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China-U.S. Trade Issues

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Summary

U.S.-China economic ties have expanded substantially over the past three decades. Total U.S.-China trade rose from \$2 billion in 1979 to \$592 billion in 2014. China is currently the United States' second-largest trading partner, its third-largest export market, and its biggest source of imports. China is estimated to be a \$350 billion market for U.S. firms, based on U.S. direct and indirect exports to China and sales by U.S.-invested firms in China. Many U.S. firms view participation in China's market as critical to staying globally competitive. General Motors (GM), for example, which has invested heavily in China, sold more cars in China than in the United States each year from 2010 to 2014. In addition, U.S. imports of low-cost goods from China greatly benefit U.S. consumers, and U.S. firms that use China as the final point of assembly for their products, or use Chinese-made inputs for production in the United States, are able to lower costs. China is the largest foreign holder of U.S. Treasury securities (\$1.26 trillion as of April 2015). China's purchases of U.S. government debt help keep U.S. interest rates low.

Despite growing commercial ties, the bilateral economic relationship has become increasingly complex and often fraught with tension. From the U.S. perspective, many trade tensions stem from China's incomplete transition to a free market economy. While China has significantly liberalized its economic and trade regimes over the past three decades, it continues to maintain (or has recently imposed) a number of state-directed policies that appear to distort trade and investment flows. Major areas of concern expressed by U.S. policymakers and stakeholders include China's relatively poor record of intellectual property rights (IPR) enforcement; alleged widespread cyber economic espionage against U.S. firms by Chinese government entities; discriminatory innovation policies; its mixed record on implementing its World Trade Organization (WTO) obligations; its extensive use of industrial policies (such as financial support of state-owned firms, trade and investment barriers, and pressure on foreign-invested firms in China to transfer technology in exchange for market access) in order to promote the development of industries favored by the government and protect them from foreign competition; and its policies to hold down the value of its currency. Many U.S. policymakers argue that such policies negatively impact U.S. economic interests and have contributed to U.S. job losses. There are a number of U.S. views on how to more effectively address commercial disputes with China:

- Take a more aggressive stand against China, such as increasing the number of dispute settlement cases brought against China in the WTO, or threatening to impose trade sanctions against China unless it addresses policies (such as IPR infringement and cyber theft of trade secrets) that hurt U.S. economic interests.
- Intensify negotiations through existing high-level bilateral dialogues, such as the U.S.-China Strategic and Economic Dialogue (S&ED), which was established to discuss long-term challenges in the relationship. In addition, seek to complete ongoing U.S. negotiations with China to reach a high-standard bilateral investment treaty (BIT), as well as to finalize negotiations in the WTO toward achieving China's accession to the Government Procurement Agreement (GPA).
- Encourage China to join the Trans-Pacific Partnership (TPP) negotiations and/or seek to negotiate a bilateral free trade agreement (FTA) with China, which would require it to significantly reduce trade and investment barriers.
- Continue to press China to implement comprehensive economic reforms, such as diminishing the role of the state in the economy and implementing policies to boost domestic consumption, which, many economists contend, would benefit both the Chinese and U.S. economies.

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Economic and trade reforms begun in 1979 have helped transform China into one of the world's fastest-growing economies. China's economic growth and trade liberalization, including comprehensive trade commitments made upon entering the World Trade Organization (WTO) in 2001, have led to a sharp expansion in U.S.-China commercial ties. Yet, bilateral trade relations have become increasingly strained in recent years over a number of issues, including a large and growing U.S. trade deficit with China, resistance by China to appreciate its currency to market levels, China's mixed record on implementing its WTO obligations, infringement of U.S. intellectual property (including through cyber espionage), and numerous Chinese industrial policies that appear to impose new restrictions on foreign firms or provide unfair advantages to domestic Chinese firms (such as subsidies). Several Members of Congress have called on the Obama Administration to take a tougher stance against China to induce it to eliminate trade and economic policies deemed harmful to U.S. economic interests and/or inconsistent with WTO rules. This report provides an overview of U.S.-China commercial relations, including major trade disputes.

Most Recent Developments

From June 22 to 24, 2015, U.S. and Chinese officials held the seventh round of the U.S.-China Strategic and Economic Dialogue (S&ED). Major topics included negotiations for reaching a bilateral investment treat, U.S. concerns over China's proposed technology regulations, and cyber-theft issues.

On March 2, 2015, President Obama reportedly raised concerns with Chinese President Xi about certain aspects of a proposed Chinese anti-terror law that could require high technology companies to hand over encryption keys and install security backdoors in their systems to give Chinese authorities surveillance access to the users (and data) of those services. On February 27, 2015, USTR Michael Froman raised concerns that China's proposed banking regulations would require companies that sell equipment to Chinese banks to turn over sensitive technologies and intellectual property to the Chinese government.

On February 11, 2015, the United States initiated a WTO dispute settlement case against China over its use of certain measures providing subsidies contingent upon export performance to enterprises in several industries in China.

On February 9, 2015, Qualcomm Incorporated announced that it had reached a resolution with China's NDRC over its determination that Qualcomm had violated China's AML. Qualcomm agreed to pay a \$975 million fine and to reduce license fees in China.

Following the December 16-18, 2014, session of the U.S.-China Joint Commission on Commerce and Trade (JCCT), China stated that it would approve the importation of new biotechnology varieties of U.S. soybeans and corn and improve IPR trademark protection for certain agricultural products; amend its trade secrets law and increase cooperation with the United States on enhancing sales of legitimate U.S. intellectual property-intensive goods and services in China; streamline China's processes and cut red tape for imports of pharmaceuticals and medical devices; and make improvements to its competition enforcement policies by improving transparency and ensuring equal treatment for foreign firms in anti-monopoly investigations with Chinese firms.

On November 10-12, 2014, President Obama travelled to China in order to attend the Asia-Pacific Economic Cooperation (APEC) economic leaders meeting and for a state visit. Following his meetings with Chinese President Xi Jinping, the United States and China announced that they had reached agreements on information technology trade and visa extensions.

On July 15, 2014, China, along with Brazil, Russia, India, and South Africa, announced the creation of a \$100 billion “New Development Bank,” to be headquartered in Shanghai, China. The new bank would be aimed at assisting developing economies.

On July 9-10, 2014, U.S. and Chinese officials held the sixth round of talks under the S&ED. The two sides agreed to a broad timetable for reaching a bilateral investment treaty (BIT).

On May 23, 2014, a WTO dispute settlement panel ruled that duties (of up to 21.5%) imposed by China (beginning in 2011) on certain imported U.S.-made vehicles (resulting from antidumping and countervailing procedures) were largely inconsistent with China’s WTO obligations.

On May 19, 2014, the U.S. Department of Justice issued a 31-count indictment against five members of the Chinese PLA for cyber economic espionage and other offenses that allegedly targeted five U.S. firms and a labor union for commercial advantage.

On March 23, 2014, a WTO panel ruled that China’s restrictions on rare earth elements and two other metals were inconsistent with its WTO obligations, and this holding was largely upheld after China appealed.

On January 23, 2014, Lenovo, a Chinese technology company, announced that it would purchase IBM’s x86 server business for \$2.3 billion. On January 29, 2014, Lenovo announced that it would acquire Motorola Mobility from Google for \$2.9 billion.

From November 9 to 12, 2013, the Communist Party of China held the 3rd Plenum of its 18th Party Congress, a meeting that many analysts anticipated would result in the initiation of extensive new economic reforms. Following the meeting, the Communist Party issued a communique with a number of broad policy statements. One highlighted by the Chinese media was that the market would now play a “decisive” role in allocating resources in the economy.

U.S. Trade with China¹

U.S.-China trade rose rapidly after the two nations reestablished diplomatic relations (in January 1979), signed a bilateral trade agreement (July 1979), and provided mutual most-favored-nation (MFN) treatment beginning in 1980.² In 1979 (when China’s economic reforms began), total

¹ This report focuses primarily on U.S.-China trade relations. For information on China’s economy, see CRS Report RL33534, *China’s Economic Rise: History, Trends, Challenges, and Implications for the United States*, by Wayne M. Morrison. For general information on U.S.-China political ties, see CRS Report R41108, *U.S.-China Relations: An Overview of Policy Issues*, by Susan V. Lawrence.

² The United States suspended China’s MFN status in 1951, which cut off most bilateral trade. China’s MFN status was conditionally restored in 1980 under the provisions set forth under Title IV of the 1974 Trade Act, as amended (including the Jackson-Vanik freedom-of-emigration provisions). China’s MFN status (which was re-designated under U.S. trade law as “normal trade relations” status, or NTR) was renewed on an annual basis until January 2002, when permanent NTR was extended to China (after it joined the WTO in December 2001).

U.S.-China trade (exports plus imports) was \$2 billion; China ranked as the United States' 23rd-largest export market and its 45th-largest source of imports. In 2014, total bilateral trade (exports plus imports) reached \$592 billion. China is currently the second-largest U.S. trading partner (after Canada), the third-largest U.S. export market (after Canada and Mexico), and the largest source of U.S. imports. According to the U.S.-China Business Council, China was a \$350 billion market (2013) for U.S. firms if direct and indirect U.S. exports to China, and sales by U.S.-invested firms in China, are counted.³ Over the past 10 years or so, China has been one of the fastest-growing U.S. export markets. The importance of the Chinese market for the United States is expected to grow significantly in the years ahead

A major concern among some U.S. policymakers has been the size of the U.S. trade deficit with China. That deficit rose from \$10 billion in 1990 to \$342 billion in 2014 (see **Table 1** and **Figure 1**). For the past several years, the U.S. trade deficit with China has been significantly larger than that with any other U.S. trading partner and several trading groups. Some analysts contend that the large U.S. trade deficit is an indicator that the trade relationship is unbalanced, unfair, and damaging to the U.S. economy. Others argue the large trade deficit with China is more of a reflection of global supply chains, where China is often the final point of assembly for export-oriented multinational firms (discussed more fully later in the report). A joint study by the Organization for Economic Cooperation and Development (OECD) and the WTO estimated that the U.S. trade deficit in China would be reduced by 25% (in 2009) if bilateral trade flows were measured according to the value-added that occurred in each country before it was exported.⁴

Table 1. U.S. Merchandise Trade with China: 1980-2014
(\$ billions)

