Order Code IB91121

CRS Issue Brief for Congress

Received through the CRS Web

China-U.S. Trade Issues

Updated November 3, 2004

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Outlook for U.S.-China Trade Relations

China-U.S. Trade Issues

SUMMARY

U.S.-China economic ties have expanded substantially over the past several years. Total U.S.-China trade rose from $5 billion in 1980 to $181 billion in 2003. China is now the third largest U.S. trading partner, its second largest source of imports, and its sixth largest export market. With a huge population and a rapidly expanding economy, China is becoming a large market for U.S. exporters. Yet, U.S.-China commercial relations have been strained by a number of issues, including a surging U.S. trade deficit with China ($124 billion in 2003), China's restrictive trade barriers, failure to provide adequate protection for U.S. intellectual property rights (IPR), and its refusal to float its currency.

After 15 years of negotiations, China joined the World Trade Organization (WTO) on December 11, 2001. China's entry into the WTO requires it to significantly reform its trade regime by eliminating or reducing an extensive array of tariff and non-tariff barriers on goods, services, and foreign investment. The removal of these barriers could result in significant new opportunities for U.S. exporters. Many Members of Congress have called on the Bush Administration to closely monitor China's compliance with its WTO commitments. In December 2003, the U.S. Trade Representative (USTR) issued its second annual China WTO compliance report, finding that, although China had made significant progress in meeting its WTO obligations, a number of major problems remained, especially in regards to agriculture, services, IPR protection, tax policies, trading rights and distribution, and transparency of trade laws and regulations. Some progress toward resolving these issues has been made in recent months. In April 2004, China pledged to expand efforts to crack down on IPR piracy, accelerate market liberalization for various services, make its trade rules on agricultural products more transparent, and revise rules on telecommunications standards. In July 2004, China agreed to end its discriminatory tax policy on certain imported semiconductors (after the United States filed a WTO case against China in March 2004).

The continued rise in the U.S.-China trade imbalance, complaints from several U.S. manufacturing firms over the competitive challenges posed by cheap Chinese imports, and concerns that U.S. manufacturing jobs are being lost to Chinese competitors have led several Members to call on the Bush Administration to take a more aggressive stance against certain Chinese trade policies. For example, some Members argue that China's policy of pegging its currency (the yuan) to the U.S. dollar makes U.S. exports to China more expensive, and U.S. imports from China cheaper, than they would be if the yuan were fully convertible. Several bills have been introduced in Congress to address China's "currency manipulation." In addition, some industry representatives have called on the Administration to utilize special safeguard provisions to restrict imports from China that threaten to harm U.S. firms.

Most Recent Developments

On October 22, 2004, the United States imposed safeguard restrictions on certain sock imports from China.

On September 9, 2004, the U.S. Department of Treasury announced that China had recently taken a number of important steps to facilitate its transition to a market based exchange rate system. On the same day, the USTR's office formally rejected a Section 301 petition by the China Currency Coalition (a group of U.S. industrial, service, agricultural, and labor organizations) on China's exchange rate policy.

On July 8, 2004, China agreed to end a tax policy that gave preferential treatment to semiconductors produced in, or designed in, China. The United States had filed a WTO case against China in March 2004, charging that the tax preference discriminated against U.S. semiconductor exports to China and violated WTO rules.

On April 21, 2004, U.S. and Chinese officials announced progress on a number of trade disputes. China pledged to expand efforts to crack down on IPR piracy, accelerate market liberalization for various services, make its trade rules on agricultural products more transparent, and revise rules on telecommunications standards. The United States pledged to ease export controls and to begin a dialogue with China on its treatment as a nonmarket economy under U.S. anti-dumping laws.

