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Beyond Technology Transfer: Reducing Investment Restrictions in China

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Steven Mnuchin, Secretary of the Department of the Treasury, will be travelling to Beijing soon to take part in trade and investment negotiations. China continues to maintain significant barriers to foreign investment in a number of sectors. Many of the barriers are highlighted in a recent report by the Office of the U.S. Trade Representative (USTR) following an investigation of China's illiberal market practices.[1] While China is far less restrictive than it was before joining the World Trade Organization (WTO) in 2001, the U.S. and other foreign governments would still like to see it fully abide by its WTO commitments and grant greater market access.

While in China, Secretary Mnuchin should move beyond the U.S. administration's immediate complaints about technology transfer. It should demand Beijing remove its restrictions on foreign investment and requirements for companies to enter into joint ventures with Chinese partners.

Section 301

On August 14, 2017, President Trump initiated Section 301 of the Trade Act of 1974 and asked the USTR to investigate the illiberal policies or practices within China that unreasonably burden or restrict U.S. commerce. The USTR was tasked with focusing on four areas:[2]

1. China's foreign ownership restrictions, such as joint-venture requirements and foreign-equity limitations, and various administrative review and licensing processes, to require or pressure technology transfer from U.S. companies;
2. China's regime of technology regulations, which forces U.S. companies seeking to license technologies to Chinese entities to do so on non-market-based terms that favor Chinese recipients;
3. Whether China directs and unfairly facilitates the systematic investment in and acquisition of U.S. companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property (IP) and generate the transfer of technology to Chinese companies; and
4. Whether China conducts and supports unauthorized intrusions into and theft from the computer networks of U.S. companies to access sensitive commercial information and trade secrets.

The investigation resulted in three distinct measures to be taken by the Administration. The first was to take China to the WTO to dispute certain measures concerning the IP protection. Consultation for this dispute began on March 23, 2018.[3] Second, the Department of Treasury was tasked with proposing measures to limit Chinese investment into the U.S. These restrictions are forthcoming but could possibly sidestep the hard work Congress has been doing to systematically reform current U.S. mechanisms for investment review.[4]

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Finally, on April 6, 2018, the USTR proposed a list of Chinese imports valued at roughly $50 billion it would tariff with a 25 percent import tax.[5] The list included goods like machinery parts, batteries, color monitors, and cars. While the list of 1,333 things the USTR has targeted may seem haphazard, it is fully compatible with the law. The Trade Act of 1974 allows the USTR to target any goods or economic sector from China "without regard to whether or not such goods or economic sector were involved in the act, policy, or practice that is the subject of such action."[6] This means the USTR can target *any* good from China until a solution is found regarding the issues highlighted in Section 301. That said, the Trump Administration claims to have carefully designed the list to target China's "Made in China 2025" plan to dominate key industrial sectors.

Since the U.S. accession to the WTO in 1995, Section 301 disputes now often result in filing a case at the WTO as final recourse. Traditionally the use of Section 301 in these cases and before has been very targeted, aiming for fair access abroad for items like beef or semiconductors. From the current Section 301 investigation and ongoing talks about trade, the U.S. Administration has made no specific requests of the Chinese government, other than to improve overall market access, reduce the annual trade deficit, and generally reduce its state support for industries.[7]

The Chinese Ministry of Commerce (MOFCOM) reciprocated the USTR's list with its own list of goods imported from the U.S., valued at roughly $50 billion, that it would target with a 25 percent tariff. While neither side has initiated these tariffs yet, President Trump has since asked the USTR to suggest an additional $100 billion of goods to be tariffed, again at 25 percent, because of China's reciprocal threats of tariffs. If both sides were to initiate these tariffs, not only would it be a direct cost to American families, but it would make American farmers and other producers less price competitive in China.

China's Market Restrictions

The Chinese National Development and Reform Commission and MOFCOM publish a *Catalogue of Industries for Guiding Foreign Investment*, laying out the foreign direct investment restrictions in China.[8] The most current edition includes 35 industries that are restricted and typically require joint ventures with a Chinese partner. These include restrictions on investment in insurance, market surveying companies, movie theaters, and manufacturing for certain items like cars and ships. The catalogue also outright prohibits investment in 28 industries such as mineral exploration, tobacco sales, and publishing.