Year	U.S. Exports	U.S. Imports	U.S. Trade Balance
1980	3.8	1.1	2.7
1990	4.8	15.2	-10.4
2000	16.3	100.1	-83.8
2005	41.8	243.5	-201.6
2006	55.2	287.8	-232.5
2007	65.2	321.5	-256.3
2008	71.5	337.8	-266.3
2009	69.6	296.4	-226.8
2010	91.9	364.9	-273.1
2011	103.9	393.3	-295.5
2012	110.6	425.6	-315.0
2013	121.7	440.4	-318.4
2014	124.0	466.7	-342.3

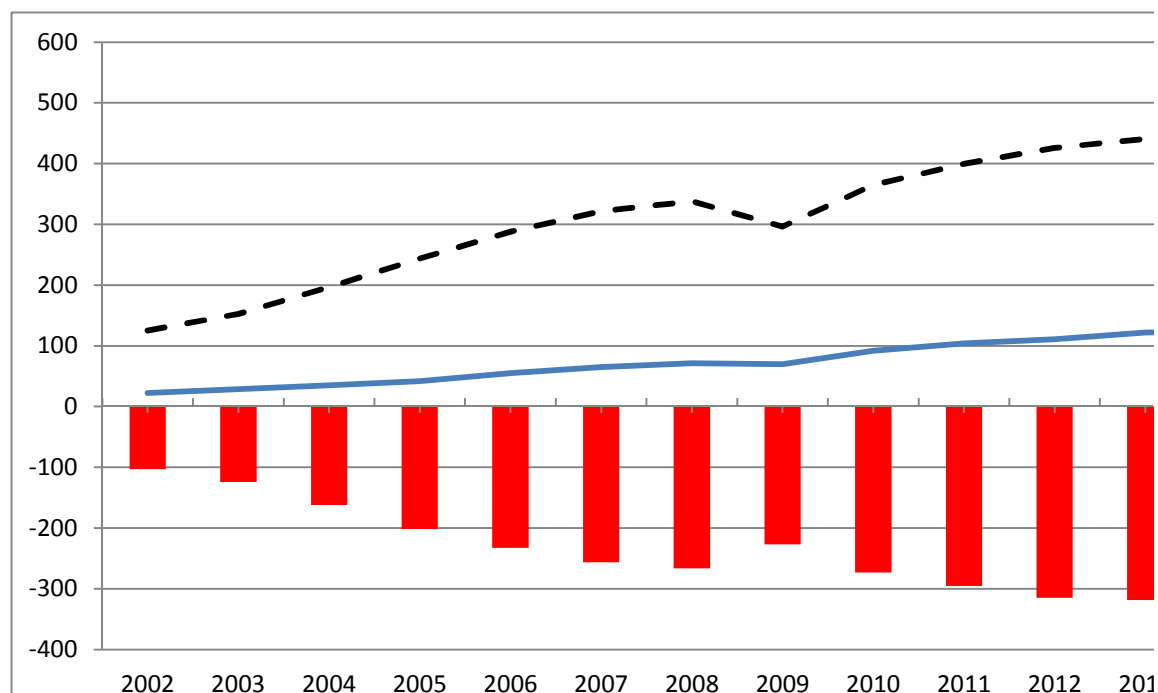
Source: U.S. International Trade Commission DataWeb.

³ Reuters, "RPT-U.S. Firms Lower China Expectations as Growth Slows, Scrutiny Rises," November 12, 2014, at <http://www.reuters.com/article/2014/11/12/china-apec-ceos-idUSL3N0T25LE20141112>.

⁴ OECD/WTO Trade in value-Added (TIVA) Database: China, at <http://www.oecd.org/sti/ind/TiVA%20China.pdf>.

Figure 1. U.S. Merchandise Trade with China: 2002-2014

(\$ billions)



Source: U.S. International Trade Commission DataWeb.

U.S. Merchandise Exports to China

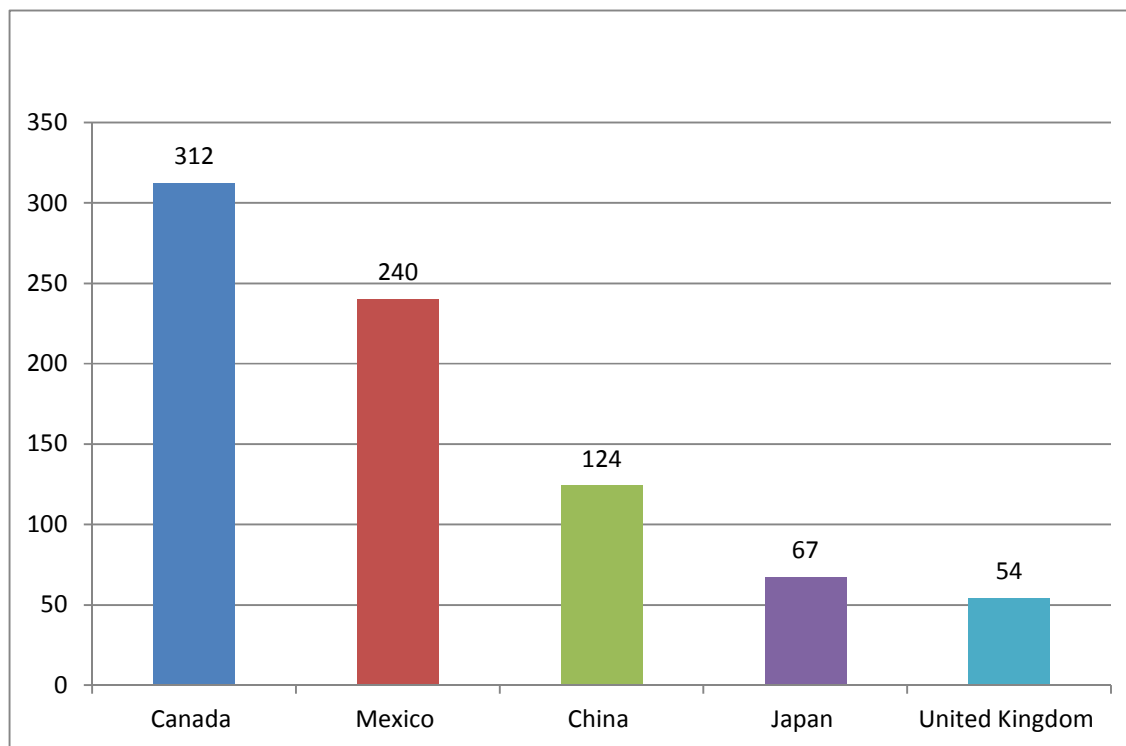
U.S. merchandise exports to China in 2014 were \$124.0 billion, up 1.9% over 2013 levels. In 2014, China was the third-largest U.S. merchandise export market after Canada and Mexico (see **Figure 2**). From 2000 to 2014, the share of total U.S. exports going to China rose from 2.1% to 9.1%. As indicated in **Table 2**, the top five merchandise U.S. exports to China in 2014 were oilseeds and grains; aircraft and parts; motor vehicles; waste and scrap; and semiconductors and other electronic components. As indicated in **Table 3**, and **Figure 3**, from 2005 to 2014, U.S. exports to China increased by 295%, which was the fastest growth rate for U.S. exports among its top 10 export markets. During the first five months of 2015, U.S. merchandise exports to China fell by 6.1% over the same period in 2014.

China was the second-largest U.S. agricultural export market in 2014 at \$24.5 billion. China is also a significant market for U.S. exports of services. These totaled \$41.5 billion in 2014, making China the fourth-largest export market for U.S. services.⁵

⁵ U.S. Bureau of Economic Analysis, *International Transactions*.

Figure 2. Top 5 U.S. Merchandise Export Markets: 2014

(\$ billions)



Source: U.S. International Trade Commission DataWeb.

Table 2. Major U.S. Exports to China: 2013-2014

(\$ millions and percent change)

NAIC 4-Digit Commodity	2013	2014	2013-2014 % change
Total Exports to China	121,736	124,024	1.9%
Oilseeds and grains	15,725	16,599	5.6%
Aerospace products and parts	12,591	13,928	10.6%
Motor vehicles	8,643	11,191	29.5%
Waste and scrap	8,757	7,097	-19.0%
Semiconductors and other electronic components	5,723	6,480	13.2%
Navigational, measuring, electro-medical, and controlling instruments	5,737	5,438	-5.2%
Basic chemicals	5,123	4,497	-12.2%
Resin, synthetic rubber, & artificial & synthetic fibers & filament	4,234	4,293	1.4%
Other general purpose machinery	3,168	3,387	6.9%
Meat products and meat packaging products	2,758	2,356	-14.6%

Source: USITC DataWeb.

Note: Top 10 U.S. exports to China in 2014 using the North American Industry Classification (NAIC) System.

Table 3. Major U.S. Merchandise Export Markets: 2005-2014

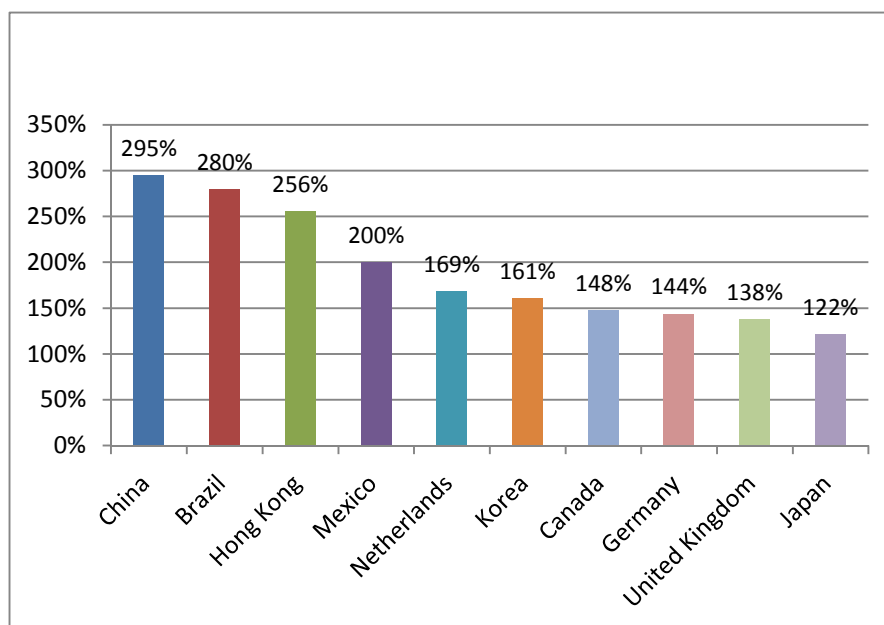
(\$ billions and percent change)

Country	2005	2014	Percent Change: 2013-2014	Percent Change: 2005-2014
Canada	211	312	3.5%	147.9%
Mexico	120	240	6.3%	200.0%
China	42	124	1.9%	295.2%
Japan	55	67	2.7%	121.8%
United Kingdom	39	54	13.8%	138.5%
Germany	34	49	4.4%	144.1%
Korea	28	45	6.8%	160.7%
Netherlands	26	44	2.6%	169.2%
Brazil	15	42	-3.9%	280.0%
Hong Kong	16	41	-3.5%	256.3%

Source: U.S. International Trade Commission DataWeb.