Background and Analysis

U.S. Trade with China

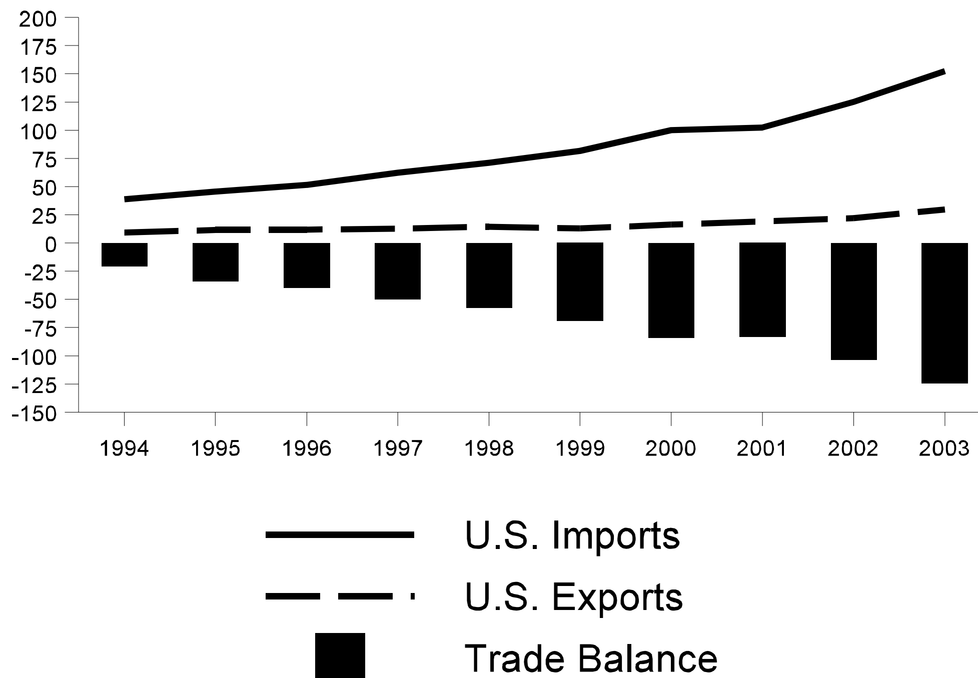
U.S.-China trade rose rapidly after the two nations established diplomatic relations (January 1979), signed a bilateral trade agreement (July 1979), and provided mutual most-favored nation (MFN) treatment beginning in 1980. Total trade (exports plus imports) between the two nations rose from about $5 billion in 1980 to an estimated $181 billion in 2003 — China is now the third largest U.S. trading partner. Over the past few years, U.S. trade with China has grown at a faster pace than that of any other major U.S. trading partner. The U.S. trade deficit with China has grown significantly in recent years, due largely to a surge in U.S. imports of Chinese goods relative to U.S. exports to China. That deficit rose from $29.5 billion in 1994 to $124.0 billion in 2003 (see **Table 1** and **Figure 1**). The U.S. trade deficit with China is now larger than that of any other U.S. trading partner, including Japan (at $66 billion in 2003). Data for January-August 2004 indicate that the trade deficit with China could top $159 billion in 2004.

Table 1. U.S. Merchandise Trade with China: 1994-2003 and Projection for 2004*
($billions)

Year	U.S. Exports	U.S. Imports	U.S. Trade Balance
1994	9.3	38.8	-29.5
1995	11.7	45.6	-33.8
1996	12.0	51.5	-39.5
1997	12.8	62.6	-49.7
1998	14.3	71.2	-56.9
1999	13.1	81.8	-68.7
2000	16.3	100.1	-83.8
2001	19.2	102.3	-83.1
2002	22.1	125.2	-103.1
2003	28.4	152.4	-124.0
2004 (projection)*	38.4	197.4	-159.0

*Projection, based on data for January-August 2004.
Source: U.S. Department of Commerce.

Figure 1. U.S. Trade with China: 1994-2003
($ Billion)



Major U.S. Exports to China

U.S. exports to China 2003 totaled $28.4 billion, accounting for 3.9% of total U.S. exports, and making China the sixth largest U.S. export market.. The five U.S. exports to China in 2003 were electrical machinery, oil seeds (mainly soybeans), transport equipment (mainly aircraft), metal ores and scrap, and general industrial equipment. A large share of U.S. exports to China are parts and components (such as semiconductors and integrated circuits, computer parts, etc.) that are further assembled in China and re-exported elsewhere. China is becoming an increasingly important market for many U.S. exports. For example, in 2003, China was the largest market for U.S. soybean exports and accounted for over one-third of total U.S. soybean exports. U.S. soybean exports to China in 2003 were 218% higher than 2002 levels. U.S. aircraft sales to China fell by 27.5% in 2003 over the previous year, however, they were up 47% over 2000 levels (see **Table 2**). From 2000 to 2003, U.S. exports to the world declined by 7.3%, while those to China increased by 74.8%. U.S. exports to China during the first eight months of 2004 were up by 35% (over the same period in 2003).

Table 2. Top 5 U.S. Exports to China: 2000-2003

($ in millions and % change)

SITC Commodity Groupings	2000	2001	2002	2003	2002/2003 % Change	2000/2003 % Change
Total all commodities	16,253	19,235	22,053	28,414	28.9%	74.8%
Electrical machinery, apparatus and appliances, and parts	1,747	2,110	2,658	3,723	40.1	113.1
Oil seeds and oleaginous fruits (mainly soybeans)	1,020	1014	891	2,832	218.0	177.6
Transport equipment (mainly aircraft and parts)	1,698	2,471	3,44	2,496	-27.5	47.0
Metalliferous ores and metal scrap	619	920	957	1,525	59.4	146.4
General industrial machinery & equipment and parts	839	1,081	1,146	1,404	22.6	67.3
Total Top 5	5,923	7,596	5,996	11,980	99.8	102.3

Commodities sorted by top 5 exports in 2003 using SITC classification, 2-digit level.
Source: U.S. International Trade Commission Database.

