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China-U.S. Trade Issues

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CONTENTS

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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 an estimated $231 billion in 2004. China is now the third-largest U.S. trading partner, its second-largest source of imports, and its fifth-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 ties have been strained by a number of issues, including a surging U.S. trade deficit with China ($162 billion in 2004), lax protection of U.S. intellectual property rights (IPR), widespread trade barriers, and China's pegged currency policy.

China joined the World Trade Organization (WTO) on December 11, 2001. WTO membership requires China to eliminate or reduce an extensive array of tariff and non-tariff barriers on goods, services, and foreign investment. In December 2004, the U.S. Trade Representative (USTR) issued its third annual China WTO compliance report, stating that, while China's efforts to implement its WTO commitments have been "impressive," they remain "far from complete and have not always been satisfactory." Major areas of concern identified by the USTR's report include IPR protection, agriculture, services, industrial policies, trading rights and distribution, and transparency of trade laws.

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 due to unfair Chinese trade practices have led several Members to call on the Bush Administration to take a more aggressive stance against certain Chinese trade policies deemed to be unfair. 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. In the 109th Congress, S.14 (Stabenow) and S. 295 (Schumer) would raise U.S. tariffs on Chinese goods by an additional 27.5% unless China appreciated its currency. In addition, H.R. 1216 (English) and S. 593 (Collins) would ensure that U.S. countervailing laws (dealing with government subsidies) apply to nonmarket economies, such as China.

Many U.S. industry and labor groups have called on the Administration to utilize special safeguard provisions to restrict imports from China that threaten to harm U.S. firms, especially textiles. Under WTO rules, the United States was required to end all quotas on such products from WTO members by January 1, 2005. U.S. textile and apparel imports from China surged by 41% in 2004 (over 2003 levels) and now account for over a quarter of all U.S. imports of such products. U.S. industry officials and labor groups have raised concerns over the potential impact a continued influx of Chinese textile and apparel products have on U.S. firms.

Most Recent Developments

On February 8, 2005, the International Intellectual Property Alliance urged the USTR to initiate WTO consultations with China for its poor record on IPR enforcement.

On December 16, 2004, GM Daewoo Auto & Technology Company (a division of General Motors) filed a case in China against Chery Automobile Co. Ltd. (a Chinese firm) for allegedly violating its intellectual property rights by copying one of its car models (the Chevrolet Spark).

On December 7, 2004, IBM Corp. announced that would sell its personal computer division for $1.75 billion to Lenovo Group Limited, a computer company primarily owned by the Chinese government. On March 9, 2005, the Committee on Foreign Investment in the United States, an interagency committee headed by the U.S. Treasury Department, approved the deal.

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.

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 $231 billion in 2004; 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 $30 billion in 1994 to $162 billion in 2004 (see **Table 1**). The U.S. trade deficit with China is now larger than that of any other U.S. trading partner, including Japan ($75.2 billion), Canada ($65.8 billion), and Mexico ($45.1 billion). The U.S. trade deficit with China in 2004 was 30.6% higher than it was in 2003.

Table 1. U.S. Merchandise Trade with China: 1994-2004
($ in 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	34.7	196.7	-162.0

Source: U.S. Department of Commerce.

Major U.S. Exports to China

U.S. exports to China in 2004 totaled $34.7 billion, up 22.2% over 2003 levels, making China the fifth-largest U.S. export market in 2004 (it ranked sixth in 2003). U.S. exports to China accounted for 4.2% of total U.S. exports in 2004 (compared to 3.9% in 2003). The top five U.S. exports to China in 2004 were semiconductors and electronic components, soybeans, waste and scrap, aircraft, and chemicals (see **table 2**).