Note: Ranked according to the top 10 U.S. export markets in 2014.

Figure 3. Percentage Change in U.S. Merchandise Exports to Major Trading Partners: 2005-2014 (%)



Source: USITC Dataweb.

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.⁶ China's goals of modernizing its infrastructure, upgrading its industries, and improving rural living standards could generate substantial demand for foreign goods and services. Finally, economic growth has substantially improved the purchasing power of Chinese citizens, especially those living in urban areas along the east coast of China. In addition, China's growing economy, large foreign exchange reserves (at nearly \$3.9 trillion as of December 2014), and its 1.37 billion population, make it a potentially enormous market. To illustrate:

- According to a report by McKinsey & Company, China could have 630 million middle class households (45% of the entire nation) by 2022.⁷
- Although Chinese private consumption as a percent of GDP is much lower than that of most other major economies, the rate of growth of Chinese private consumption has been rising rapidly. From 2002 to 2013, the annual average rate of growth in Chinese private consumption was 10.3%, compared to 2.5% for the United States.⁸
- China's government has indicated that it plans to step up efforts to boost domestic spending to help lessen its dependence on exports as the major contributor to China's economic growth. China's goals of developing its western regions, expanding and modernizing its infrastructure, boosting its social safety net (such as health care and pensions), modernizing and developing key industries, reducing pollution, and raising incomes of the rural poor will likely result in large-scale government spending levels. China's 12th Five-Year Plan (2011-2015) reportedly planned to spend \$1 trillion on infrastructure spending.⁹
- China currently has the world's largest mobile phone network and one of the fastest-growing markets, with an estimated 1.29 billion mobile phone subscribers as of December 2014.¹⁰
- Boeing Corporation predicts that over the next 20 years (2014-2033), China will need 6,020 new airplanes valued at \$870 billion, and will be Boeing's largest commercial airplane customer outside the United States.¹¹
- China replaced the United States as the world's largest Internet user in 2008. At the end of 2013, China had an estimated 618 million users versus 262 million in the United States. Yet, the percentage of the Chinese population using the Internet is small relative to the United States: 45% versus 82%, respectively.¹²

⁶ China's real GDP growth from 2006 to 2011 averaged 10.9%. However, that growth has moderated in recent years; it was 7.7% in both 2012 and 2013, and 7.4% in 2014.

⁷ McKinsey & Company, *Preparing For China's Middle Class Challenge (Part 1)*. Middle class is defined as those with annual household disposable income of between RMB60,000 (\$10,000) and RMB229,000 (\$34,000).

⁸ Source: *Economist Intelligence Unit*.

⁹ China Daily, "China to invest 7t Yuan for Urban Infrastructure in 2011-15," May 13, 2013.

¹⁰ Statista, at <http://www.statista.com/statistics/278204/china-mobile-users-by-month>.

¹¹ Boeing Corporation, *Current Market Outlook: 2014-2033*, September 4, 2014, available at <http://www.boeing.com/boeing/commercial/cmo/china.page>.

¹² Internet World Stats, at <http://www.internetworldstats.com/stats.htm>.

- In 2009, China became the world's largest producer of motor vehicles as well as the largest market for new vehicles, and has remained the largest for each through 2014. China's motor vehicle production in 2014 was 23.7 million vehicles versus 11.7 million for the United States, while Chinese motor vehicle sales in that year were 23.5 million (U.S. levels were 16.8 million vehicles).¹³
- General Motors (GM) reported that it sold more cars and trucks in China than in the United States each year from 2010 to 2014.¹⁴ GM's China sales in 2014 were 3.5 million vehicles compared to 2.9 million vehicle sales in the United States.

Major U.S. Imports from China

China was the largest source of U.S. merchandise imports in 2014, at \$467 billion. China's share of total U.S. merchandise imports rose from 8.2% in 2000 to 20.7% in 2014. The importance (ranking) of China as a source of U.S. imports has risen sharply, from eighth largest in 1990, to fourth in 2000, to second in 2004-2006, and to first in 2007-present. During the first five months of 2015, U.S. merchandise imports from China fell by 3.9% over the same period in 2014. The top five U.S. imports from China in 2014 were computer equipment, communications equipment, miscellaneous manufactured products (such as toys and games), apparel, and semiconductors and other electronic parts (see **Table 4**). China was also the third-largest source of U.S. agricultural imports (at \$9.9 billion) and the eighth-largest source of U.S. imports of services (at \$14.7 billion).¹⁵

Table 4. Major U.S. Merchandise Imports From China: 2013-2014
(\$ millions and percent change)

NAIC Commodity 4-digit level	2013	2014	2013 – 2014 Percent change
Total imports from China	272,123	284,114	4.4%
Computer equipment	68,120	67,001	-1.6%
Communications equipment	58,837	64,154	9.0%
Miscellaneous manufactured commodities	32,443	33,531	3.4%
Apparel	27,411	27,140	-1.0%
Semiconductors and other electronic components	19,362	22,439	15.9%
Footwear	16,768	16,844	0.5%
Audio and video equipment	13,827	14,648	5.9%
Household and institutional furniture and kitchen cabinets	13,228	14,009	5.9%
Household appliances and miscellaneous machines	11,674	12,211	4.6%
Motor vehicle parts	10,453	12,138	16.1%

¹³ *The International Organization of Motor Vehicle Manufacturers*, available at <http://www.oica.net>.

¹⁴ A large share of these vehicles was produced by GM and its joint-venture partners in China. GM's website states that it currently has 10 joint ventures and two wholly owned foreign enterprises in China.

¹⁵ U.S. Bureau of Economic Analysis, *International Transactions*.

Source: U.S. International Trade Commission DataWeb.

Note: Top 10 U.S. imports from China in 2014 using the (NAIC) System on a 4-digit level.

Throughout the 1980s and 1990s, nearly all U.S. imports from China were low-value, labor-intensive products, such as toys and games, consumer electronic products, footwear, and textiles and apparel. However, over the past few years, an increasing proportion of U.S. imports from China have been comprised of more technologically advanced products (see **text box** below).

U.S.-China Trade in Advanced Technology Products

According to the U.S. Census Bureau, U.S. imports of “advanced technology products” (ATP) from China in 2014 totaled \$154.6 billion. ATP products accounted for 33.1% of total U.S. imports from China, compared with 19.2% (\$29.3 billion) in 2003. In addition, ATP imports from China accounted for 36.7% of total U.S. ATP imports (compared with 14.1% in 2003). U.S. ATP exports to China in 2014 were \$30.8 billion; these accounted for 24.8% of total U.S. exports to China and 9.2% of U.S. global ATP exports. In comparison, U.S. ATP exports to China in 2003 were \$8.3 billion, which accounted for 29.2% of U.S. exports to China and 4.6% of total U.S. ATP exports.

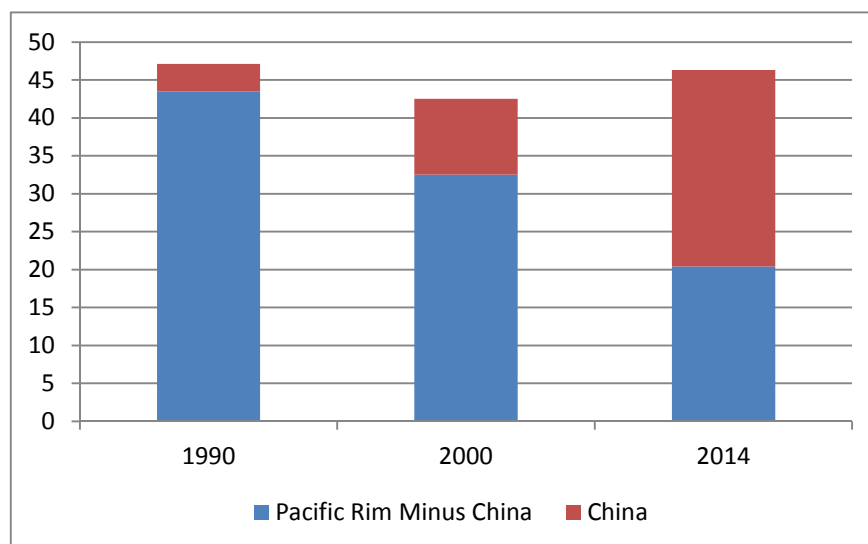
The United States ran a \$123.8 billion deficit in its ATP trade with China in 2014, up from a \$21.0 billion deficit in 2003. Some see the large and growing U.S. trade deficit in ATP with China as a source of concern, contending that it signifies the growing international competitiveness of China in high technology. Others dispute this, noting that a large share of the ATP imports from China are in fact relatively low-end technology products and parts, such as notebook computers, or are products that are assembled in China using imported high technology parts that are largely developed and/or made elsewhere.