Many trade analysts argue that China could prove to be a much more significant market for U.S. exports in the future. China is one of the world's fastest growing economies, and rapid economic growth is likely to continue in the near future, provided that economic reforms are continued. China's goal of modernizing its infrastructure and upgrading its industries is predicted to generate substantial demand for foreign goods and services. According to a U.S. Department of Commerce report: "China's unmet infrastructural needs are staggering. Foreign capital, expertise, and equipment will have to be brought in if China is to build all the ports, roads, bridges, airports, power plants, telecommunications networks and rail lines that it needs." Finally, economic growth has substantially improved the

purchasing power of Chinese citizens, especially those living in urban areas along the east coast of China. It is projected that by the year 2005, China will have more than 230 million middle-income consumers (i.e., those earning $1,000 or more annually), whose combined retail spending will exceed $900 billion. China's growing economy and large population make it a potentially enormous market. To illustrate:

- China currently has the world's largest market mobile phone network (with 145 million cellular phone uses), even though only 13% of the population uses mobile phones.
- Boeing Corporation predicts that China will be the largest market for commercial air travel outside the U.S. for the next 20 years; during this period, China will purchase 2,300 aircraft valued at $183 billion.
- In 2002, China replaced Japan as the world's second largest PC market. China also became the world's second largest internet user (after the U.S.) with over 56 million users.

Major U.S. Imports from China

China is a relatively large source of many U.S. imports, especially labor-intensive products. In 2003, imports from China totaled $152.4 billion, accounting for 12.1% of total U.S. imports (compared with 6.5% in 1996). U.S. imports from China rose by 21.7% in 2003 over the previous year; over the past four years they have risen by 52.3%. The importance (ranking) of China as a source of U.S. imports has risen dramatically, from 8th largest in 1990, to 4th in 2000, to 2nd in 2003. During the first six months of 2004, U.S. imports from China rose by 28.8% over the same period in 2003.

As indicated in **Table 3**, the top five U.S. imports from China were miscellaneous manufactured articles (such as toys, games, etc.); office machines; telecommunications equipment, sound recording, and reproducing equipment (such as telephone answering machines, radios, tape recorders and players, televisions, VCRs, etc.);electrical machinery; and articles of textile and apparel. Traditionally, nearly all of U.S. imports from China have been low value, labor intensive, products such as toys and games, footwear, and textiles. Over the past few years, however, an increasing level of U.S. imports from China have consisted of more technologically advanced products, such as computers and computer parts.

U.S. trade data strongly suggest that the sharp increase in U.S. imports from China is largely the result of movement in production facilities from other Asian countries to China.[1] That is, various products that used to be made in Japan, Taiwan, Hong Kong, etc., and then exported to the United States are now being made in China (in many cases, by foreign firms in China) and exported to the United States. To illustrate, in 1996, 38.8% of U.S. imports from the world came from Asia (including China); and 16.8% of U.S. imports from Asia came from China. In 2003, the share of U.S. imports from Asia to total U.S. imports dropped to 35.8%. However, China now accounted for 33.8% of U.S. imports from Asia.

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[1] Chinese data indicate that the share of China's exports produced by foreign-invested enterprises (FIEs) in China has risen from 1.9% in 1986 to 52.2% in 2002.

This shift in trade appears to have affected U.S. trade with Japan the most. From 1996-2003, the share of U.S. imports from Asia that came from Japan fell from 37.6% to 26.2%.

Table 3. Top 5 U.S. Imports from China: 2000-2003
($ in millions)

SITC Commodity	2000	2001	2002	2003	2002/2003 % Change	2000/2003 % Change
Total All Commodities	100,063	102,280	125,168	152,379	21.7	52.3
Miscellaneous manufactured articles (e.g., toys, games, etc.)	19,441	19,764	23,492	26,294	11.9	35.3
Office machines and automatic data processing machines (mainly computers and parts)	11,000	10,764	15,256	23,646	55.0	115.0
Telecommunication & sound record & reproduce app. & equip.	9,935	10,118	14,254	16,937	18.8	70.5
Electrical machinery, apparatus and appliances, and parts	9,119	9,111	10,253	11,876	15.8	30.2
Articles of apparel and clothing accessories	8,483	8,866	9,565	11,381	19.0	34.2
Total Top 5	57,978	58,623	72,821	90,135	23.8	55.5

Commodities sorted by top 5 imports in 2003 using SITC classification, 2-digit level.
Source: U.S. International Trade Commission Database.

Major U.S.-China Trade Issues

Although China's economic reforms and rapid economic growth have expanded U.S.-China commercial relations in recent years, disputes have arisen over a wide variety of issues, including the growth and size of the U.S. trade deficit with China (which is viewed by many Members as an indicator that the trade relationship is unbalanced), China's currency peg (which many Members blame for the size of the U.S. trade deficit with China and the loss of manufacturing jobs in the United States), China's mixed record on implementing its obligations in the WTO, and China's failure to provide adequate protection of U.S. IPR.

