November 24, 2014

U.S.-China Trade Issues

Background

The U.S.-China trade and economic relationship has expanded significantly over the past three decades, especially since China's entrance into the World Trade Organization (WTO) in 2001. China is currently the United States' third largest export market and biggest source of imports, making it the second largest overall U.S. trading partner. In 2013, U.S. exports to China amounted to $122 billion while U.S. imports from China were $440 billion. According to the U.S. Bureau of Economic Analysis, cumulative Chinese foreign direct investment (FDI) in the United States by the end of 2013 was $8.1 billion, while cumulative U.S. FDI in China was $61.5 billion. China also is the largest foreign holder of U.S. Treasury securities ($1.3 trillion as of September 2014), which helps keep U.S. interest rates low. However, tension between the two countries has risen in recent years over a number of issues.

Key U.S. Issues

Intellectual Property Rights (IPR) and Cybersecurity. U.S. firms cite the lack of effective protection of IPR as one of the biggest impediments that they face in conducting business in China and sometimes view lax IPR enforcement in the country as a way to give domestic firms an advantage over foreign competitors. In May 2013, an independent commission estimated that the United States suffers an annual loss of over $300 billion due to the international theft of U.S. intellectual property and attributed up to 80% of the problem to China.

In 2011, the U.S. Office of the National Counterintelligence Executive described Chinese actors as "the world's most active and persistent perpetrators of economic espionage" and as aggressive collectors of sensitive U.S. business information and technologies. In May 2014, the United States Department of Justice indicted five members of the Chinese People's Liberation Army (PLA) for government-sponsored cyber espionage against U.S. companies and theft of proprietary information to aid state-owned enterprises (SOEs). China responded by suspending its participation in a bilateral working group on cybersecurity with the United States. Some U.S. policymakers are concerned that the issue will negatively impact commercial ties between the two countries.

Industrial Policies. Many U.S.-China trade tensions arise from China's incomplete transition to a market economy, including its government support and protection of SOEs. Critics have charged that the Chinese government has been employing policies such as subsidies, tax breaks, low-cost loans, market access barriers, lax enforcement of IPR, limits on FDI, and restrictions on exports of raw materials in order to aid and develop industries deemed critical to China's economic growth.

WTO Compliance. China's accession into the WTO advanced its market reforms and openness to trade. However, U.S. trade officials contend that while China made significant progress toward market liberalization in the years immediately after its accession, it moved towards a more restrictive trade regime beginning in 2006. The United States has brought 15 WTO dispute settlement cases against China as of July 2014 on issues such as IPR, export subsidies, discriminatory industrial policies, and restrictions on trading and distribution rights.

Figure 1. Recent U.S. WTO Cases Against China

September 2012
The United States initiated a case against China for providing export subsidies to Chinese auto and auto parts manufacturers. The results are still pending.

July 2012
The United States brought a case against China for imposing anti-dumping and countervailing duties on certain autos from the United States that were inconsistent with WTO regulations. The United States prevailed.

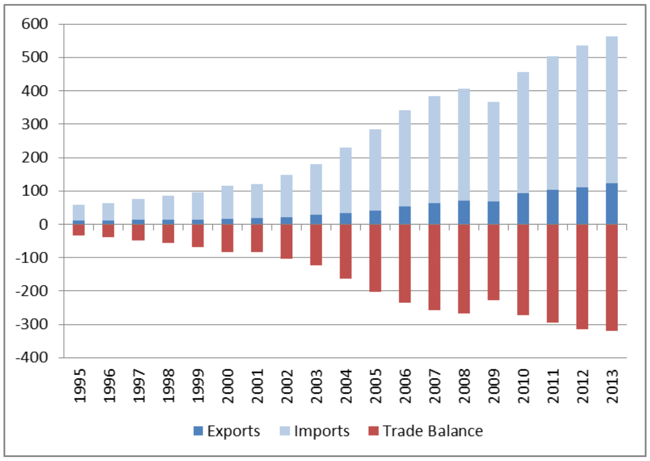
March 2012
The United States, Japan, and the European Union jointly brought a case against China over its restrictive export policies on rare earths and other minerals, which were found to have violated China's WTO commitments.

Source: World Trade Organization (WTO).

Currency Policy. Since 1994, the Chinese government has intervened in the currency market to limit or halt the appreciation of the Chinese renminbi (RMB) against the U.S. dollar, which many argue has allowed Chinese exports to the United States to be less expensive and U.S. exports to China to be more expensive than under a floating exchange rate system. Some U.S. policymakers contend that China's currency policy has contributed to the large annual U.S. trade deficit with China and the loss of U.S. manufacturing jobs in some industries. Others note that since the RMB appreciated by almost 33% against the U.S. dollar from July 2005 to May 2014, the focus on China's currency policy may depend on whether China backtracks on its current currency appreciation in order to increase its exports.