China as a Major Center for Global Supply Chains

Many analysts contend that the sharp increase in U.S. imports from China (and hence the growing bilateral trade imbalance) is largely the result of movement in production facilities from other (primarily Asian) countries to China. That is, various products that used to be made in such places as 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). To illustrate, in 1990, 47.1% of the value of U.S. manufactured imports came from Pacific Rim countries (including China); this figure declined to 46.3% in 2013.¹⁶ Over this period, the share of total U.S. manufactured imports that came from China increased rose from 3.6% to 25.9%. In other words, while China was becoming an increasingly important source for U.S. manufactured imports, the relative importance of the rest of the Pacific Rim (excluding China) as a source of U.S. imports was declining, in part because many multinational firms were shifting their export-oriented manufacturing facilities to China (see **Figure 4**). In 1990, China accounted for 7.7% of U.S. manufactured imports from all Pacific Rim countries, but by 2014, this figure grew to 55.9%.

¹⁶ Pacific Rim countries include Australia, Brunei, Cambodia, China, Hong Kong, Indonesia, Japan, South Korea, Laos, Macao, Malaysia, New Zealand, North Korea, Papua New Guinea, the Philippines, Singapore, Taiwan, Thailand, Vietnam, and several small island nations.

Figure 4. U.S. Manufactured Imports from Pacific Rim Countries as a Percent of Total U.S. Manufactured Imports: 1990, 2000, and 2014



Source: U.S. International Trade Commission DataWeb.

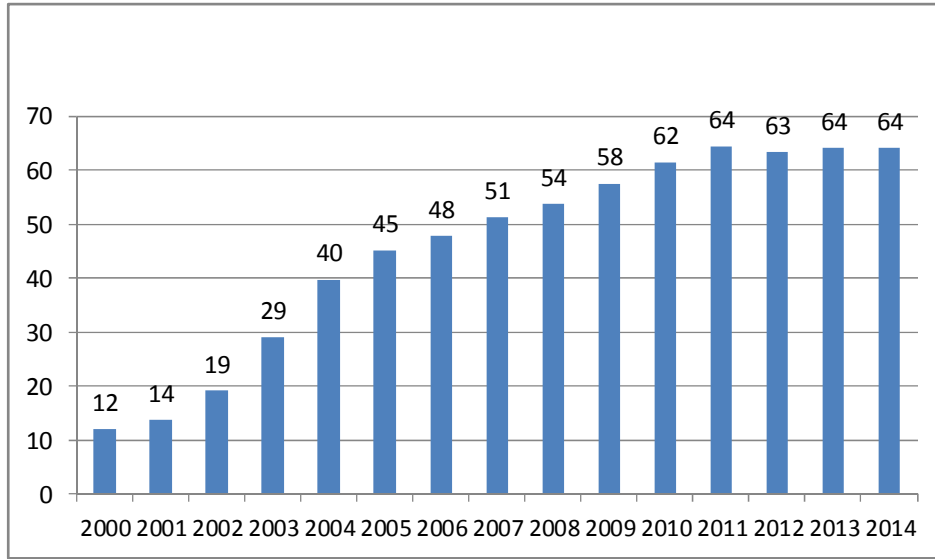
Notes: Standard International Trade Classification (SITC) definition of manufactured imports.

Another illustration of the shift in production can be seen in the case of U.S. computer equipment imports, which constitute the largest category of U.S. imports from China (on an NAIC basis, 4-digit level). In 2000, Japan was the largest foreign supplier of U.S. computer equipment (with a 19.6% share of total U.S. imports), while China ranked fourth (with a 12.1% share). By 2014, Japan's ranking had fallen to fourth; the value of its shipments dropped by 73.1% over 2000 levels, and its share of U.S. computer imports declined to 3.4% (2014). China was by far the largest foreign supplier of computer equipment in 2014 with a 64.0% share of total U.S. computer equipment imports, compared to 12.0% in 2000 (see **Figure 5**). While U.S. imports of computer equipment from China from 2000 to 2014 rose by 725.1%, the total value of U.S. computer imports worldwide rose by only 52.4%.¹⁷ A study by the U.S. International Trade Commission (USITC) estimated that in 2002 over 99% of computer exports in China were from foreign-invested firms in China.¹⁸ Taiwan, one of the world's leaders in sales of information technology, produces over 90% of its information hardware equipment (such as computers) in China. Computer equipment, like many other globally traded products, often involves many stages of production, using parts and other inputs made by numerous multinational firms throughout the world, a significant share of which is assembled in China. The globalization of supply chains makes it increasingly difficult to interpret conventional U.S. trade statistics (see **text box** below).

¹⁷ China's accession to the WTO (with the reduction of trade and investment barriers) appears to have been a major factor behind the migration of computer production from other countries to China.

¹⁸USITC, *How Much of Chinese Exports Is Really Made In China? Assessing Foreign and Domestic Value-Added in Gross Exports*, report number 2008-03-B, March 2008, p. 21.

Figure 5. U.S. Computer Imports from China as a Percentage of Total U.S. Computer Imports: 2000-2014
(percent)



Source: U.S. International Trade Commission DataWeb.

Global Supply Chains, China, and the Apple iPod: Who Benefits?

Many U.S. companies sign contracts with Taiwanese firms to have their products manufactured (mainly in China), and then shipped to the United States where they are sold by U.S. firms under their own brand name. In many instances, the level of value-added that occurs in China (often it simply involves assemblage) can be quite small relative to the overall cost/price of the final product. One study by researchers at the University of California looked at the production of a 2005 Apple 30 gigabyte video iPod, which is made in China by Foxconn, a Taiwanese company, using parts produced globally (mainly in Asia). The study estimated that it cost about \$144 to make each iPod unit. Of this amount, only about \$4, or 2.8% of the total cost, was attributable to the Chinese workers who assembled it; the rest of the costs were attributable to the numerous firms involved in making the parts (for example, Japanese firms provided the highest-value components—the hard drive and the display).¹⁹ From a trade aspect, U.S. trade data would have recorded the full value of each iPod unit imported from China at \$144 (excluding shipping costs) as originating from China, even though the value added in China was quite small. The retail price of the iPod sold in the United States was \$299, meaning that there was a mark-up of about \$155 per unit, which was attributable to transportation costs, retail and distributor margins, and Apple's profits. The study estimated that Apple earned at least \$80 on each unit it sold in its stores, making it the single largest beneficiary (in terms of gross profit) of the sale of the iPod. The study concluded that Apple's innovation in developing and engineering the iPod and its ability to source most of its production to low-cost countries, such as China, has helped enable it to become a highly competitive and profitable firm (as well as a source for high-paying jobs in the United States). The iPod example illustrates that the rapidly changing nature of global supply chains has made it increasing difficult to interpret the implications of U.S. trade data. Such data may show where products are being imported from, but they often fail to reflect who benefits from that trade. Thus, in many instances, U.S. imports from China are really imports from many countries.

U.S.-China Investment Ties²⁰

Investment plays a large and growing role in U.S.-China commercial ties.²¹ China's investment in U.S. assets can be broken down into several categories, including holdings of U.S. securities, foreign direct investment (FDI), and other non-bond investments. A significant share of China's investment in the United States is comprised of U.S. securities, while FDI constitutes the bulk of U.S. investment in China. The Department of the Treasury defines foreign holdings of U.S. securities as "U.S. securities owned by foreign residents (including banks and other institutions) except where the owner has a direct investment relationship with the U.S. issuer of the securities." U.S. statutes define FDI as "the ownership or control, directly or indirectly, by one foreign resident of 10% or more of the voting securities of an incorporated U.S. business enterprise or the equivalent interest in an unincorporated U.S. business enterprise, including a branch."²² BEA reports data on FDI flows to and from the United States.²³ China has also

¹⁹ Communications of the ACM, *Who Captures Value in a Global Innovation Network? The Case of Apple's iPod*, March 2009.

²⁰ U.S. data on FDI flows to and from China differ from Chinese data on FDI flows to and from the United States. This section examines only U.S. data.

²¹ Investment is often a major factor behind trade flows. Firms that invest overseas often import machinery, parts, and other inputs from the parent company to manufacture products for export or sale locally. Other such invested overseas firms may produce inputs and ship them to their parent company for final production.

²² 15 CFRS 806.15(a)(1). The 10% ownership share is the threshold considered to represent an effective voice or lasting influence in the management of an enterprise. See BEA, *International Economic Accounts, BEA Series Definitions*, available at <http://www.bea.gov/international>.

²³ BEA also reports FDI data according to broad industrial sections, including mining; utilities; wholesale trade; information; depository institutions; finance (excluding depository institutions); professional, scientific, and technical services; nonbank holding companies; manufacturing (including food, chemicals, primary and fabricated metals, machinery, computers and electronic products, electrical equipment, appliances and components, transportation equipment, and other manufacturing); and other industries.

invested in a number of U.S. companies, projects, and various ventures which do not meet the U.S. definition of FDI, and thus, are not reflected in BEA's data.

China's Holdings of U.S. Public and Private Securities²⁴

China's holdings of U.S. public and private securities are significant.²⁵ These include U.S. Treasury securities, U.S. government agency (such as Freddie Mac and Fannie Mae) securities, corporate securities, and equities (such as stocks). China's large holdings of U.S. securities can be largely attributed to its policy of intervening in exchange rate markets to limit the appreciation of its currency to the U.S. dollar (discussed in more detail below). For example, the Chinese government requires Chinese exporters (who are often paid in dollars) to turn over their dollars in exchange for Chinese currency. As a result, the Chinese government has accumulated a significant amount of dollars.²⁶ Rather than holding onto U.S. dollars, which earn no interest, the Chinese government has chosen to invest many of them into U.S. Treasury securities because they are seen as a relatively safe investment.²⁷ China's investment in public and private U.S. securities totaled \$1.7 trillion as of June 2013.²⁸

U.S. Treasury securities, which help the federal government finance its budget deficit, are the largest category of U.S. securities held by China.²⁹ As indicated in **Table 5** and **Figure 6**, China's holdings of U.S. Treasury securities increased from \$118 billion in 2002 to nearly \$1.22 trillion as of December 2014, making China the largest foreign holder of U.S. Treasury securities (it overtook Japan as the largest holder in 2008). China's holdings of U.S. Treasury securities as a share of total foreign holdings rose from 9.6% in 2002 to 26.1% in 2010 (year-end), but then declined to 21.9% in December 2013 and to 20.2% as of December 2014. China's holdings of U.S. Treasury securities increased to \$1.26 trillion as of April 2015, or 20.6% of total foreign holdings.

²⁴ For additional information on this issue, see CRS Report RL34314, *China's Holdings of U.S. Securities: Implications for the U.S. Economy*, by Wayne M. Morrison and Marc Labonte.