China's Currency Peg[2]

China pegs its currency, the yuan, to the U.S. dollar at about 8.3 yuan to the dollar. It is able to maintain this peg because its currency is not fully convertible in international

[2] For additional information on this issue, see CRS Report RS21625 and CRS Report RL32165.

markets and because it maintains restrictions and controls over capital transactions. As a result, China's exchange rate is not based on market forces. Many U.S. policymakers and business representatives have charged that China's currency is significantly undervalued vis-a-vis the U.S. dollar (with estimates ranging from 15 to 40%), making Chinese exports to the United States cheaper, and U.S. exports to China more expensive, than they would be if exchange rates were determined by market forces. They complain that this policy has particularly hurt several U.S. manufacturing sectors (such as textiles and apparel, furniture, plastics, machine tools, and tool and die) who are forced to compete domestically against low-cost imports from China, and has contributed to the growing U.S. trade deficit with China. They have called on the Bush Administration to pressure China either to appreciate its currency (by increasing the band in which it is allowed to be traded in China) or to allow it to float freely in international markets.

During the mid-1990s, Chinese officials indicated that they were considering making the yuan fully convertible by 2000. However, these plans were abandoned as a result of the 1997 Asian financial crisis when the economies of East Asian countries experienced a number of economic shocks, including a sharp depreciation in their currencies. China's currency peg and capital controls were a major factor in enabling China to maintain economic growth and stability, while many of its neighbors experienced sharp economic declines. While Chinese exports suffered somewhat from sharp currency depreciations in several East Asian countries, China pledged not to devalue its currency, a policy that many analysts claim helped stabilize the effects of the economic crisis in Asia and gained China high praise from U.S. officials.

Chinese officials argue that its currency peg policy is not meant to favor exports over imports, but instead to foster economic stability. They have expressed concern that abandoning the peg could cause an economic crisis in China and would especially hurt its export industries sectors at a time when painful economic reforms (such as closing down inefficient state-owned enterprises and restructuring the banking system) is being implemented. Chinese officials view economic stability as critical to sustaining political stability; they fear an appreciated currency could reduce jobs and lower wages in several sectors and thus could cause worker unrest.

U.S. critics of China's currency peg contend that the low value of the yuan is forcing other East Asian economies to keep the value of their currencies low (vis-a-vis the U.S. dollar) in order to compete with Chinese products, to the detriment of U.S. exporters and U.S. domestic industries competing against foreign imports. They further note that, while China is still a developing country, it has been able to accumulate massive amounts of foreign exchange reserves ($483 billion at end of July 2004) and thus has the resources to maintain the stability of its currency if it were fully convertible. They also argue that appreciating the yuan would greatly benefit China by lowering the cost of imports for Chinese consumers and producers who use imported parts and machinery. Finally, critics of the peg argue that China's accumulation of large amounts of foreign exchange reserves (in order to maintain the currency peg) could be better spent on investment in infrastructure and development of poor regions.

Some economists are skeptical over the wisdom of pushing China too hard to appreciate its currency. They note that a significant share of U.S. imports from China are produced by foreign multinational corporations that are increasingly shifting production to China (and

other countries) to take advantage of low costs there and that a change in China's peg would do little to reverse this trend. Some economists have warned that, given the weak state of China's banking system, moving to a fully convertible currency might actually cause the yuan to depreciate, rather than appreciate. Such analysts have called on the United States to press China to implement currency reform in stages over time.

Several bills have been introduced in the 108th Congress that seek to address the currency issue:

- H.Con.Res. 285 (Manzullo) expresses congressional concern over the detrimental effects of currency manipulation by foreign government on the U.S. economy and calls on the president to vigorously enforce U.S. trade laws dealing with such practices.

- H.Res. 414 (English) encourages China to comply with its commitments in the WTO and to adopt a market based exchange rate system, and urges the Administration to continue to press China to reform its banking sector and to establish a more flexible exchange rate (passed in the House on October 29, 2003).

- H.R. 3058 (English) and S. 1758 (Voinovich) would require the U.S. Secretary of Treasury to analyze and report on China's exchange rate policies, and would require additional tariffs to be assessed on Chinese products imported into the United States if the Secretary determined that China manipulates its currency.

- H.R. 3269 (Dingell) would require the Secretary of Commerce to issue biannual reports describing actions by foreign governments to manipulate their currencies (in order to boost their exports to and restrict imports from the United States) and would require the President to negotiate the elimination of such practices. If such negotiations failed, the President would be required to utilize U.S. trade laws and international agreements (including the WTO) to address the issue. In addition, the President would be required to seek compensation for U.S. manufactures harmed by currency manipulation from designated countries.