Table 2. Top Five U.S. Exports to China: 2000-2004
($ in billions and % change)

NAIC Commodity Groupings	2000	2001	2002	2003	2004	2003-2004 % Change	2000-2004 % Change
Total all commodities	**16.3**	**19.2**	**22.1**	**28.4**	**34.7**	**22.2**	**112.9**
Semiconductors and other electronic components	1.3	1.7	2.2	3.0	3.6	20.0	176.9
Oilseeds and grains (mainly soybeans)	1.0	1.0	0.9	2.9	2.8	-1.4	180.0
Waste and scrap	0.7	1.1	1.2	1.9	2.5	29.1	257.1
Aerospace products and parts (mainly aircraft)	1.8	2.6	3.6	2.7	2.1	-22.1	16.7
Basic chemicals	0.7	0.6	0.8	1.4	2.0	41.1	187.4

Commodities sorted by top five exports in 2004 using NAIC classification, four-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. China's growing economy and large population make it a potentially enormous market. To illustrate:

- China currently has the world's largest mobile phone network, and one of the fastest-growing markets, with 320 million cellular phone users as of 2004 (50 million new subscribers were added in 2004). In 2004, 73.3 million mobile phones (were sold in China and the predicts this level will rise to 112 million by 2007.

- 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. On January 28, 2005, Boeing Corporation signed a preliminary agreement with Chinese officials to sell 60 planes to China valued at $7.2 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 United States) with nearly 94 million users at the end of 2004.

- The Chinese government projects that by the year 2020, there will be 140 million cars in China (seven times the current level), and that the number of cars sold annually will rise from 4.4 million units to 20.7 million units.

Major U.S. Imports from China

China is a relatively large source of many U.S. imports, especially labor-intensive products. In 2004, imports from China totaled $196.7 billion, accounting for 13.4% of total U.S. imports in 2004 (up from 12.1% in 2003 and 6.5% in 1996). U.S. imports from China rose by 29.1% in 2004 over the previous year; over the past four years they have risen by 92.3%. 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 2004.

As indicated in **Table 3**, the top five U.S. imports from China were computers and parts, miscellaneous manufactured articles (such as toys, games, etc.), audio and video equipment, footwear, 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. However, over the past few years, however, an increasing proportion of U.S. imports from China has comprised more technologically advanced products, such as computers.

Table 3. Top Five U.S. Imports from China: 2000-2004
($billions and % change)

NAIC Commodity	2000	2001	2002	2003	2004	2003-2004 % Change	2000-2004 % Change
Total All Commodities	**100.1**	**102.3**	**125.2**	**152.4**	**196.7**	**28.7**	**92.3**
Computer equipment	8.3	8.2	12.0	18.7	29.5	58.1	255.4
Miscellaneous manufactured commodities (e.g., toys, games, etc.)	16.3	16.5	19.5	21.8	23.7	8.9	45.4
Audio and video equipment	6.3	6.3	8.9	10.0	11.2	26.4	77.8
Footwear	9.1	9.6	10.1	10.4	11.2	7.4	23.1
Apparel	7.0	7.2	7.7	9.0	10.5	16.8	50.0

Commodities sorted by top five imports in 2004 using NAIC classification, four-digit level.
Source: U.S. International Trade Commission Trade Data Web.

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. An illustration of this phenomenon can be seen in **table 4** on U.S. imports of computer equipment and parts from 2000-2004. In 2000, Japan was the largest foreign supplier of U.S. computer equipment (with a 19.6% share of total shipments), while China ranked 4th (at 12.1%). In just five years, Japan's ranking fell to 5th, the value of its shipments dropped by over half, and its share of shipments declined to 8.5% (2004); Singapore and Taiwan also experienced significant declines in their computer equipment shipments to the United States over this period. In 2004, China was by far the largest foreign supplier of computer equipment with a 39.9% share of total shipments. However, while U.S. imports of computer equipment from China rose by 255% over the past five years, the total value of U.S. imports of these commodities rose by only 7.9%, indicating in part that several foreign firms have shifted their production facilities to China.

[1] Chinese data indicate that the share of China's exports produced by foreign-invested enterprises (FIEs) in China rose from 1.9% in 1986 to 54.8% in 2003.

Table 4. Major Foreign Suppliers of U.S. Computer Equipment Imports: 2000-2004 ($billions and % change)

	2000	2001	2002	2003	2003	2000-2004 % Change
Total	68.5	59.0	62.3	64.0	73.9	7.9
China	8.3	8.2	12.0	18.7	29.5	255.4
Malaysia	4.9	5/0	7.1	8.0	8.7	77.6
Mexico	6.9	8.5	7.9	7.0	7.4	7.2
Singapore	8.7	7.1	7.1	6.9	6.6	-24.1
Japan	13.4	9.5	8.1	6.3	6.3	-53.0
Taiwan	8.3	7.0	7.1	5.4	4.1	-50.6

Ranked according to top 6 suppliers in 2004.
Source: U.S. International Trade Commission Trade Data Web.

