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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 2015, China overtook Canada to become the United States' largest trading partner. U.S. exports to, and imports from, China were $116.2 billion and $481.9 billion, respectively. China is the largest source U.S. imports and the third largest U.S. export market. In addition, China is the largest foreign holder of U.S. Treasury securities (at $1.24 trillion as of December 2015). However, tension between the two countries has risen in recent years over a number of issues.

Key U.S. Issues

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. A May 2013 report by the Commission on the Theft of American Intellectual Property estimated that IP theft by Chinese entities annually cost the U.S. economy up to $240 billion. In May 2014, the United States Department of Justice indicted five members of the Chinese People's Liberation Army (PLA) for government-sponsored cyber espionage against U.S. companies and theft of proprietary information to aid state-owned enterprises (SOEs). China responded by suspending its participation in a bilateral working group on cybersecurity with the United States. In April 2015, President Obama issued an executive order authorizing certain sanctions against "persons engaging in significant malicious cyber-enabled activates." Shortly before the arrival of Chinese President Xi's state visit to the United States, the Obama Administration indicated that it was considering imposing sanctions against Chinese entities over cyber-theft. During Xi's visit, the two sides reached an agreement on cyber issues, such as the creation of a new joint dialogue on cybercrime, which met in December 2015.

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. Several U.S. business groups contend that the business climate in China has worsened in recent years, due in part to Chinese policies that give preferences to Chinese firms over foreign ones. China's recently-enacted national security law and proposed rules of foreign banks appear to impose new restrictions on U.S. information technology and communications (ICT) firms.

WTO Compliance. 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 17 WTO dispute settlement cases against China (as of March 4, 2016) on issues such as IPR protection, export subsidies, discriminatory industrial policies, and restrictions on trading and distribution rights.

Agreement on Cyber Security Issues at the September 2015 U.S-China Summit

The two sides agreed that::

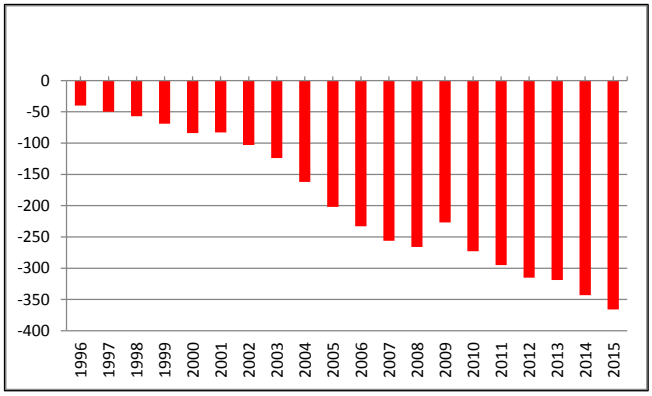
- Neither country's government will conduct or knowingly support cyber-enabled theft of IP, including trade secrets or other confidential business information, with the intent of providing competitive advantages to companies or commercial sectors;
- They will establish a high-level joint dialogue mechanism on fighting cybercrime and related issues;
- They will seek to work together to identify and promote appropriate norms of state behavior in cyberspace internationally; and
- Each side will provide timely responses to requests for information and assistance concerning malicious cyber activities.

Source: The White House.

Currency Policy. Since 1994, the Chinese government has intervened in currency markets to limit or halt the appreciation of the Chinese renminbi (RMB) against the U.S. dollar, which many argue has allowed Chinese exports to the United States to be less expensive and U.S. exports to China to be more expensive than under a floating exchange rate system, which, some U.S. policymakers contend, has contributed to the large annual U.S. trade deficit with China and the loss of U.S. manufacturing jobs in some industries. From July 2005 through July 2015, the RMB appreciated by 35.3% against the dollar. On August 11, 2015, China announced that daily RMB parity values would become more "market-oriented," but over the next three days, it depreciated by 4.4% against the dollar and by February 28, 2016, it had declined by a total of 6.8%. The RMB's recent decline has raised concerns by some analysts that China might be pursuing a policy to depreciate the RMB in order to boost exports (and stimulate the economy) rather than reforming the currency. Others contend that China's economic problems and market forces are the main factors pushing down the RMB's value.

The Trade Deficit. At $366 billion in 2015, the U.S. merchandise trade deficit with China is significantly larger than its trade deficit with any other partner. Some U.S. analysts argue that this is largely the result of China's "unfair" trade practices. Others maintain that it is a reflection of China's role as a major center for global supply chains.