- H.R. 4896 (Rogers) would require the Department of Treasury to issue an annual report on China's currency policy to determine if that policy interferes with the effective balance of payment adjustments or confers a competitive advantage to Chinese products that would not exist if the currency were determined by market forces. If such a determination is made, the Treasury Department would be required to determine the "rate of undervaluation" of China's currency, and the President would be required to bring a case before the WTO seeking authorization to raise U.S. tariffs comparable to the effects on U.S. trade of the undervalued currency.

- S.Res. 219 (Lindsey Graham) states support for the U.S. Treasury Secretary's efforts to encourage China to adopt and a market based exchange

rate and urges China to abide by its international trade agreements (passed Senate on 09/26/03).

- S. 1586 (Schumer) and H.R. 3364 (Myrick) would impose an additional duty of 27.5% on Chinese goods imported into the United States if China refused to make its currency freely convertible.

- S. 1592 (Lieberman) would require the President to negotiate with China, Japan, Taiwan, and South Korea to end their currency manipulation. If such negotiations failed, the President would be required to institute action under U.S. and international trade law (e.g., U.S. trade laws dealing with unfair trading practices and the dispute resolution mechanism in the World Trade Organization) to force countries to eliminate such practices.

- S. 2927(Schumer) would require the Treasury Department to clarify the definition of "currency manipulation" in its semi-annual reports to Congress on international exchange policy to be "protracted large-scale intervention in one direction in the exchange market."

- Three bills: H.R. 2938 (English), H.R. 3716 (English), and S. 2212 (Collins) would ensure that U.S. countervailing duty laws (dealing with subsidies) apply to imports from non-market economies. Sponsors of the bills have indicated that China's currency policy is the main target of such legislation.

President Bush on a number of occasions has criticized China's currency peg, stating that exchange rates should be determined by market forces, and he raised the issue in a meeting with Chinese President Hu Jintao on October 19, 2003. On October 30, 2003, the Treasury Department released its semi-annual report on exchange rate policies. Although Treasury was under intense pressure from several Members of Congress to state that China "manipulated" its currency (which by U.S. law would have required Treasury to negotiate with China to end such practices), it did not make such a designation. However, Bush Administration has pledged to pursue the issue with China, largely under the auspices of a joint technical cooperation program that was agreed to on October 14, 2003 to promote the development of China's financial markets and to examine ways China can move more quickly towards a floating exchange rate.

On September 9, 2004, the U.S. Department of Treasury announced that China had recently taken a number of important steps to facilitate its transition to a market based exchange rate system, including liberalizing capital flows, reforming the banking sector, and encouraging the development of foreign exchange trading systems and financial instruments. On the same day, the USTR's office formally rejected a Section 301 petition filed by the China Currency Coalition (a group of U.S. industrial, service, agricultural, and labor organizations) on China's exchange rate policy. The coalition was seeking to have the United States bring a case against China in the WTO to get it to eliminate the "undervaluation" of its currency (which the coalition put at 40%) and to seek across-the-board tariffs on U.S. imports from China if it failed to do so. On September 30, 2004, 30 Members of Congress filed a similar Section 301 case on China's exchange policy with the USTR's office.

China and the World Trade Organization

The rapid rise of China as an economic and trade power during the 1980s led U.S. trade officials to take a greater interest in China's trade regime. U.S. officials complained that, while U.S. markets were generally open to Chinese products, Chinese markets were largely closed to U.S. products, due to China's extensive use of tariff and non-tariff barriers. In 1991, the United States threatened to impose $3.9 billion in trade sanctions against China unless it removed specific trade barriers. In October 1992, the United States and China settled the trade dispute after China agreed to reduce or eliminate a wide variety of trade barriers, make its trade regime more transparent, and to eliminate scientific standards and testing barriers to agricultural imports. The 1992 accord was somewhat successful in getting China to liberalize its trade regime. Thereafter, U.S. officials sought to use China's desire to join the World Trade Organization (WTO) as a means to negotiate even greater access to China's markets.

Negotiations for China's accession to the General Agreement on Tariffs and Trade (GATT) and its successor organization, the WTO, began in 1986 and took over 15 years to complete. During the WTO negotiations, Chinese officials insisted that China was a developing country and should be allowed to enter under fairly lenient terms. The United States insisted that China could enter the WTO only if it substantially liberalized its trade regime. In the end, a compromise agreement was reached that requires China to make immediate and extensive reductions in various trade and investment barriers, but allowing it to maintain some level of protection (or a transitionary period of protection) for certain sensitive sectors.