²⁵ The Department of the Treasury estimates that 72% of China's total holdings of U.S. government and private securities as of June 2013 were in U.S. Treasury securities.

²⁶ China's large annual trade surpluses and inflows of FDI are major contributors to China's accumulation of foreign exchange reserves.

²⁷ However, over the past few years, Chinese officials have expressed concern over the "safety" of their large holdings of U.S. debt. They worry that growing U.S. government debt and expansive monetary policies will eventually spark inflation in the United States, resulting in a sharp depreciation of the dollar. This would diminish the value of China's dollar asset holdings.²⁷ Some Chinese officials have called for replacing the dollar as the world's major reserve currency with some other currency arrangement, such as through the International Monetary Fund's special drawing rights system, although many economists question whether this would be a feasible alternative in the short run.

²⁸ China was the second-largest foreign holder of U.S. public and private securities as of June 2013 (after Japan).

²⁹ Some observers characterize foreign holdings of U.S. Treasury securities as "foreign ownership of U.S. government debt."

Table 5. China's Holdings of U.S. Treasury Securities: 2002-2014

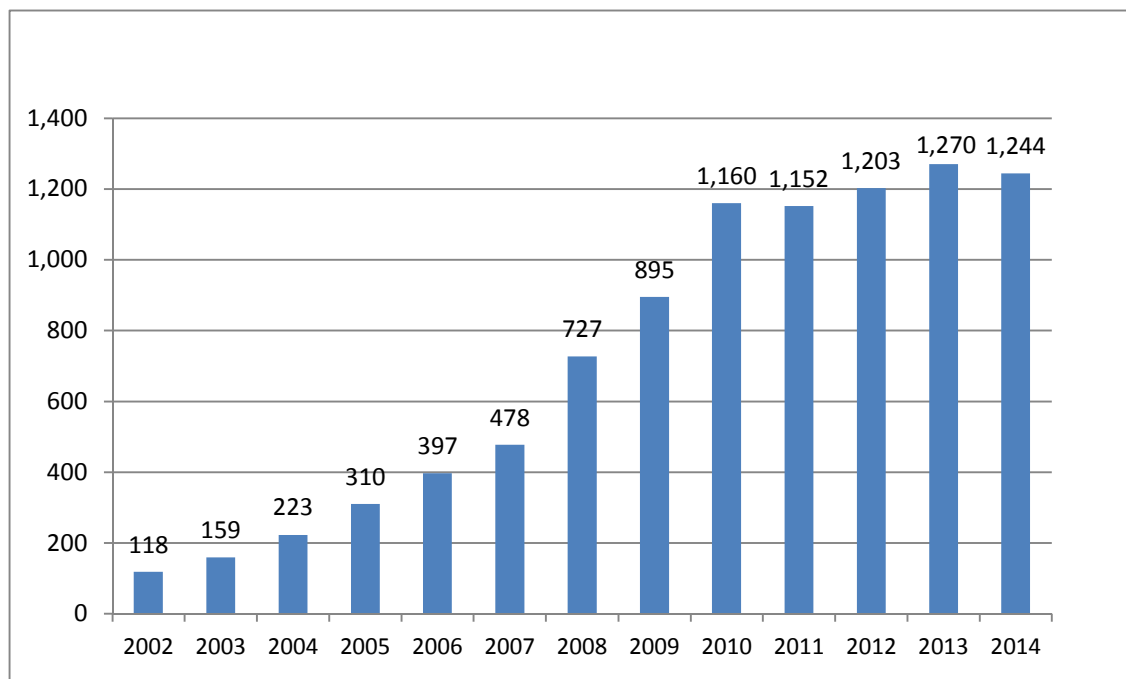
	2002	2004	2006	2008	2010	2011	2012	2013	2014
China's Holdings (\$ billions)	118.0	222.9	396.9	727.4	1,160.1	1,151.9	1,202.8	1,270	1,244.3
China's Holdings as a Percent of Total Foreign Holdings	9.6%	12.1%	18.9%	23.6%	26.1%	23.0%	21.7%	21.9%	20.2%

Source: U.S. Department of the Treasury.

Note: Year-end data.

Some analysts have raised concerns that China's large holdings of U.S. debt securities could give China leverage over U.S. foreign policy, including trade policy. They argue, for example, that China might attempt to sell (or threaten to sell) a large share of its U.S. debt securities as punishment over a policy dispute, which could damage the U.S. economy. Others counter that China's holdings of U.S. debt give it very little practical leverage over the United States. They argue that, given China's economic dependency on a stable and growing U.S. economy, and its substantial holdings of U.S. securities, any attempt to try to sell a large share of those holdings would likely damage both the U.S. and Chinese economies. Such a move could also cause the U.S. dollar to sharply depreciate against global currencies, which could reduce the value of China's remaining holdings of U.S. dollar assets. Analysts also note that, while China is the largest foreign owner of U.S. Treasury securities, those holdings are equal to only 6.8% of total U.S. public debt (as of December 2014). Finally, it is argued that, as long as China continues to largely peg the RMB to the U.S. dollar, it has little choice but to purchase U.S. dollar assets in order to maintain that peg.

Figure 6. China's Year-End Holdings of U.S. Treasury Securities: 2002-2014
(\$ billions)



Source: U.S. Department of the Treasury.

In the 112th Congress, the conference report accompanying the National Defense Authorization Act of FY2012 (H.R. 1540, P.L. 112-81) included a provision requiring the Secretary of Defense to conduct a national security risk assessment of U.S. federal debt held by China. The Secretary of Defense issued a report in July 2012, stating that “attempting to use U.S. Treasury securities as a coercive tool would have limited effect and likely would do more harm to China than to the United States.” As the threat is not credible and the effect would be limited even if carried out, it does not offer China deterrence options, whether in the diplomatic, military, or economic realms, and this would remain true both in peacetime and in scenarios of crisis or war.³⁰

Bilateral Foreign Direct Investment Flows

The level of foreign direct investment (FDI) flows between China and the United States is relatively small given the large volume of trade between the two countries. Many analysts contend that an expansion of bilateral FDI flows could greatly expand commercial ties. The U.S. Bureau of Economic Analysis (BEA) is the main U.S. federal agency that collects data on FDI flows to and from the United States.³¹ Its data show the stock of U.S. FDI in China through 2013

³⁰ Office of the Secretary of Defense, *Report to Congress, Assessment of the National Security Risks Posed to the United States as a Result of the U.S. Federal Debt Owed to China as a Creditor of the U.S. Government*, July 2012.

³¹ According the BEA, direct investment implies that a person in one country has a lasting interest in, and a degree of influence over, the management of, a business enterprise in another country. As such, it defines FDI as ownership or (continued...)

at \$61.5 billion on a historical-cost basis (see **Table 6**). Annual FDI flows have changed significantly from year to year (the peak year for U.S. FDI in China was 2008 at \$16 billion), and in some years, U.S. net FDI flows to China have been negative (reflecting an outflow of funds by U.S. investors in China back to the United States). In 2013, U.S. FDI flows to China were \$7.2 billion. BEA also estimates that U.S. majority-owned affiliates in China employed 1.6 million workers in China in 2012 (most recent data available), of which 699,000 were in manufacturing.³²

According to BEA, the stock of Chinese FDI in the United States through 2013 was \$8.1 billion (on a historical-cost basis). Annual Chinese FDI flows to the United States rose from \$500 million in 2009 to \$2.4 billion in 2013. Some analysts contend that the BEA's data on China's FDI in the United States do not fully capture all investments. For example, the Rhodium Group (a private research consultancy and advisory company) estimates that annual Chinese FDI flows to the United States rose from \$1.7 billion in 2008 to \$14 billion in 2013.³³

Table 6. Data on Annual U.S.–China Bilateral FDI Flows: 2005-2013 and Cumulative Value of FDI at Year-End 2013

(\$ millions)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	Cumulative: Value of FDI at 2013 Year-End
BEA's Data on U.S. FDI in China	1,955	4,221	5,243	15,971	-7,512	5,420	-1,720	-1,726	7,230	61,534
BEA's Data on China's FDI in the United States	146	315	8	500	500	1,037	1,105	3,491	2,419	8,073
Rhodium Group's Estimates of Chinese FDI in the United States	2	178	345	747	1,687	4,593	4,845	7,333	14,026	36,169

Source: U.S. Bureau of Economic Analysis, *International Data*; and the Rhodium Group, *China Investment Monitor*.

Notes: BEA's annual data are financial flows without current-cost adjustment. A negative number indicates more financial flows held by foreign investors were returned to the home country than were invested in the host country (i.e., China). BEA's cumulative data are the stock of FDI on a historical-cost basis.

(...continued)

control of 10% or more of an enterprise's voting securities, or the equivalent, is considered evidence of such a lasting interest or degree of influence over management.

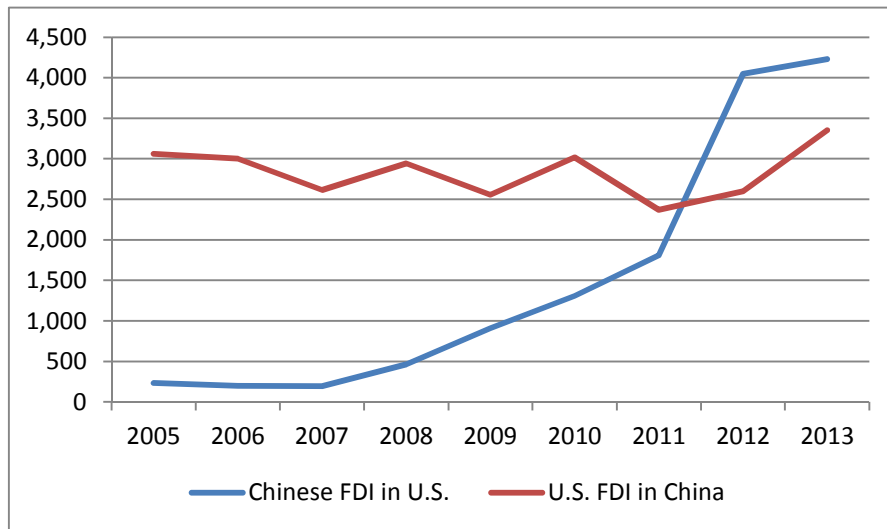
³² BEA, U.S. *Direct Investment Abroad: Financial and Operating Data for U.S. Multinational Companies*, available at <http://www.bea.gov/international/di1usdop.htm>.

