

U.S.-China Trade Issues

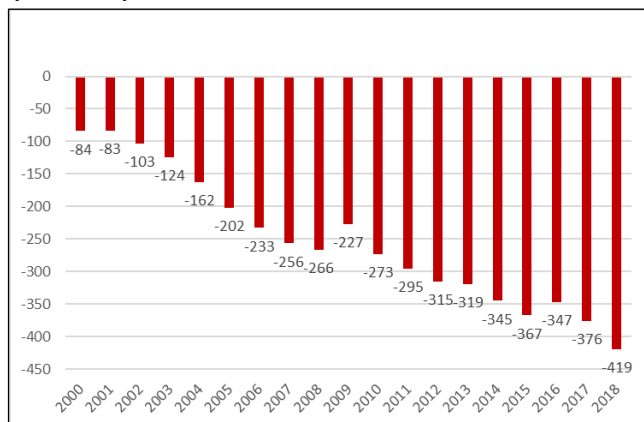
Background

The U.S.-China trade and economic relationship has expanded significantly over the past three decades. In 2018, China was the United States' largest U.S. merchandise trading partner (total trade at \$660 billion), third-largest export market (\$120 billion), and largest source of imports (\$540 billion). China is also the largest foreign holder of U.S. Treasury securities (at \$1.1 trillion year-end 2018). However, tensions have grown sharply in recent years over a number of economic and trade issues.

Key U.S. Issues

The Trade Deficit. President Trump has complained about the U.S. bilateral trade imbalances. The U.S. merchandise trade deficit with China in 2018 was \$419 billion (up from \$376 billion in 2017), and is by far the largest U.S. bilateral trade imbalance. Some U.S. policymakers view large U.S. bilateral trade deficits as an indicator of an “unfair” trade relationship. Others, however, view conventional bilateral trade deficit data as misleading, given the growth of global supply chains used by multinational firms. Products may be invented or developed in one country and manufactured or assembled elsewhere using imported components from multiple foreign sources and then exported. Conventional U.S. trade data may not fully reflect the value added in each country, and thus are often a relatively poor indicator of the beneficiaries of its global trade. Also, most economists argue that the overall size of the trade balance is what really matters to the economy (not bilateral balances), and that this is largely a function of macroeconomic forces, such as low U.S. domestic savings relative to total investment, not trade barriers.

Figure 1. U.S.-China Merchandise Trade Balances (\$ billions)



Source: USITC Dataweb.

Intellectual Property Rights (IPR) and Cyber-Theft.

U.S. firms cite the lack of effective protection of IPR as one of the biggest impediments that they face in conducting business in China. A May 2013 study by the Commission on the Theft of American Intellectual Property estimated that China accounted for up to 80% (or \$240 billion) of

U.S. annual economic losses from global IPR theft. The U.S. Customs and Border Protection reported that China and Hong Kong together accounted for 78% of counterfeit goods it seized in FY2017.

In 2011, the U.S. Office of the National Counterintelligence Executive described Chinese actors as “the world’s most active and persistent perpetrators of economic espionage” and as aggressive collectors of sensitive U.S. business information and technologies. In May 2014, the U.S. Justice Department indicted five members of the Chinese People’s Liberation Army for government-sponsored cyber-espionage against U.S. companies and theft of proprietary information to aid state-owned enterprises. During Chinese President Xi Jinping’s state visit to the United States in September 2015, the two sides reached an agreement on cyber security, pledging that neither country’s government would conduct or knowingly support cyber-enabled theft of intellectual property for commercial purposes and to establish a joint dialogue on cybercrime and related issues. In October 2018, CrowdStrike, a U.S. cybersecurity technology company, identified China as “the most prolific nation-state threat actor during the first half of 2018.” It found that Chinese entities had made targeted intrusion attempts against multiple sectors of the economy. In November 2018, FBI Director Christopher Wray stated: “No country presents a broader, more severe threat to our ideas, our innovation, and our economic security than China.” In December 2018, U.S. Assistant Attorney General John C. Demers stated at a Senate hearing that from 2011-2018, China was linked to more than 90% of the Justice Department’s cases involving economic espionage and two-thirds of its trade secrets cases.

Industrial Policies. Many U.S.-China trade tensions arise from China’s incomplete transition to a market economy, including the use of industrial policies to support and protect domestic firms, especially state-owned enterprises (SOEs). Major Chinese government practices of concern to U.S. stakeholders include subsidies, tax breaks, and low-cost loans given to Chinese firms; foreign trade and investment barriers; discriminatory intellectual property (IP) and technology policies; and technology transfer mandates. Several recently issued economic plans, such as the “Made in China 2025” plan, appear to indicate a sharply expanded government role in the economy. The Trump Administration has characterized such policies as “economic aggression.” Some officials have expressed concerns that participation by Chinese firms in certain global supply chains, such as for information and communications technology products and services, could pose risks to U.S. IP and national security interests.

