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IN FOCUS

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U.S.-China Trade Issues

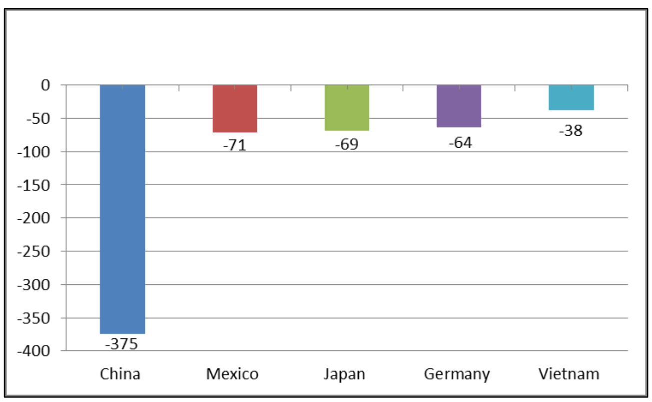
Background

The U.S.-China trade and economic relationship has expanded significantly over the past three decades. In 2017, China was the United States' largest U.S. merchandise trading partner (at $636 billion), third-largest export market ($130 billion), and largest source of imports ($506 billion). China is also the largest foreign holder of U.S. Treasury securities (at nearly $1.2 trillion as of May 2018). However, tensions between the two countries have grown sharply in recent years over a number of economic and trade issues.

Key U.S. Issues

The Trade Deficit. President Trump has complained about the U.S. bilateral trade imbalances. The U.S. merchandise trade deficit with China in 2017 was $375 billion (projected to rise to $413 billion in 2018), and was by far the largest U.S. bilateral trade imbalance (**Figure 1**). Some U.S. policymakers view large U.S. trade deficits as an indicator of an "unfair" trade relationship. Others, however, view conventional bilateral trade deficit data as misleading, given the growth of global supply chains used by multinational firms. Products may be invented or developed in one country and manufactured or assembled elsewhere using imported components from multiple foreign sources and then exported. Conventional U.S. trade data may not fully reflect the value added in each country, and thus are often a relatively poor indicator of the beneficiaries of its global trade. Also, most economists argue that the overall size of the trade balance is what really matters to the economy (not bilateral balances), and that this is largely a function of macroeconomic forces, such as domestic savings and investment, not trade barriers.

Figure 1. Major U.S. Bilateral Merchandise Trade Imbalances: 2017 ($billions)



Source: USITC Dataweb.

Intellectual Property Rights (IPR) and Cyber-Theft. U.S. firms cite the lack of effective protection of IPR as one of the biggest impediments that they face in conducting business in China and sometimes view lax IPR enforcement in the country as a way to give domestic firms an advantage over foreign competitors. In 2011, the U.S. Office of the National Counterintelligence Executive described Chinese actors as "the world's most active and persistent perpetrators of economic espionage" and as aggressive collectors of sensitive U.S. business information and technologies. In May 2014, the U.S. Justice Department indicted five members of the Chinese People's Liberation Army for government-sponsored cyber-espionage against U.S. companies and theft of proprietary information to aid state-owned enterprises. During Chinese President Xi Jinping's state visit to the United States in September 2015, the two sides reached an agreement on cyber security, pledging that neither country's government would conduct or knowingly support cyber-enabled theft of intellectual property for commercial purposes and to establish a joint dialogue on cybercrime and related issues (which has continued under the Trump Administration). Several U.S. business groups have raised concerns over several recently-enacted Chinese laws relating to national security (such as a 2017 cyber-security law) which, many contend, could restrict market access to U.S. high-technology firms (including digital trade) or condition it to technology transfers.

China is considered to be a major source of U.S. economic losses due to IPR violations. For example, the U.S. Department of Homeland Security reported that in FY2017, China and Hong Kong combined accounted for 78% of the counterfeit goods seized by the in FY2017. The USTR estimated the annual cost to the U.S. economy of certain Chinese IPR policies and practices total at least $50 billion.

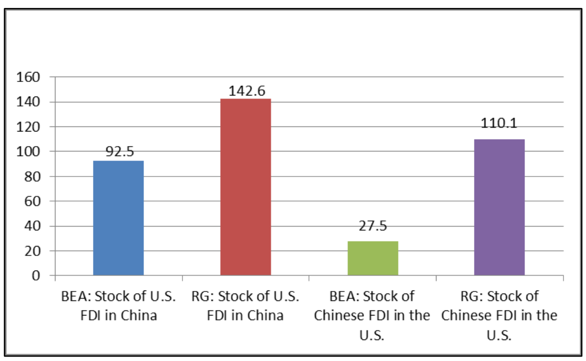
Industrial Policies. Many U.S.-China trade tensions arise from China's incomplete transition to a market economy, including its government support and protection of SOEs. Critics have charged that the Chinese government has been employing policies such as subsidies, tax breaks, tariff rebates, low-cost loans, trade and investment barriers, lax IPR enforcement and cyber-theft of trade secrets, pressure put on foreign firms to transfer technology, and restrictions on exports of raw materials in order to aid and develop industries deemed critical to China's economic growth. A 2018 American Chamber of Commerce in China business climate survey found that 75% of its members felt less welcomed in China than before. Several recent proposals by the Chinese government, such as its "Made in China 2025," appear to indicate a sharply expanded role by the government in the economy.