China Joins the WTO. On September 13, 2001, China concluded a WTO bilateral trade agreement with Mexico, the last of the original 37 WTO members that had requested such an accord. On September 17, 2001, the WTO Working Party handling China's WTO application announced that it had resolved all outstanding issues regarding China's WTO accession. On November 10, 2001, China's WTO membership was formally approved at the WTO Ministerial Conference in Doha, Qatar on November 10, 2001 (Taiwan's WTO membership was approved the next day). On November 11, 2001, China notified the WTO that it had formally ratified the WTO agreements, which enabled China to enter the WTO on December 11, 2001. Under the WTO accession agreement, China agreed to:

- Reduce the average tariff for industrial goods to 8.9% and to 15% for agriculture. Most tariff cuts will be made by 2004; all cuts will occur by 2010.

- Limit subsidies for agricultural production to 8.5% of the value of farm output and will not maintain export subsidies on agricultural exports.

- Within three years of accession, grant full trade and distribution rights to foreign enterprises (with some exceptions, such as for certain agricultural products, minerals, and fuels).

- Provide non-discriminatory treatment to all WTO members. Foreign firms in China will be treated no less favorably than Chinese firms for trade purposes. Duel pricing practices will be eliminated as well as differences

in the treatment of goods produced in China for the domestic market as oppose to those goods produced for export. Price controls will not be used to provide protection to Chinese firms.

- Implement the WTO's Trade-Related Aspects of Intellectual Property Rights (TRIPs) Agreement upon accession.
- Accept a 12-year safeguard mechanism, available to other WTO members in cases where a surge in Chinese exports cause or threaten to cause market disruption to domestic producers.
- Fully open the banking system to foreign financial institutions withing five years. Joint ventures in insurance and telecommunication will be permitted (with various degrees of foreign ownership allowed).

WTO Implementation Issues. On December 11, 2003, the USTR released its second annual China WTO compliance report.[3] While stating that China had made significant overall progress in meeting its WTO obligations, the report raised serious concerns over China's compliance with its commitments on agriculture, services, IPR protection, tax policies, and transparency of trade laws and regulations. The U.S.-China Business Council (USCBC) raised similar concerns in its mid-year 2003 report on China's WTO implementation issued on June 18, 2003. The report stated that, while China has promptly implemented its WTO tariff-reduction commitments, it has failed to fulfill its obligations in a number of areas, including the removal of agricultural and industrial quotas and tariff-rate quotas, unreasonable standards for genetically modified organisms applied to agricultural trade, high capital requirements for establishment of services businesses, discriminatory tax policies on imports, failure to issue promised regulations for auto finance operations, insufficient regulatory transparency, and lack of protection for U.S. intellectual property rights. The USCBC noted "growing concerns" among U.S. firms over China's ability to deliver on key commitments on time and in full.

China's compliance with its WTO obligations have often been hampered by resistance to reforms by central and local government officials seeking to protect or promote industries under their jurisdictions, government corruption, and lack of resources devoted by the central government to ensure that WTO reforms are carried out in a uniform and consistent manner (especially in regards to IPR enforcement).

U.S. officials have raised a number of implementation issues with Chinese officials over the past year:

- **Soybeans**. China is a major soybean importer and the largest foreign market for U.S. soybean exports. In June 2001, China announced it would implement new rules on bio-engineered foods, effective in 2002. However, China did not provide details of these rules which led to a disruption in U.S. soybean exports to China from January-March 2002. President Bush raised the issue with Chinese President Jiang Zemin in October 2001 and in March

[3] See [http://www.ustr.gov/regions/china-hk-mongolia-taiwan/2003-12-18-china.pdf].

2002, which led China to agree to the interim use of U.S. and foreign safety certificates until China implements its new biotechnology regulations. On October 18, 2002, China issued regulations applying this policy through September 2003, and then again through April 2004. U.S. officials stated that the regulation "should remove the threat of an interruption of U.S. soybean sales to China." However, U.S. exporters have complained that the regulations require each GMO shipment to have an interim biotech safety certificate and a Chinese government import license. Additionally, in January 2003, the Chinese government indicated that it might delay permanent approval of various GMO crops and might require another round of food safety studies, a move that led the U.S. to issue an official protest. Some analysts charge that China may be attempting to use such regulations to limit biotech imports in order to protect its domestic producers as well as its own biotech industries. U.S. officials have warned that they make take this issue to the WTO for resolution. Despite these problems, U.S. soybean exports to China grew substantially in 2003 (although sales have decreased in 2004 over 2003 levels).