³³ Rhodium's data for 2013 was 480% higher than BEA's data. Rhodium estimates that Chinese FDI in the United States in 2014 was \$11.9 billion. See, <http://rhg.com/interactive/china-investment-monitor>.

China's official data on FDI flows with the United States differ from U.S. data, due largely to different methodologies used. Chinese data list the cumulative level of U.S. FDI in China through 2013 at \$73.5 billion, and the flow of FDI in 2013 at \$3.4 billion. China's cumulative FDI in the United States through 2013 is reported at \$21.3 billion and the annual flow in 2013 at \$4.2 billion. China's reported annual FDI flows to and from the United States for 2005-2013 are shown in **Figure 7**. Chinese data would indicate that in both 2012 and 2013, Chinese FDI flows to the United States were greater than U.S. FDI flows to China.

Figure 7. Official Chinese Data on FDI Flows to and from the United States: 2005-2013

(\$ millions)



Source: Chinese Ministry of Commerce and United Nations.

Chinese Companies in the United States

Although the level of Chinese FDI in the United States is relatively small, it appears to be growing rapidly. Some examples of Chinese FDI in the United States include the following:

Volvo Cars (which is owned by the Chinese firm, Geely Holdings, announced in May 2015 that it would invest up to build \$500 million to build an assembly plant in South Carolina with a capacity to initially produce up to 100,000 cars per year.³⁴

The Dalian Wanda Group Corporation Ltd. on May 21, 2011, announced that it had signed a merger and acquisition agreement to acquire AMC Entertainment (the world's second-largest theater chain) for \$2.6 billion.

Suntech Power Holdings Co., Ltd., the world's largest producer of solar panels, opened a solar plant in Goodyear, Arizona, in October 2010, employing 100 workers. However, in March 2013, the company announced it planned to close the plant, citing higher production costs exacerbated by U.S. anti-dumping import duties imposed on solar cells and aluminum, as well as global solar module oversupply.³⁵

Sany Group, a global producer of construction equipment, founded Sany America Inc. in 2006, headquartered in Peachtree City, Georgia. In 2007, it announced it would invest \$100 million to create and establish a manufacturing facility for constructing and engineering Sany products, with expected employment of 300 workers by the time the project is completed.³⁶

Wanxiang Group, an automotive parts manufacturer, established Wanxiang America Corporation in 1994, based in Illinois. Over the past decade, Wanxiang America reportedly has purchased or invested in more than 20 U.S. firms and employs 5,000 U.S. workers—more than any other Chinese company.³⁷ In January 2013, Wanxiang America acquired nearly all of A123 Systems, a manufacturer of advanced lithium-ion batteries, for \$256.6 million.

Pacific Centuries Motor (a subsidiary of AVIC Automobile Industry Co., Ltd, purchased Nexteer Automotive, a Michigan-based firm that produces steering and driveline systems, for an estimated \$450 million.³⁸

Tianjin Pipe Corporation, China's largest steel pipe-maker, announced in 2009 that it planned to spend \$1 billion to construct a mini-mill facility in Gregory, Texas, that will manufacture steel products from recycled scrap steel. Over the first 10 years of operation, the project is projected to boost the local economy by \$2.7 billion and generate \$327 million in direct employee salaries.³⁹

Haier Group, a major global appliance and electronics firm, maintains its corporate headquarters for Haier America in New York City, has sales offices in 13 U.S. states, and operates a \$40 million refrigerator plant in Camden, South Carolina (employing 120 people), reportedly the first U.S. manufacturing facility built by a Chinese firm (2000).

Huawei Technologies is a leading global information and communications technology solutions provider. Since gaining a U.S. presence in 2011, Huawei has reportedly partnered with 280 U.S. technology providers, with total procurement contracts exceeding \$30 billion, covering such items as software, components, chipsets, and services. In February 2012, Huawei announced procurement contracts with U.S. firms worth \$6 billion.⁴⁰

Golden Dragon Precise Copper Tube Group Inc., one of the world's largest precise copper tube manufacturers, announced in February 2012 that it planned to build a \$100 million manufacturing facility in Alabama.

³⁴ Volvo Cars of America *Press Release* May 11, 2015.

³⁵ Suntech press release, March 12, 2013, available at <http://ir.suntech-power.com/phoenix.zhtml?c=192654&p=irol-newsArticle&id=1794801>.

³⁶ Sany America website at <http://www.sanyamerica.com/about-sany-america.php#ribbon>.

³⁷ *Washington Post*, "Job creation seen as key to China's investment in U.S.," January 19, 2011, available at <http://www.washingtonpost.com/wp-dyn/content/article/2011/01/18/AR2011011806676.html>.

³⁸ The purchase reportedly represented China's biggest single investment in the global auto parts-making industry to date and made the Chinese company the largest private employer in Saginaw, Michigan at nearly 3,000 (source: *New York Times*, *G.M. Sells Parts Maker to a Chinese Company*, November 29, 2010). The firm owns 20 manufacturing plants worldwide, 5 regional engineering and test centers, and 14 local customer support centers.

³⁹ Xinhua News Agency, "U.S official hails Chinese Project in Texas, October 11, 2011."

⁴⁰ <http://www.prnewswire.com/news-releases/huawei-poised-to-sustain-tens-of-thousands-of-job-opportunities-for-us-businesses-139525078.html>.

In addition to China's FDI in the United States and its holdings in U.S. Treasury securities, China (as of June 2014) held \$361 billion in U.S. equities (such as stocks), up from \$3 billion in June 2005. It also held \$168 billion in U.S. agency securities, many of which are asset-backed (such as Fannie Mae and Freddie Mac securities),⁴¹ and \$24 billion in corporate bonds. The China Investment Corporation (CIC), a sovereign wealth fund established by the Chinese government in 2007 with \$200 billion in registered capital to help better manage China's foreign exchange reserves, had financial assets totaling \$482 billion at the end of 2011. CIC has been one of the largest Chinese purchasers of U.S. equities and other U.S. assets; it has stakes in such firms as Morgan Stanley, the Blackstone Group, and J.C. Flowers & Co.⁴² It appears that many of the investments by the CIC and other Chinese entities have attempted to avoid political controversy in the United States by limiting their ownership shares to less than 10%.

According to the National Association of Realtors (NAR), Chinese investors have been the largest foreign buyers of U.S. real estate over the past two years. From March 2013 to March 2014, U.S. property sales to Chinese buyers totaled \$22 billion (up from \$12.8 billion in the previous year) and accounted for 24% of the total value of U.S. international sales.⁴³

Issues Raised by Chinese FDI in the United States

Many U.S. analysts contend that greater Chinese FDI in the United States, especially in "greenfield" projects (new ventures) that manufacture products or provide services in the United States and create new jobs for U.S. workers,⁴⁴ could help improve bilateral economic relations and might lessen perceptions among some critics in the United States that growing U.S.-China trade undermines U.S. employment and harms U.S. economic interests.⁴⁵ A number of analysts note that China's outward FDI has been growing rapidly since 2004 and is likely to continue in the years ahead.⁴⁶

Such analysts contend that greater efforts should be made by U.S. policymakers to encourage Chinese firms to invest in the United States rather than block them for political reasons. In June 2011, President Obama issued an executive order establishing the "SelectUSA Initiative" to coordinate federal efforts to promote and retain investment in the United States. According to a White House factsheet issued during the U.S. visit of then Chinese Vice President Xi Jinping in February 2012, China was already one of SelectUSA's top 10 focus markets, and the Administration was planning a significant expansion of the initiative, including with resources dedicated to attracting Chinese investors and facilitating their investment. The two sides further pledged to deepen cooperation on infrastructure financing.⁴⁷ At the July 2013 session of the U.S.-

⁴¹ U.S. Department of the Treasury, *Foreign Portfolio Holdings of U.S. Securities as of June 30, 2014*, April 2015.

⁴² For more information on the CIC, see CRS Report R41441, *China's Sovereign Wealth Fund: Developments and Policy Implications*, by Michael F. Martin.

⁴³ National Association of Realtors, *2014 Profile of International Home Buying Activity Purchases of U.S. Real Estate by International Clients for the Twelve Month Period Ending March 2014*, June 2014, p. 7.

⁴⁴ According to the BEA, Chinese majority-owned nonbank affiliates in the United States employed 1,700 U.S. workers in 2006 (most recent data available).

⁴⁵ During the 1980s, Japanese firms significantly boosted their FDI in the United States, such as in automobile manufacturing, in part to help to alleviate bilateral trade tensions.

⁴⁶ According to the United Nation's Conference on Trade and Development, China was the third-largest source of FDI outflow in 2013 at \$101 billion, up from being the sixth largest in 2011.

⁴⁷ The White House, *Joint Fact Sheet on Strengthening U.S.-China Economic Relations*, February 14, 2012.

China S&ED, the United States pledged to welcome investment from China, including those made by Chinese state-owned enterprises (SOEs).

Some critics of China's current FDI policies and practices contend that they are largely focused on mergers and acquisitions that are geared toward boosting the competitive position of Chinese firms and enterprises favored by the Chinese government for development (some of which also may be receiving government subsidies). Some argue that such investments are often made largely to obtain technology and know-how for Chinese firms, but do little to boost the U.S. economy by, for example, building new factories and hiring workers. Another major issue relating to Chinese FDI in the United States is the relative lack of transparency of Chinese firms, especially in terms of their connections to the central government. When Chinese SOEs attempt to purchase U.S. company assets, some U.S. analysts ask what role government officials in Beijing played in that decision. Chinese officials contend that investment decisions by Chinese companies, including SOEs and publicly held firms (where the government is the largest shareholder), are solely based on commercial considerations, and have criticized U.S. investment policies as "protectionist."

According to the Foreign Investment and National Security Act (FINSA) of 2007 (P.L. 110-149), the Committee on Foreign Investment in the United States (CFIUS) may conduct an investigation on the effect of an investment transaction on national security if the covered transaction is a foreign government-controlled transaction (in addition to if the transaction threatens to impair national security, or results in the control of a critical piece of U.S. infrastructure by a foreign person).⁴⁸ The House report on the bill (H.Rept. 110-24, H.R. 556) noted: "The Committee believes that acquisitions by certain government-owned companies do create heightened national security concerns, particularly where government-owned companies make decisions for inherently governmental—as opposed to commercial—reasons."