WTO Compliance Issues. China's accession into the WTO advanced its market reforms and openness to trade. However, U.S. trade officials contend that while China made significant progress toward market liberalization in the years immediately after its accession, it moved towards a more restrictive trade regime beginning in 2006. The United States has brought 23 WTO dispute settlement cases against China (through July 2018) on issues such as IPR protection, subsidies, and discriminatory industrial policies.

The United States has largely prevailed in most WTO case brought against China, although in some instance, Chinese compliance has been lacking.

Foreign Direct Investment (FDI). U.S.-China FDI flows are relatively small given the high level of bilateral trade, although estimates of such flows differ. The U.S. Bureau of Economic Analysis (BEA) is the official U.S. agency that collects and reports FDI data. BEA estimates the stock of Chinese FDI in the United States through 2016 at $27.5 billion, and the stock of U.S. FDI in China at $92.5 billion. BEA's data on U.S. flows to China, and Chinese FDI flows to the United States in 2016 were $9.5 billion and $10.3 billion. Some analysts contend BEA's balance of payment methodology for measuring FDI significantly undercounts the level of actual U.S.-China FDI, in large part because it does not capture all FDI that is made through other countries, territories (such as Hong Kong), or tax havens (such as the British Virgin Islands), as well as acquisitions made by U.S. affiliates of foreign firms. The Rhodium Group (RG), a private advisory firm, uses a "bottom-up approach" by tracking Chinese FDI in the United States when the investor is a Chinese entity and U.S. FDI in China when the actual investor is a U.S. entity, regardless where the investment funds originate. RG's data on U.S.-China FDI are much higher than BEA's data. For example, RG estimates the stock of China's FDI in the United States through 2016 at $110.1 billion and the stock of U.S. FDI in China at $242.6 billion. RG estimates China's 2016 FDI flows to the United States and U.S. FDI flows to China at $46.2 billion and $13.8 billion, respectively.

Figure 2. BEA and RG Estimates of the Stock of U.S-China Bilateral FDI through 2016 ($billions)



Sources: BEA and the Rhodium Group.

China's largest U.S. acquisition to date has been HNA Group's 2017 purchase of CIT Group for $10.3 billion. Some Chinese acquisitions have raised concerns by some in Congress, in large part because of the Chinese investor's possible links to the Chinese government. Several bills have been introduced in Congress that would expand the types of commercial transactions reviewable by the Committee on Foreign Investment in the United States (CFIUS) for national security purposes. Although China is the world's third largest recipient of FDI, it imposes numerous restrictions on the level and of types of FDI allowed in China, many of which appear to relate to China's industrial policies. According to the U.S.-China Business Council, China imposes ownership barriers on nearly 100 industries.

Tariffs on Steel and Aluminum. On March 8, 2018, President Trump issued a proclamation increasing U.S. import tariffs on steel (by 25%) and aluminum (by 10%), based on "national security" justifications (§232 of the 1962 Trade Act). In response, China, on April 2 raised tariffs by 15% to 25% on $3 billion worth of imported U.S. products, and on April 5, it initiated a WTO dispute settlement case against the United States over its Section 232 tariffs.

Section 301 Case on China's IPR Policies. On August 14, 2017, President Trump issued a memorandum directing the USTR to determine if China's policies on IPR protection and forced technology requirements "may be harming American intellectual property rights, innovation, or technology development," and thus warranted a Section 301 investigation. On August 18th, the USTR launched a Section 301 investigation, and on March 22, President Trump signed a *Memorandum on Actions by the United States Related to the Section 301 Investigation*. It listed four IPR-related policies that justified U.S. action, including China's forced technology transfer requirements, cyber-theft of U.S. trade secrets, discriminatory licensing requirements, and attempts to acquire U.S. technology to advance its industrial policies. The United States said it would propose to boost tariffs by 25% on about $50 billion worth of Chinese goods, initiate a WTO dispute settlement case against China's discriminatory licensing policies (which it did on March 23) and impose new restrictions against certain Chinese investment in the United States. In response, China on April 4 released a list of retaliatory sanctions on U.S. products and initiated a WTO dispute settlement case against the United States for its Section 301 actions. The next day Trump called on the USTR to propose an additional $100 billion in tariffs against China. On May 19, the United States and China released a joint statement announcing that that progress was made on a number of trade issues, including a Chinese commitment to "significantly increase purchases of United States goods and services," including U.S. agricultural and energy products. On May 21, U.S. Secretary of the Treasury Steven Mnuchin stated that both sides had suspended threatened trade sanctions. However, on May 29, the White House announced that it planned to move ahead with the proposed Section 301 sanctions against China by imposing 25% ad valorem tariffs on $50 billion worth of imports from China, including those related to the *Made in China 2025* initiative; and (2) implementing new investment restrictions and enhanced export controls on Chinese entities and persons in regards to the acquisition of "industrially significant technology" for national security purposes. On June 15, the USTR announced a two-stage plan to impose 25% ad valorem tariffs on $50 billion worth of Chinese imports. Under the first stage, tariffs would be increased on 818 tariff lines, on roughly $34 billion worth of Chinese products on July 6. Under the second stage, the USTR proposed increasing tariffs on 228 tariff lines on $16 billion worth of Chinese imports, mainly targeting China's industrial policies. China on June 16 issued its own two-stage retaliation list of equal value against the United States. On June 18, President Trump directed the USTR to come up with a an additional list of products worth $200 billion that would be subject to 10% ad valorem tariffs if worth of Chinese products to be imposed if Chinese tariff retaliation takes place, and on August, 1 he asked USTR to raise that level to 25%.

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