Foreign Direct Investment (FDI). U.S.-China FDI flows are relatively small given the high level of bilateral trade, although estimates of such flows differ. The U.S. Bureau of Economic Analysis (BEA) is the official U.S. agency that collects and reports FDI data. BEA estimates the stock of

Chinese FDI in the United States through 2017 at \$40 billion and the stock of U.S. FDI in China at \$108 billion. Some analysts contend BEA's methodology for measuring FDI significantly undercounts the level of actual U.S.-China FDI, in large part because it does not capture all FDI that is made through other countries, territories or tax havens, as well as acquisitions made by U.S. affiliates of foreign firms. The Rhodium Group (RG), a private advisory firm attempts to identify FDI by Chinese firms in the United States, regardless of where they are based or where the money for investment comes from. RG's data on U.S.-China FDI are much higher than BEA's data. For example, RG estimates the stock of China's FDI in the United States through 2017 at \$140 billion and the stock of U.S. FDI in China at \$256 billion. RG estimates that China's FDI flows to the United States rose from \$14.9 billion in 2015 to \$45.6 billion in 2016, but fell to \$29.4 billion in 2017 and to \$4.8 billion in 2018. The decline in Chinese FDI flows to the United States may reflect Beijing's efforts rein in "irrational" capital outflows, as well as enhanced scrutiny by the Trump Administration, which contends that the Chinese government seeks to obtain U.S. cutting-edge technologies and IP in order to further its industrial policy goals. For example, in September 2017, President Trump prohibited a group of investors, with alleged links to the Chinese government, from acquiring U.S. firm Lattice Semiconductor Corporation.

Congressional concerns over the ability of the Committee on Foreign Investment in the United States (CFIUS) to adequately screen foreign investment in terms of U.S. national security led to the enactment of the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) (P.L. 115-232) in August 2018. The act seeks to modernize CFIUS and expand the types of investment subject to review, including certain non-controlling investments in "critical technology." In November 2018 the U.S. Commerce Department issued a notice requesting public comment on criteria for identifying emerging and foundational technologies deemed essential to U.S. national security that could be subject to new export controls.

Tariffs on Steel and Aluminum. On March 8, 2018, President Trump issued a proclamation increasing U.S. import tariffs on steel (by 25%) and aluminum (by 10%), based on "national security" justifications (§232 of the 1962 Trade Act). In response, China on April 2 raised tariffs by 15% to 25% on \$3 billion worth of imported U.S. products.

Section 301 Case on China's IPR Policies. On August 14, 2017, President Trump issued a memorandum directing the USTR to determine if China's policies on IPR protection and forced technology requirements "may be harming American intellectual property rights, innovation, or technology development," and thus warranted a Section 301 investigation. On August 18th, the USTR launched a Section 301 investigation, and on March 22, President Trump signed a *Memorandum on Actions by the United States Related to the Section 301 Investigation*. It listed four IPR-related policies that justified U.S. action, including China's forced technology transfer requirements, cyber-theft of U.S. trade secrets, discriminatory licensing requirements, and attempts to acquire U.S. technology to advance its industrial policies. The United States said it would propose to boost tariffs by 25% on about \$50 billion worth of Chinese goods, initiate a WTO dispute settlement case against China's

discriminatory licensing policies (which it did on March 23) and impose new restrictions on certain Chinese investment in the United States.

On May 19, 2018, the United States and China released a joint statement announcing that that progress was made on a number of trade issues, including a Chinese commitment to "significantly increase purchases of United States goods and services," including U.S. agricultural and energy products. On May 21, U.S. Secretary of the Treasury Steven Mnuchin stated that both sides had suspended threatened tariff hikes. However, on May 29, the United States said it would implement the proposed Section 301 tariff hikes against China. It subsequently imposed three rounds of tariff increases on a total of \$250 billion worth imports from China, while China retaliated with tariff hikes on \$110 billion worth of U.S. products (see **Table 1**). President Trump has warned that he may increase tariffs on an additional \$267 billion worth of imports from China.

Table 1. Section 301-Related Tariff Hikes

Effective Date	Tariff Hike	Import Value	China's Reaction
July 6	25%	\$34 billion	Full retaliation
August 23	25%	\$16 billion	Full retaliation
September 24	10% (further rate hikes put on hold)	\$200 billion	5%-10% tariff hikes on \$60 billion worth of imports

Source: USTR and Chinese Ministry of Commerce.

On December 1, 2018, President's Trump and Xi met at the G20 Summit in Argentina where the two sides announced they would hold intensive negotiations over 90 days. President Trump agreed to suspend the planned Stage 3 Section 301 tariff rate increases (from 10% to 25%) that were planned to take effect on January 1, 2019, but stated that the increases would go into effect if no agreement was reached by March 1, 2019. On February 24, he announced that tariff hikes would be suspended because of progress in recent trade talks. U.S. officials have indicated that the talks are focused on structural changes to China's economy, including on IP and innovation policies, market barriers, and currency. The talks also focused on reducing the bilateral trade imbalance, including obtaining a Chinese commitment to purchase a "substantial amount" of agricultural, energy, manufactured goods from the United States. The U.S. side has indicated that it also wants a final agreement to include an enforcement mechanism.

Long Term Challenges. China's emergence as a major economic power poses number of challenges for the United States. These include China's efforts to become more technologically advanced in a number of dual-use industries (including through state intervention and IPR theft), attempts to use its financial resources to advance its interests globally (such as through the Belt and Road initiative) and promote its soft power, and attempts to present China's economic model of authoritarian capitalism as an alternative to the U.S. economic model.

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