China's growth into a major manufacturing center for increasingly sophisticated products has raised concerns among some U.S. policymakers over the competitive challenge posed by China, especially because wage rates in China are so low vis-à-vis the United States and because of the perception that China maintains a number of unfair trade policies.

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, tensions 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 unfair), 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, failure to provide adequate protection of U.S. intellectual property rights, and over the competitive challenge posed by China's rising economic power.

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, *China's Currency Peg: A Summary of the Economic Issues*, by Wayne Morrison and Marc Labonte; and CRS Report RL32165, *China's Exchange Rate Peg: Economic Issues and Options for U.S. Trade Policy*, by Wayne Morrison and Marc Labonte.

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-à-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), which 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) are 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-à-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 foreign exchange reserves ($609.9 billion at end of 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 is 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. Many warn 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. Finally, economists note that China is the second-largest purchaser of U.S. treasury securities ($194.5 billion as of January 2005), which helps to fund the U.S. federal budget deficit and helps keep U.S. interest rates low.

Eleven bills seeking to induce China to change its currency policy were introduced during the 108th Congress. In the 109th Congress, S. 14 (Stabenow) and S. 295 (Schumer) would raise U.S. tariffs on Chinese goods by an additional 27.5% unless China appreciated its currency to level close to its "fair market value."

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 semiannual 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, the Bush Administration has pledged to pursue the issue with China, largely under the auspices of a joint technical cooperation program, agreed to on October 14, 2003, to promote the development of China's financial markets and to examine ways China can move more quickly toward 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 estimated 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, but this petition was also rejected. The Bush Administration has expressed doubts that the United States could win such a case in the WTO and contends such an approach would be "more damaging than helpful at this time."[3]

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

[3] USTR press release, November 12, 2004.

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, while 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 were implemented 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. China's compliance with its WTO obligations has 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). In December 2004, the USTR issued its third annual China WTO compliance report, stating that while China's efforts to implement its WTO commitments have been "impressive," they remain "far from complete and have not always been satisfactory." Major areas of concern identified by the USTR's report include IPR protection, agriculture, services, industrial policies, trading rights and distribution, and transparency of trade laws and regulations.

- **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 to March 2002. President Bush raised the issue with Chinese President Jiang Zemin in October 2001 and in March 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 may take this issue to the WTO for resolution. Despite these problems, U.S. soybean exports to China grew substantially in 2003 (although sales decreased in 2004 over 2003 levels).

- **Tariff-rate quotas**. In November 2001, the Chinese government developed new rules on tariff-rate quotas (TRQs) 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 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 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 that 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 products. 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) 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.

[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.

- **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 are 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 made progress with China 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 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 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 of illegal reproduction of software, retail piracy, and trademark counterfeiting. It is estimated that counterfeits constitute between15 and 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 $2.5 billion in lost sales in 2004.[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).

IPR protection has become of the most important bilateral trade issue between the United States and China in recent years:

- In April 2004, the Chinese government 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 that it would allocate $210,000 to provide IPR enforcement training to Chinese government officials (e.g., judges, police, legislators, etc.).

- On November 19, 2004, eight members of the House Ways and Means Committee sent a letter to the Chinese Ambassador to the United States (Yang Jiechi) expressing concern over that proposed Chinese regulations on government procurement of software would virtually lock out U.S. software companies due to requirements for local content and technology transfer.

- On December 16, 2004, General Motors Daewoo Auto & Technology Company (a division of General Motors) filed a case in China against Chery Automobile Co. Ltd. (a Chinese firm) for allegedly violating its intellectual property rights by copying one of its car models (the Chevrolet Spark) to produce the Chery QQ. This particular case was raised by Secretary of Commerce Donald Evans with Chinese government officials during his last visit to China (January 12-13, 2005). The case has generated further interest in the United States because Chery is planning to export its vehicles to the United States beginning in 2007.

[5] International Intellectual Property Alliance, *2004 Special 301 Report: People's Republic of China, February 2005* (available at [http://www.iipa.com]).

- On February 9, 2005, the International Intellectual Property Alliance and the U.S. Chamber of Commerce urged the USTR to initiate a WTO consultations with China for its poor record on IPR enforcement, which could lead the United States to pursue a dispute resolution case against China in the WTO.