- **Tariff-rate quotas**. In November 2001, the Chinese government developed new rules on tariff- rate-quotas on certain agricultural products that the U.S. charged were discriminatory and violated WTO rules because they created two categories of import quota licenses: one for domestic consumption and one for "processing" trade. The U.S. further charged that China has failed to provide adequate information on the administration of its tariff-rate quotas (TRQs) for farm commodities. In July 2002, the U.S. Department of Agriculture (USDA) reported that China's TRQ licenses had authorized relatively small levels of imports, making their use impractical. For example, under the WTO accession agreement, China's TRQ for cotton in 2002 was 818,500 tons. In June 2002, China announced that the TRQ would be distributed as follows: 500,000 tons for processing trade, 270,000 tons for state-owned mills, and 48,500 tons for private mills. U.S. firms charge that this allocation policy violates WTO rules on national treatment. In other instances, China announced TRQs for various agriculture and manufactured products several months after their required implementation date. In December 2002, USTR Robert Zoellick sent a letter to China's Ministry of Foreign Trade and Economic Cooperation (MOFTEC) expressing U.S. concern over China's administration of TRQs. In January 2003, Zoellick was quoted in the press as saying that the TRQ issue was "one of the areas we're most frustrated with" in terms of China's WTO compliance and warned the United States was considering bringing a dispute resolution case to the WTO. In June 2003, China pledged to eliminate sub-quotas and restrictive license procedures and to improve transparency in identifying quota allocation recipients.

- **Export subsidies and discriminatory taxes**. U.S. officials charge that China has subsidized grain exports (mainly corn) and cotton, and uses its tax system to promote exports and discourage imports, contrary to its WTO commitments. For example, China continues to give rebates on value-added taxes (VAT) for certain exports, especially high tech. In some instances,

China imposes higher VAT rates on certain imported products (such as fertilizers and various agricultural products) than it does for similar products produced domestically. On March 18, 2004, the USTR announced it had filed a WTO dispute resolution case against China over its discriminatory tax treatment of imported semiconductors.[4] Following consultations with the Chinese government, the USTR announced on July 8, 2004, that China agreed to end its preferential tax policy on certain semiconductors by April 2005.

- **Services.** U.S. firms have complained that Chinese regulations on services are confusing and often discriminatory. China maintains high capital requirements, restrictions on branching, and prudential requirements (e.g., already operating in China for a certain number of years, profit requirements, etc.) in order for firms to enter the market. In addition, many U.S. firms have complained that they have not been afforded the extent of market access promised under China's WTO accord, especially regarding geographic market access and the amount of foreign ownership allowed for insurance and telecommunications companies in China.

- **Health and safety requirements**. U.S. officials charge that China continues to use a variety of health and safety regulations to effectively bar foreign imports, especially food products (such as wheat, poultry and meats, and citrus). Many of these issues where supposed to have been resolved under a 1999 agreement with China.

- **Industry Subsidies**. Although China agreed to make state-owned enterprises (SOEs) operate according to free market principles when it joined the WTO, U.S. officials contend that such enterprises are still being subsidized, especially through the banking system. This is seen as a significant problem since nearly half of China's exports come from SOEs. The use of subsidies is viewed as giving Chinese firms an unfair trade advantage.

- **Technical standards**. Many U.S. high tech companies have complained that China's proposed mandatory encryption technical standards on wireless technology is discriminatory (by excluding encryption technology already in existence) and would force U.S. firms to work with Chinese communication companies in order to sell their products in China.

- **IPR**. While China has enacted a variety of new IPR laws, enforcement of those laws remains relatively weak (see section on IPR below).

On April 21, 2004, U.S. and Chinese officials announced that they had resolved a number of trade disputes. China pledged to expand efforts to crack down on IPR piracy, accelerate market liberalization for various services, make its trade rules on agricultural

[4] The United States claims that China applies a 17% VAT rate on semiconductor chips that have been designed and made outside China, but gives VAT rebates to domestic producers.

products more transparent, and revise rules on wireless standards for computers and mobile phones. The United States pledged to ease export controls and to begin a dialogue with China to examine steps China would need to take in order to be treated as a market economy under U.S. anti-dumping laws (see below).

Violations of U.S. Intellectual Property Rights

The United States has pressed China to improve its IPR protection regime since the late 1980s. In 1991, the United States (under a Section 301 case) threatened to impose $1.5 billion in trade sanctions against China if it failed to strengthen its IPR laws. Although China later implemented a number of new IPR laws, it often failed to enforce them, which led the United States to once again threaten China with trade sanctions. The two sides reached a trade agreement in 1995, which pledged China to take immediate steps to stem IPR piracy by cracking down on large-scale producers and distributors of pirated materials and prohibiting the export of pirated products, establishing mechanisms to ensure long-term enforcement of IPR laws, and providing greater market access to U.S. IPR-related products.