Trade Deficit. At $319 billion in 2013, the U.S. trade deficit with China is significantly larger than its trade deficit with any other partner. Some U.S. analysts argue that the large deficit is a result of China's alleged unfair trade practices. Others maintain that it is a reflection of China's role as a major center for global supply chains. A joint study released by the Organization for Economic Cooperation and Development (OECD) and WTO estimated that the 2009 U.S. trade deficit with China would have been reduced by up to 25% if bilateral trade flows were measured according to the value-added that occurred in China prior to being exported, as China often serves as the final point of assembly for many of its products and thus contributes little to the final value of the exports.

Figure 2. U.S.-China Trade Deficit ($ billions)



Source: United States Census Bureau, *Trade in Goods with China.*

Foreign Direct Investment (FDI). U.S.-China FDI flows are relatively small given the high level of bilateral trade. Although Chinese FDI in the United States has grown recently as a result of large-scale acquisitions in industries such as food, energy and real estate, cumulative Chinese FDI in the United States remains modest in comparison to countries such as Japan ($342.3 billion by end of 2013). Some policymakers have raised concerns that certain Chinese acquisitions of U.S. domestic firms may cause a loss of sensitive technologies and outsourcing of jobs. U.S. firms in China have also faced challenges, including equity caps, lack of regulatory transparency, and restrictions on investments in industries that China considers strategic, including telecommunications and financial services. To encourage more domestic development of technological innovations, Chinese officials have reportedly pressured U.S. firms to transfer technology to Chinese partners or set up research and development facilities in China in exchange for access to China's markets—an issue exacerbated by China's weak IPR protection.

Ongoing Bilateral Dialogues

U.S.-China Strategic and Economic Dialogue (S&ED). The cabinet-led S&ED—first launched in 2006 as the Strategic Economic Dialogue—was established in 2009 to enable senior Chinese and U.S. officials to address long-term strategic and economic challenges. At the July 2014 S&ED, China pledged to continue to increase the flexibility of the RMB exchange rate, boost domestic consumption, lessen government involvement in market operations, and reduce trade and investment barriers for U.S. firms.

Joint Commission on Commerce and Trade (JCCT). Established in 1983 and held annually in December, the JCCT is a high-level forum for addressing bilateral trade issues between China and the United States and promoting commercial opportunities between the two. The next round of the JCCT will be on December 16-18, 2014, in Chicago.

Current Negotiations

Bilateral Investment Treaty (BIT). China and the United States are currently negotiating a BIT that could expand bilateral investment ties. It aims to establish mutual nondiscriminatory treatment of investments and reduce both market access barriers and ownership restrictions for U.S. firms in China, among other provisions. China has agreed to use the "negative list" approach in reducing ownership restrictions via the BIT, where all industries except those explicitly listed would be open to investments. At the 2014 S&ED, both parties committed to solidifying major articles of the BIT by the end of 2014, as well as initiating negotiations on the "negative list" by early 2015.

WTO Government Procurement Agreement (GPA). The GPA is a plurilateral agreement established by the WTO in 1996 to provide market access for nondefense government procurement projects to its signatories. China's accession to the GPA would provide U.S. firms access to an estimated $200 billion market and has been a priority for the United States, which is already a GPA member. It would also allow Chinese firms to bid on U.S. contracts based on GPA thresholds. China has submitted several offers to join the GPA since 2007, but GPA members have rejected the offers because they allowed only limited access to the Chinese public procurement market, among other concerns.

Trans-Pacific Partnership (TPP). The TPP is a free trade agreement (FTA) currently being negotiated among the United States and 11 countries in the Asia-Pacific region. China is not part of the current negotiations, but has expressed interest in joining the agreement. Its participation would depend in large part on its ability to meet the TPP objectives of reaching a comprehensive and high-standard FTA, including on issues such as investment, IPR, and SOEs. Inclusion in the TPP may be an opportunity to accelerate China's market reforms and improve its business climate for U.S. firms.

The WTO Information Technology Agreement (ITA). During President Obama's visit to China in November 2014, the United States and China announced that they had reached an understanding on products that would be covered under a new ITA pact, a plurilateral agreement that is currently being negotiated among 70 WTO members. The agreement would seek to expand on the 1996 ITA agreement by adding more than 200 tariff lines that would be subject to zero tariffs. Up until recently, China had been accused by U.S. officials of holding up the ITA agreement by seeking to exclude a broad range of products from tariff elimination, such as semiconductors, in order to protect certain Chinese industries, a position that contributed to a suspension in the ITA negotiations in November 2013. China's new position is expected to help facilitate final adoption of the ITA agreement in the WTO.

For more information, see CRS Report R33536, *China-U.S. Trade Issues*, by Wayne M. Morrison.

Wayne M. Morrison, wmorrison@crs.loc.gov, 7-7767

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