The Proposed IBM-Lenovo Deal

China's growth into a major manufacturing center for increasingly sophisticated products has raised concerns among some U.S. policymakers over the competitive challenge posed by China, especially because wage rates in China are so low vis-à-vis the United States and because of the perception that China maintains a number of unfair trade policies. For example, many U.S. policymakers expressed concerns following the December 7, 2004, IBM Corp. announcement that it would sell its personal computer division for $1.75 billion to Lenovo Group Limited, a computer company primarily owned by the Chinese government. Some policymakers contend that the acquisition by Lenovo of IBM's computer division is an example of how Chinese state-owned enterprises (SOEs), which are often heavily subsidized by the Chinese government, are becoming major internationally competitive companies; others have raised concerns over the impact on national security of transferring IBM's computer technology to China and over potential espionage activities that could occur in the United States at IBM research facilities by Lenovo employees. Despite such concerns, on March 9, 2005, the Committee on Foreign Investment in the United States, an interagency committee headed by the U.S. Treasury Department, approved the deal.

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. U.S. producers of textile and apparel products have been particularly vocal over the competitive pressures they face from China, especially since U.S. textile and apparel quotas on Chinese goods were eliminated in January 2005. According to the U.S. Commerce Department China is the United States' largest foreign supplier of textiles and apparel, accounting for 17.5 percent of total imports in 2004 (or $14.6 billion), compared with a 9.1% share ($6.5 billion) in 2000. U.S. textile and apparel imports rose by 22% in 2003 and by 25.4% in 2004. Many U.S. textile and apparel representatives argue that the flood of Chinese textile and apparel products into the United States will continue, especially now that the quotas have been eliminated, and 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. In an attempt to prevent further trade restrictions by the United States on its textile industry, the Chinese government, in December 2004, announced that it would impose an export tax on certain textile products.

China as a Non-Market Economy

The terms of China's WTO accession allow other WTO members, including the United States, to continue to treat China as a "nonmarket economy" in antidumping cases for a period of 15 years after its accession. In effect, this can often lead to the application of higher duties on Chinese goods (determined to have been sold at less than fair market value) than would occur if China were treated as a market economy.[6] As a result, China is vigorously seeking to get its trading partners to afford it full market-economy status.[7] Chinese officials contend that China's economy is largely operated according to free market principles. U.S. officials counter that many sectors and aspects of China's economy remain under state control. Under U.S. law, the Commerce Department can switch a country's designation from nonmarket to market economy status under U.S. anti-dumping laws (after conducting an investigation and holding public hearings). Commerce is required to consider 6 basic factors: 1) the extent to which the currency is convertible; (2) the extent to which wage rates are determined by free bargaining between labor and management; (3) the extent to which joint ventures or foreign investment are permitted; (4) the extent of government ownership or control of means of production; (5) the extent of government control over allocation of resources and over price and output decisions of enterprises; and (6) other factors the Department considers appropriate. Opponents of granting China full market economy status contend that China's currency peg and poor labor rights conditions alone disqualify China from obtaining this status.

On the other hand, some analysts contend that China should be afforded market economy status because it would then be subject to U.S. countervailing laws (such laws currently do not apply to nonmarket economies) dealing with foreign government subsidies. Several sectors of China's economy are believed to be subsidized by the government, especially through the banking system. Many U.S. firms that have been negatively affected by imports of low-cost Chinese goods would like to utilize U.S. countervailing laws, which could be utilized to impose countervailing duties against Chinese products deemed to have been unfairly subsidized by the Chinese government. Some Members of Congress support a different approach: simply amending U.S. law to apply countervailing measures to nonmarket economies. Proposed bills to apply this measure include H.R. 1216 (English) and S. 593 (Collins).

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[6] See CRS Report RS20570, *Trade Remedies and the U.S.-China Bilateral WTO Accession Agreement*, by William H. Cooper

[7] According to Chinese officials, a number of nations have given China full market economy status, including New Zealand, Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam, Pakistan, Russia, Chile, Peru, Brazil, Guyana, Barbados, Venezuela, Jamaica, Trinidad and Tobago, Antigua and Barbuda, St. Lucia, Dominica, Surinam, Bahamas, Nigeria, Armenia, Georgia, Kyrgyzstan, Benin, Togo, South Africa, and Nigeria.