Under the terms of China's WTO accession (see above), China agreed to immediately bring its IPR laws in compliance with the WTO agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). The USTR has stated on a number of occasions that China has made great strides in improving its IPR protection regime, noting that it has passed several new IPR-related laws, closed or fined several assembly operations for illegal production lines, seized millions of illegal audio-visual products, curtailed exports of pirated products, expanded training of judges and law enforcement officials on IPR protection, and has expanded legitimate licensing of film and music production in China. However, the USTR has indicated that much work needs to be done to improve China's IPR protection regime. U.S. business groups continue to complain about significant IPR problems in China, especially in terms of illegal reproduction of software, retail piracy, and trademark counterfeiting. It is estimated that counterfeits account for 15 to 20% of all products made in China and totals and accounts for about 8% of China's GDP. Chinese enforcement agencies and judicial system often lack the resources (or the will) needed to vigorously enforce IPR laws; convicted IPR offenders generally face minor penalties. In addition, while market access for IPR-related products has improved, high tariffs, quotas, and other barriers continue to hamper U.S. exports; such trade barriers are believed to be partly responsible for illegal IPR-related smuggling and counterfeiting in China. Industry analysts estimate that IPR piracy in China cost U.S. copyright firms $2.6 billion in lost sales in 2003 (compared to losses of $1.9 billion in 2002).[5] The piracy rate for IPR-related products in China (such as motion pictures, software, and sound recordings) is estimated at around 90%. In addition, China accounts for a significant share of imported counterfeit products seized by U.S. Customs and Border Protection ($62.5 million, or 66% of total goods seized, in FY2003).

Under the April 21, 2004 U.S.-China trade agreement, China pledged to "significantly reduce" IPR infringement levels by increasing efforts to halt production, imports, and sales of counterfeit goods and lowering the threshold for criminal prosecution of IPR violations. On October 6, 2004, the U.S. State Department announced it would allocate $210,000 to

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[5] International Intellectual Property Alliance, *2004 Special 301 Report: People's Republic of China, February 2004* (available at [http://www.iipa.com]).

provide IPR enforcement training to Chinese government officials (e.g., judges, police, legislators, etc.).

U.S. Restrictions on Certain Imports From China

Various U.S. industry groups have called on the Administration to invoke special safeguard provisions (included in China's WTO accession package) that would enable the United States to restrict imports of certain Chinese products deemed harmful to U.S. industries.[6] U.S. producers of textile and apparel products have been particularly vocal over the competitive pressures they face from China, especially as U.S. textile and apparel quotas on Chinese goods have been reduced since China joined the WTO in 2001 and are scheduled to be eliminated by January 2005.[7] Many U.S. textile and apparel representatives argue that the phaseout of U.S. quotas has lead to a flood of cheap imports from China (and will get worse after quotas are eliminated). According to the U.S. International Trade Commission, China is the largest foreign supplier of textiles and apparel, accounting for17.7% percent of total imports in 2003 (up from 15.4% in 2002). U.S. textile and apparel imports rose by 22% in 2003. Many U.S. textile and apparel representatives argue that the flood of Chinese textile and apparel products into the United States poses a major threat to the economic viability of their firms and workers.

In December 2003, the Administration imposed safeguard restrictions on three categories of textile and apparel imports from China (knit fabric, cotton and man-made fiber brassieres, and cotton and man-made fiber dressing gowns). On October 22, 2004, the United States imposed safeguard restrictions on certain sock imports from China, and is currently considering a safeguard action on Chinese-made trousers. Some textile groups contend that additional safeguard measures should be put in place before (the anticipated) increased imports from China begin to occur.

Outlook for U.S.-China Trade Relations

U.S.-China economic ties are likely to expand significantly in the years ahead, due in part to China's rapid economic growth and its trade liberalization policies. However, tensions will likely remain over a number of issues. Many U.S. firms continue to express frustration over certain aspects of China's implementation of its WTO obligations, particularly in regards to agricultural products and certain services. Some Members have called on the Bush Administration to take action against China in the WTO if it fails to resolve these issues. The Bush Administration brought its first case against China in the WTO on March 18, 2004 regarding China's discriminatory tax treatment of imported semiconductors, and it successfully resolved the issue in July 2004. Some analysts contend

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[6] See articles in CRS Briefing Book on Trade: *China: Import Relief (Safeguards) for U.S. Industry*, [http://www.congress.gov/brbk/html/ebtra139.html], and *China: Textile-Specific Safeguards*, [http://www.congress.gov/brbk/html/ebtra138.html], both authored by Vivian C. Jones.

[7] Under a 1995 WTO agreement, all WTO members must eliminate textile and apparel quotas by 2005. See CRS Report RS20889, *Textile and Apparel Quota Phaseout: Some Economic Implications*, by Bernard A. Gelb.

that China did not want the issue to go before a WTO dispute panel. Some argue that the United States should bring other cases against China to the WTO.

Although U.S. exports to China have risen sharply, U.S. imports from China continue to surge as well. Many U.S. industries and labor unions have raised concern over the effects of low-cost Chinese imports on U.S. manufacturing, employment, and wages, as well as over U.S. firms moving production and service facilities to China. This appears to be a major factor behind the call by several Members of Congress to pressure China to appreciate its currency.