Figure 1. U.S.-China Trade Balance ($ billions)



Source: U.S. International Trade Commission.

Foreign Direct Investment (FDI). U.S.-China FDI flows are relatively small given the high level of bilateral trade. According to the U.S. Bureau of Economic Analysis (BEA), the stock of Chinese foreign direct investment (FDI) in the United States at the end of 2014 was $9.5 billion (although some private organizations argue the figure is much higher), while the stock of U.S. FDI in China through 2014 was $65.8 billion. Although Chinese FDI in the United States has grown in recent years as a result of Chinese acquisitions in various industries, such as food, technology, energy, and autos, the level of annual Chinese FDI in the United States (at $968 million in 2014) remains relatively modest, especially in comparison to other major U.S. economic partners, such as Japan. Some policymakers have raised concerns that certain Chinese acquisitions of U.S. domestic firms may cause a loss of sensitive technologies and outsourcing of jobs. U.S. firms in China also face challenges, including equity caps, lack of regulatory transparency, and restrictions on investments in industries that China considers strategic, such as financial services telecommunications. To encourage more domestic development of technological innovations, Chinese officials have reportedly pressured U.S. firms to transfer technology to Chinese partners or set up research and development facilities in China in exchange for market access—an issue exacerbated by China's weak IPR protection.

Bilateral Investment Treaty (BIT). China and the United States launched negotiations for a BIT in 2008 in an effort to boost FDI ties. The BIT aims to establish mutual nondiscriminatory treatment of investments and reduce both market access barriers and ownership restrictions for U.S. firms in China, among other provisions. China agreed to negotiate a high-standard BIT, using a "negative list" approach in reducing ownership restrictions via the BIT. This means all industries except those explicitly listed in the agreement would be open to investments. Both parties committed to solidifying major articles of the BIT by the end of 2014, although this does not appear to have been achieved. However, in June 2015, the two sides submitted their first negative lists, and submitted revised offers in September 2015. While the two sides stated that they made progress at the September 2015 U.S.-China summit, a breakthrough was not achieved, nor was a proposed timetable set for reaching an agreement made. The 24th BIT round was held in January 2016. On February 23, 2016, Chinese Foreign Minister Wang Yi said that China was "ready to work with United States to speed up the BIT negotiation." Many analysts see China's willingness to sign a high-standard BIT as a test of how committed China is toward implementing new comprehensive economic reforms. In September 2015, U.S. Trade Representative Michael Froman stated that "in order to conclude the BIT, it's going to need to be a high-standard agreement. The two sides will need to reach agreement on a text that addresses critical concerns about China's investment environment and on a negative list that is limited, narrow, and represents a substantial liberalization of the Chinese economy." He further stated that China must ensure a predictable legal and regulatory framework so that the market reforms made under the BIT are not nullified through other policy actions.

China's Treatment as a Non-Market Economy (NME). When China joined the WTO in 2001, it agreed to allow other WTO members to use a special methodology for assessing prices and costs on products subject to anti-dumping investigations, unless Chinese producers and exporters could show that market conditions prevailed. Many analysts contend that this has meant that dumping margins on Chinese products have often been much higher than those assessed against countries deemed to be market economies. China contends that WTO rules require all members to afford it market economy status (MES) after December 11, 2016, but some legal authorities disagree with this assessment. Some industry groups oppose extending MES to China, arguing that it would weaken the ability of U.S. firms to obtain relief from harmful low-cost Chinese imports. In order to obtain MES under U.S. law, China would have to formally request the U.S. Department of Commerce to review its status. Commerce would initiate an investigation and make a determination (based on six factors) as to whether or not China had become a market economy that would justify a graduation to MES status.

The WTO Government Procurement Agreement (GPA). The GPA is a plurilateral agreement established by the WTO in 1996 to provide market access for nondefense government procurement projects to its signatories. China's accession to the GPA would provide U.S. firms access to an estimated $200 billion market and has been a priority for the United States, which is already a GPA member. It would also allow Chinese firms to bid on U.S. contracts based on GPA thresholds. China has submitted several offers to join the GPA since 2007, but to date GPA members have rejected the offers because they limited access to the Chinese public procurement market. China's last offer was submitted in December 2014. In February 2015, the WTO reported that China had stated that it would be "difficult or impossible for it to make significant further additions to entity coverage but that it was ready to continue discussions on proposed exceptions."

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