The catalogue coincides with the 22 sectors of China's economy the Chinese State Council finds essential and in which the 97 central state-owned enterprises (SOEs) and numerous local SOEs operate.[9] Nominally, the current catalogue is an improvement from the restricted and prohibited 2015 list that had roughly 38 industries that were restricted and 36 industries that were prohibited; or the 2011 list that restricted roughly 79 industries and prohibited 38.

1. Office of the U.S. Trade Representative, *Findings of the Investigation Into China's Acts, Policies, And Practices Related to Technology Transfer, Intellectual Property, and Innovation Under Section 301 of the Trade Act of 1974*, March 22, 2018, https://ustr.gov/sites/default/files/Section%20301%20FINAL.PDF (accessed April 25, 2018).
2. Office of the U.S. Trade Representative, "Notice of Determination and Request for Public Comment Concerning Proposed Determination of Action Pursuant to Section 301: China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation, 2018," April 6, 2018, https://ustr.gov/sites/default/files/files/Press/Releases/301FRN.pdf (accessed April 24, 2018).
3. World Trade Organization, "DS542: China—Certain Measures Concerning the Protection of Intellectual Property Rights," March 23, 2018, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds542_e.htm (accessed April 24, 2018).
4. Tori Whiting and Riley Walters, "The White House Needs Better Guidance on Its New China Trade Policy," The Heritage Foundation *Issue Brief* No. 4831, March 27, 2018, https://www.heritage.org/trade/report/the-white-house-needs-better-guidance-its-new-china-trade-policy.
5. Office of the U.S. Trade Representative, "Notice of Determination and Request for Public Comment."
6. Trade Act of 1974, Public Law 93–618.
7. Lingling Wei and Bob Davis, "U.S., China Quietly Seek Trade Solutions After Days of Loud Threats," *The Wall Street Journal*, March 26, 2018, https://www.wsj.com/articles/u-s-china-quietly-seek-trade-solutions-after-days-of-loud-threats-1522018524 (accessed April 25, 2018).
8. National Development and Reform Commission and Ministry of Commerce, *Catalogue of Industries for Guiding Foreign Investment (Revision 2017)*, June 28, 2017, http://www.fdi.gov.cn/1800000121_39_4851_0_7.html (accessed April 24, 2018).
9. State-owned Assets and Supervision and Administration Commission of the State Council, "Central Business Directory, 2017," December 29, 2017, http://www.sasac.gov.cn/n2588035/n2641579/n2641645/index.html (accessed April 24, 2018).

The U.S. should seek to significantly pare down this catalogue of restrictions. Of course, American businesses will still continue to be disincentivized from investing in industries where there is competition with Chinese SOEs. And Chinese officials will continue to have greater objections to opening up investments in certain areas such as armaments, power generation and distribution, telecommunications, aerospace, railways, and media.

Opening Investment

China can no longer hide behind its self-proclaimed, developing-country status in the WTO. And it can no longer hide behind its accession agreement into the WTO that allows it to maintain investment barriers as a developing country. As Beijing seeks to make China a leader in cutting-edge technologies as part of its Made in China 2025 plan, it cannot have its cake and eat it, too. It cannot continue to force unreasonable requirements on foreign investors.

To that end, Secretary Mnuchin must:

- **Require the removal of China's Prohibited Industries for Foreign Investment list.** These are 28 industries where Beijing prohibits any foreign investment. Some of these prohibitions are more unreasonable than others but most continue to restrict investment freedom in China for other than national security reasons.

- **Require the removal of China's Restricted Industries for Foreign Investment list.** These are 35 industries in which Beijing restricts foreign investment and often requires a Chinese partner. The restricted list should not be seen as an improvement on the prohibited list as it requires American businesses to come in as minority holder to their Chinese counterparts. Americans should not be required to work for the Chinese in these industries.

- **Require greater intellectual property rights enforcement.** China still has a problem enforcing higher standards of IP rights—and doing so uniformly across all its provinces. China has been on the USTR Special 301 Report's Priority Watch List for its inadequate and ineffective protection of IP since the list's creation in 1989.

China's various illicit approaches to acquiring intellectual property in furtherance of its Made in China 2025 industrial policy is symptomatic of a broader disposition to foreign investment. The issue is no less of a concern for the Administration and the case against it must be made broadly.

Conclusion

China, slow to liberalize its economy, continues to impose restrictions on foreign investment. The Trump Administration is not wrong to question China's rising role in the global economy. In order to defuse trade tensions between the two economic powers, the U.S. should demand China remove its unreasonable restrictions on foreign investment.

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