet strict content requirements that are aligned with government interests. The need to significantly revise content of existing products and services results in significant time and money costs.

Healthcare



- **Bidding and Tendering Process:** The bidding and tendering process for pharmaceutical products and medical devices focuses disproportionately on price and downplays quality, thereby limiting the competitiveness of high-quality U.S. products versus generic Chinese alternatives.
- **Product Approval Process:** China requires all pharmaceutical products and medical devices to undergo a cumbersome approval process that adds no additional layer of safety and leads to significant costs for foreign companies whose products have already received approval in more developed markets. This approval process delays market entry for foreign firms and sometimes runs beyond patent exclusivity, raising concerns over IPR protection for those products.

Automotive

- **Joint Venture Requirements:** Foreign automakers are required to enter into joint ventures with Chinese firms. Ownership is capped at 50% and foreign players are restricted in the number of joint ventures they can establish, thereby preventing them from having a larger market share.

- **New Energy Vehicle (NEV) Policy Changes:** The NEV regulation-making process has been opaque and recent new rules provide a short lead time from their public release to actual enforcement, making it almost impossible for foreign players to comply. It seems many Chinese companies had more advance notice about the changes.

Agriculture

- **Development of Standards:** Foreign invested enterprises cannot fully participate in important phases of the development of standards. The lack of transparency in this process also puts foreign companies at a disadvantage relative to domestic competitors.

- **Poultry Ban:** China has maintained a ban on U.S. origin poultry and poultry products since the 2014 avian influenza outbreaks in the United States, even after the U.S. reported its avian influenza free-status to the World Organization for Animal Health, and other nations such as Korea have lifted bans on U.S. poultry exports.

China-U.S. Market Access Comparison

Financial Services: Although China has a 50% equity cap for investment in life insurance, there are no such limits on foreign investment in the insurance industry in the United States. Chinese company Oceanwide is currently awaiting approval to purchase Gemworth Financial, an American life insurance company.

ICT: China caps foreign investment in cloud computing at 50%, forcing foreign companies to enter minority-share JVs with domestic companies to establish datacenters. The United States has no such equity caps. Chinese tech giants Alibaba and Tencent operate wholly-owned datacenters in Silicon Valley that support cloud computing.

Healthcare: Foreign investment in medical institutions, including hospitals, is limited to 70%. There are no such restrictions in the United States. Aier Eye Hospital, one of the largest eye clinic chains in China, purchased a clinic in Nashville, Tennessee in April 2017 and has allocated $50 million to opening more clinics in the United States.

Automotive: Licensing and production capacity requirements for NEV battery suppliers bar foreign companies from China's promising battery market and guarantee market share for a select number of domestic suppliers. The United States has no such restrictions. GSR Capital, a Chinese investment fund, announced in August 2017 that it would acquire Nissan's electrical battery unit with operations in the United States.

Agriculture: Foreign investment in China's agriculture sector is restricted largely for national security reasons. For example, U.S. companies seeking to invest in China's bioseed industry are limited to minority-owned JVs. Chinese companies do not face such investment restrictions in the U.S. market. Chinese SOE ChemChina was allowed to purchase Swiss pesticides and seed giant Syngenta in 2017 after clearing a CFIUS review.

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