China's NTR Status and WTO Accession

Prior to January 2002, U.S. law required China's normal trade relations (NTR) status (formally referred to in U.S. law as most-favored-nation, or MFN, status) to be renewed on an annual basis, based on the freedom-of-emigration requirements under the so-called Jackson-Vanik Amendment, and was subject to possible congressional disapproval through passage and enactment of a joint resolution. From 1980 (when NTR status was restored to China after being suspended in 1951) to 1989, the renewal of China's NTR status was relatively noncontroversial and was relatively unopposed by Congress. However, congressional concern over the Tiananmen Square incident in 1989 and subsequent crackdown on human rights led many Members to support legislation terminating the extension of China's NTR status or to condition that status on additional requirements, mainly dealing with human rights. Although none of these measures were enacted, many Members sought to use the annual renewal of China's NTR status as a focal point to express concerns, as well as to pressure the executive branch, over a wide range of Chinese trade (e.g., trade barriers and failure to protect IPR) and non-trade (e.g., human rights, prison labor, Taiwan security, and weapons proliferation) issues. Several Members opposed such linkage, arguing that it had little effect on Chinese policies and that the often rancorous congressional debate over China's trade status undermined long-term U.S.-Chinese relations.

During its negotiations with China over the terms of its WTO accession, the Clinton Administration pledged that, it would press the Congress to enact PNTR legislation in return for significant market opening commitments on the part of China. Once a satisfactory bilateral agreement was reached with China in November 1999, the Clinton Administration began to push for PNTR legislation. The Clinton Administration and its supporters argued that China would get into the WTO with or without congressional approval of PNTR status for China, and that failure to pass such legislation would prevent the United States and China from having an official trade relationship in the WTO. As a result, it was contended, U.S. firms would be excluded from the trade concessions made by China to gain entry into the WTO, while U.S. competitors in the WTO would be able to take full advantage of new business opportunities in China, and the United States would be unable to use the WTO dispute resolution process to resolve trade disputes with China. The Clinton Administration further maintained that China's accession to the WTO would promote U.S. economic and strategic interests, specifically by inducing China to deepen market reforms, promote the rule of law, reduce the government's role in the economy, and further integrate China into the world economy, making it a more reliable and stable partner. Finally, the Administration contended that congressional rejection of PNTR would be viewed by the Chinese as an attempt to isolate China economically; a move that would damage U.S.-China commercial relations and undermine the political position of economic reformers in China.

H.R. 4444, as originally introduced by Representative Bill Archer, would have granted PNTR status to China upon its accession to the WTO as long as the President certified that the terms of its accession were at least equivalent to the November 1999 U.S.-China trade agreement. Several provisions were added by the House to H.R. 4444 in response to various congressional concerns. In addition to the provisions contained in the original version of H.R. 4444, the final bill (which passed in the House on May 24, 2000, in the Senate on September 19, 2000, and was signed into law, as P.L. 106-286, on October 10, 2000):

- established a special congressional-executive branch commission to monitor, and report on, various aspects of China's policies on human rights, including labor practices and religious freedom;

- requires the USTR to issue a report annually assessing China's compliance with its WTO trade obligations;

- codified the anti-surge mechanism established under the November 1999 U.S.-China trade agreement and establishes procedures for obtaining relief from import surges;

- authorized additional funding for various U.S. government agencies to monitor and seek enforcement of China's compliance with its WTO trade commitments;

- set up a special government task force to halt U.S. imports from China of products suspected of being manufactured using prison labor; and

- authorized funding for programs to promote the development of the rule of law in China.

On November 10, 2001, President Bush certified that the terms of China's WTO accession agreement were at least equivalent to the November 1999 U.S.-China trade agreement, and on December 27, 2001, he issued a proclamation extending PNTR status to China, effective January 1, 2002.

Concerns over the effects of China's unfair trade practices and the surge in the level of Chinese exports on the U.S. economy has led to the introduction of legislation in the 109th Congress, H.R. 728 (Sanders), that would terminate China's PNTR status and thereby substantially raise U.S. tariffs on a variety of goods from China.[8]

[8] The bill as introduced had 56 co-sponsors.