There have been several instances in which efforts by Chinese firms (oftentimes these have been SOEs or state-favored firms) have raised concerns of some U.S. policymakers and/or U.S. stakeholders:

- On January 23, 2014, Lenovo, a Chinese technology company, announced that it would purchase IBM's x86 server business. The acquisition was completed (after it reviewed by CFIS) on October 1, 2014, at the purchase price of \$2.1 billion.⁴⁹
- On January 29, 2014, Lenovo announced that it would acquire Motorola Mobility from Google. The acquisition was completed on October 30, 2014, for \$2.9 billion.⁵⁰
- On May 29, 2013, Shuanghui International Holdings, the majority owner of China's largest meat processing enterprise (Henan Shuanghui Investment & Development Company), announced it was seeking to purchase Smithfield Foods, the largest U.S. pork producer, for \$7.1 billion (including the assumption of Smithfield's debt). If the merger goes through, it would represent the largest

⁴⁸ CFIUS is an interagency committee that serves the President in overseeing the national security implications of foreign investment in the U.S. economy. See CRS Report RL33388, *The Committee on Foreign Investment in the United States (CFIUS)*, by James K. Jackson.

⁴⁹ IBM, *News Release*, October 2014, available at <http://www-03.ibm.com/press/us/en/pressrelease/44997.wss>.

⁵⁰ Lenovo, *Press Release*, October 30, 2014, available at http://news.lenovo.com/article_display.cfm?article_id=1860.

acquisition of a U.S. firm by a Chinese company to date. The proposed acquisition has raised a number of concerns among some U.S. policymakers.⁵¹ On June 20, 2013, 15 members of the Senate Committee on Agricultural, Nutrition, and Forestry sent a letter to the U.S. Secretary of the Treasury contending that the U.S. food supply is “critical infrastructure” and should be regarded as a national security issue during the CFIUS review process, urging that the Department of Agriculture and the Food and Drug Administration be represented in any CFIUS review of the transaction, and stating that review look to broader issues, including food security, food safety, and biosecurity.⁵² The Senate Agriculture Committee also announced plans to hold a hearing on the transaction and to “more broadly examine how the government review process of foreign acquisitions of U.S. companies addresses American food safety, protection of American technologies, and intellectual property, and the effects of increased foreign ownership of the U.S. food supply.”⁵³ In a June 21, 2013, letter to Administration officials, Senators Max Baucus and Orrin Hatch stated that the planned acquisition “has thrown a spotlight on China’s unjustified trade barriers to U.S. meat exports.”⁵⁴ A letter sent to Administration officials by Representative Rosa DeLauro and Senator Elizabeth Warren about the planned acquisition on June 26, 2013, raised a number of issues relating to food security, food safety, intellectual property rights protection, unfair Chinese trade practices, and U.S. global economic competitiveness and requested the Obama Administration to publicly respond to eight major concerns.⁵⁵ On July 10, 2013, the Senate Committee on Agricultural, Nutrition, and Forestry held a hearing on the proposed transaction. On September 26, 2013, Shuanghui International Holdings completed its purchase of Smithfield.

- In January 2013, Wanxiang America Corporation completed its acquisition of substantially all nongovernment business assets of A123 Systems, a manufacturer of lithium battery products. The acquisition included A123’s automotive, grid, and commercial business assets, including technology, products, customer contracts, and U.S. facilities in Michigan, Massachusetts, and Missouri; its manufacturing operations in China; and its equity interest in Shanghai Advanced Traction Battery Systems Company (A123’s joint venture with Shanghai Automotive).⁵⁶ Several Members of Congress expressed concerns over the national security implications of Wanxiang’s acquisition of A123 Systems, as well as concerns that U.S. government grants that had been given to A123 Systems in the past might end up benefiting a Chinese company.

⁵¹ Some argued, for example, that, given the relatively poor food safety record of many Chinese firms in China, the acquisition of Smithfield by Chinese investors could undermine food safety in the United States, and some suggested that the acquisition would eventually result in Chinese pork exports to the United States.

⁵² The text of the letter can be found at http://www.stabenow.senate.gov/?p=press_release&id=1061.

⁵³ Senate Committee on Agriculture, Nutrition, and Forestry, available at <http://www.ag.senate.gov/hearings/smithfield-and-beyond>.

⁵⁴ The text of the letter can be found at <http://www.finance.senate.gov/newsroom/chairman/release/?id=22b5b74e-5477-4ff8-9346-b46e0e158738>.

⁵⁵ The letter is available at http://delauro.house.gov/index.php?option=com_content&view=article&id=1328:delauro-warren-demand-answers-on-shuanghui-smithfield-foods-deal&catid=2:2012-press-releases&Itemid=21.

⁵⁶ A123 Systems, Press Release, January 29, 2013, available at <http://www.a123systems.com/62ce67cf-68aa-4b23-8b12-b8b210af1a3c/media-room-2013-press-releases-detail.htm>.

- On October 8, 2012, the chairman and ranking Member of the House Intelligence Committee (Representatives Mike Rogers and C.A. Dutch Ruppersberger) released a report recommending that U.S. companies considering doing business with Chinese telecommunications companies Huawei and ZTE to find another vendor, and that the CFIUS should block acquisitions, takeovers, or mergers involving Huawei and ZTE given “the threat to U.S. national security interests.” The report went on to state that “we have serious concerns about Huawei and ZTE, and their connection to the communist government of China. China is known to be the major perpetrator of cyber espionage, and Huawei and ZTE failed to alleviate serious concerns throughout this important investigation.”⁵⁷
- On September 28, 2012, President Obama issued an executive order requiring Ralls Corporation, a Chinese-owned firm, to divest its interest in four wind farm project companies in Oregon that it acquired earlier in the year, due to national security concerns, reportedly because of their proximity to a naval test facility.⁵⁸ China’s government-controlled media called the action “protectionist.”
- On May 9, 2012, the Federal Reserve announced that it had approved (1) the application by Industrial and Commercial Bank of China Limited, China Investment Corporation, and Central Huijin Investment Ltd., to become bank holding companies by acquiring up to 80% of the voting shares of the Bank of East Asia (USA) National Association; (2) the Bank of China’s application to establish a branch in Chicago, IL; and (3) the application by the Agricultural Bank of China Limited to establish a state-licensed branch in New York City.⁵⁹ In a letter to Federal Reserve Chairman Ben Bernanke, Senator Robert Casey noted that each of the entities approved by the Federal Reserve was state-owned, and he expressed concern that “these banks and their U.S. subsidiaries will use their state-support as a way to underprice U.S. banks that abide by U.S. law and do not have the support of a sovereign country behind them.”⁶⁰
- In May 2010, Huawei bought certain intellectual property assets of 3Leaf Systems (an insolvent U.S. technology firm) for \$2 million. A February 2011 letter issued by Senators Jim Webb and Jon Kyl to then-Commerce Secretary Gary Locke and then-Treasury Secretary Tim Geithner stated: “We are convinced that any attempt Huawei makes to expand its presence in the U.S. or acquire U.S. companies warrants thorough scrutiny. Moreover, the 3Leaf acquisition appears certain to generate transfer to China by Huawei of advanced U.S. computing technology. Allowing Huawei and, by extension, communist China to have access to this core technology could pose a serious risk as U.S. computer

⁵⁷ Investigative Report on the U.S. National Security Issues Posed by Chinese Telecommunications Companies Huawei and ZTE, A Report by Chairman Mike Rogers and Ranking Member C.A. Dutch Ruppersberger of the Permanent Select Committee on Intelligence, October 22, 2012, available at [http://intelligence.house.gov/sites/intelligence.house.gov/files/documents/Huawei-ZTE%20Investigative%20Report%20\(FINAL\).pdf](http://intelligence.house.gov/sites/intelligence.house.gov/files/documents/Huawei-ZTE%20Investigative%20Report%20(FINAL).pdf).

⁵⁸ New York Times, *Obama Orders Chinese Company to End Investment at Sites Near Drone Base*, September 28, 2012. Available at <http://www.nytimes.com/2012/09/29/us/politics/chinese-company-ordered-to-give-up-stake-in-wind-farms-near-navy-base.html>.

⁵⁹ Senator Robert Casey, *Press Release*, May 10, 2012, available at <http://www.federalreserve.gov>.

⁶⁰ The letter is available at <http://www.casey.senate.gov/newsroom/press/release/?id=b940fb00-0a69-42d6-bcff-6ac72c8ce0c1>.

networks come to further rely on and integrate this technology.”⁶¹ In February 2011, Huawei stated that it been formally notified by CFIUS that it should withdraw its application to acquire 3Leaf’s assets, which it later did.⁶² In an “Open Letter,” Huawei invited the U.S. government to carry out a formal investigation on any concerns it may have about Huawei.⁶³

- In May 2010, Anshan Iron and Steel Group Corporation (Ansteel), a major Chinese state-owned steel producer, announced plans to form a joint venture with Steel Development Company, a U.S. firm in Mississippi, to build and operate four mills to produce reinforcing bar and other bar products used in infrastructure applications, and one mill that would be capable of producing electrical and silicon grades of steel used in energy applications.⁶⁴ In July 2010, the Congressional Steel Caucus sent a letter signed by 50 Members to Secretary of the Treasury Tim Geithner, expressing concerns over the effect the investment would have “on American jobs and our national security.”⁶⁵ At a February 2012 hearing on China’s SOEs, Representative Visclosky, chairman of the Congressional Steel Caucus stated: “As a Caucus, we were concerned that the investment would allow a Chinese state-owned enterprise to pursue the government of China’s aims, and not the aims of the employer, the American worker, or the market. We were concerned that this investment would allow the full force and financing of the Chinese government to exploit the American steel market from American soil. We also were concerned that China would have access to new steel production technologies and information regarding American national security infrastructure projects.”⁶⁶
- In February 2010, Emcore Corporation, a provider of compound semiconductor-based components, subsystems, and systems for the fiber optics and solar power markets, announced it had agreed to sell 60% interest in its fiber optics business (excluding its satellite communications and specialty photonics fiber optics businesses) to China’s Tangshan Caofeidian Investment Corporation (TCIC) for \$27.8 million. However, Emcore announced in June 2010 that the deal had been ended because of concerns by CFIUS.⁶⁷
- In July 2009, China’s Northwest Nonferrous International Investment Company, a Chinese SOE, made a \$26 million offer to purchase a 51% stake in the Firstgold Corporation, a U.S. exploration-stage company. However, the deal reportedly raised national concerns within CFIUS because some of the mines

⁶¹ The letter also raised concerns over allegations that Huawei had ties to the Iranian government, had received substantial subsidies from the Chinese government, and had a poor record of protecting intellectual property rights.

⁶² Huawei initially stated that it would decline CFIUS’s recommendation with the intent of going through all of the procedures of the CFIUS process (including a potential decision by the President) in order to “reveal the truth about Huawei.”

⁶³ Huawei, Open Letter, February 25, 2011, available at http://www.huawei.com/huawei_open_letter.do.

⁶⁴ A press release by Ansteel stated that its intentions are “to capitalize on the opportunity to enter into an overseas joint venture with a company that is focused on utilizing advanced technology in an environmentally friendly and highly profitable manner.” See, <http://www.steeldevelopment.com/documents/ansteel2010.pdf>.

⁶⁵ See letter at http://visclosky.house.gov/SC_Geithner_CFIUS_7.2.10.pdf.

⁶⁶ Testimony of Rep. Peter J. Visclosky before the U.S.-China Economic and Security Review Commission on China’s State-Owned and State-Controlled Enterprises, February 15, 2012.

⁶⁷ Emcore Press Release, June 28, 2010, available at http://www.emcore.com/news_events/release?y=2010&news=249.

controlled by Firstgold were near U.S. military installations. As a result, the Chinese firm withdrew its bid in December 2009.⁶⁸

- In September 2007, Huawei announced plans, along with its partner, Bain Capital Partners, to buy the U.S. firm 3Com Corporation, a provider of data networking equipment, for \$2.2 billion. However, the proposed merger was withdrawn in February 2008 following a review of the deal by CFIUS when Huawei and its partner failed to adequately address U.S. national security concerns raised by CFIUS members.⁶⁹

In 2005, the China National Offshore Oil Corporation (CNOOC), a Chinese SOE, made a bid to buy UNOCAL, a U.S. energy company, for \$18.5 billion, but widespread opposition in Congress led CNOOC to withdraw its bid. Some Members argued at the time that the proposed takeover represented a clear threat to the energy and national security of the United States, would put vital oil assets in the Gulf of Mexico and Alaska into the hands of a Chinese state-controlled company, could transfer a host of highly advanced technologies to China, and that CNOOC's bid to take over UNOCAL would be heavily subsidized by the Chinese government. Some Members argued that "vital" U.S. energy assets should never be sold to the Chinese government. CNOOC officials referred to U.S. political opposition to the sale as "regrettable and unjustified."⁷⁰

- In 2004, Lenovo Group Limited, a computer company primarily owned by the Chinese government, signed an agreement with IBM Corporation to purchase IBM's personal computer division for \$1.75 billion. Some U.S. officials raised national security concerns over potential espionage activities that could occur in the United States at IBM research facilities by Lenovo employees if the deal went through. A review of the agreement by CFIUS took place in which IBM and Lenovo were able to address certain national security concerns and, as a result, the acquisition was completed in April 2005.⁷¹

Chinese Restrictions on U.S. FDI in China

U.S. trade officials have urged China to liberalize its FDI regime in order to boost U.S. business opportunities in, and expand U.S. exports to, China. Although China is one of the world's top recipients of FDI, the Chinese central government imposes numerous restrictions on the level and of types of FDI allowed in China. According to the U.S.-China Business Council, China imposes ownership barriers on nearly 100 industries.⁷² The OECD's 2012 FDI Regulatory Restrictiveness

⁶⁸ *New York Times*, "Chinese Withdraw Offer for Nevada Gold Concern," December 21, 2009.

⁶⁹ Although Huawei states that it is a private company wholly owned by its employees, many analysts contend that the company has close connections to the Chinese military. In addition, Huawei has also reportedly received extensive financial support from the Chinese government, including a \$30 billion line of credit from China Development Bank.

⁷⁰ The Senate report of its version of FINSAs (S.Rept. 110-80, S. 1610) noted that CNOOC's attempt to acquire UNOCAL "led many members of Congress to raise questions about the transfer of ownership or control of certain sectors of the U.S. economy to foreign companies, especially to foreign companies located within or controlled by countries the governments of which might not be sympathetic to U.S. regional security interests."

⁷¹ IBM and Lenovo reportedly agreed to address national security concerns by CFIUS. For example, it was agreed that 1,900 employees from a North Carolina research facility, which IBM had shared with other technology companies, would move to another building. See the *Financial Times*, "US State Department limits use of Chinese PCs," May 18, 2006.

⁷² U.S.-China Business Council, *China's WTO Compliance*, September 20, 2013.

Index, which measures statutory restrictions on foreign direct investment in 57 countries (including all OECD and G20 countries, and covering 22 sectors), ranked China's FDI regime as the most restrictive, based on foreign equity limitations, screening or approval mechanisms, restrictions on the employment of foreigners as key personnel, and operational restrictions (such as restrictions on branching, capital repatriation, and land ownership).⁷³

To a great extent, China's investment policies appear to be linked to industrial policies that seek to promote the development of sectors identified by the government as critical to future economic development. For example, since the early 1980s, the Chinese government has encouraged foreign auto companies to invest in China, but has limited FDI in that sector to 50-50 joint ventures with domestic Chinese partners.⁷⁴ In addition, the central government maintains a "Guideline Catalogue for Foreign Investment" (the latest revision was issued in January 2012), which lists FDI categories that are encouraged, restricted, or prohibited.⁷⁵ Many of the sectors under the "encouraged" category include high technology, green technology, and energy conservation, and pollution control.⁷⁶ Several of the sectors under the "restricted" category limit FDI to joint ventures (such as for rare earth smelting) or where the Chinese parties are the controlling shareholders (such as railway passenger transport companies). "Prohibited" sectors are those that fall under "national security" concerns (such as manufacturing of ammunition and weapons) or are categories where the government seeks to preserve state monopolies (such as postal companies) or protect Chinese firms from foreign competition (such as mining of rare earth elements).

The Chinese government also sets restrictions on FDI inflows during the investment screening process, or through its mergers and acquisition regulations, especially when seeking to protect pillar or strategic industries that the central government (as well as many provincial and local governments) seeks to promote. Many critics of China's investment policies contend that the Chinese government often requires foreign firms to transfer technology to their China partners, and sometimes to set up research and development facilities in China, in exchange for access to China's markets.⁷⁷ Foreign-invested firms in China face a number of challenges, including local protectionism, lack of regulatory transparency, IPR theft, and discriminatory license practices. A 2013 business survey by the American Chamber of Commerce in China (AmCham China) found that 35% of respondents stated that they were at a competitive disadvantage as a result of Chinese industrial policies that favored state-owned enterprises.⁷⁸ Some U.S. policymakers have suggested that Chinese investment in certain U.S. sectors should be restricted in response to Chinese policies that limit U.S. FDI in China in similar sectors.⁷⁹

⁷³ OECD, *FDI Regulatory Restrictiveness Index*, at <http://www.oecd.org/investment/fdiindex.htm>.

⁷⁴ The automotive industry was designated a "pillar industry" by the Chinese government in 1991.

⁷⁵ China also maintains a permitted category which represents a neutral position by the government that FDI in that area is neither encouraged nor discouraged. Prior to 2012, FDI in the manufacture of complete automobiles was listed as an encouraged category, but now is listed under the neutral category.

⁷⁶ One major function of the Guideline Catalogue for Foreign Investment is to promote FDI in sectors that the government has targeted for growth in its five-year macro-economic plans.

⁷⁷ USTR, *2011 Report to Congress on China's WTO Compliance*, December 2011, p. 7.

⁷⁸ AmCham China, *China Business Climate Survey*, 2013, p. 9.

⁷⁹ For example, in March 2011, Senators Casey, Schumer, Stabenow, and Whitehouse sent a letter to the Obama Administration urging that they oppose Chinese mining projects in the United States because of China's restrictive and anticompetitive policies on rare earth. The letter noted China's prohibition on foreign investment in rare earth mining and requirements that FDI in rare earth smelting and separation can only be in the form of a joint venture. See <http://www.casey.senate.gov/newsroom/press/release/print.cfm?id=81a1fa95-49d2-47a7-98b4-65973ae14ddc>.

At the Communist Party of China's third plenum meeting in November 2013, the government stated that it would reduce regulations on FDI in China and create a number of free trade zones that may open up certain sectors to foreign investment. Progress on this commitment has been slow to date.

Some recent surveys by U.S. business groups suggest that foreign firms in China may be less optimistic about the Chinese market than in the past, due in part to perceived growing protectionism. To illustrate:

- An October 2013 member survey by the U.S.-China Business Council (USCBC) of its members noted that, when it comes to the business climate in China, “fundamentally, there continues to be a significant difference in how foreign companies are treated, both formally and informally, versus their domestic Chinese counterparts. As one respondent noted, ‘As long as the term ‘foreign-invested company’ exists [in Chinese policies and regulations], the competition will not be very fair and the discrimination will exist in some way.’ In other words, there is an inherent element of bias in the system.”⁸⁰
- A September 2014 survey by AmCham China found that 60% of respondents felt that foreign business in China was less welcomed than before (compared to 41% in 2013).⁸¹ An Amcham China press release stated that, while there have been many encouraging promises of reform, “the environment for many foreign companies has nevertheless deteriorated.”⁸²

China's Anti-Monopoly Law and FDI

China passed an anti-monopoly law (AML) in 2007, which became effective in 2008. Article 1 of the law states: “this Law is enacted for the purpose of preventing and restraining monopolistic conducts, protecting fair competition in the market, enhancing economic efficiency, safeguarding the interests of consumers and social public interest, and promoting the healthy development of the socialist market economy.”⁸³ Reportedly, the next few years were spent establishing a regime to implement the law and develop regulations. Enforcement responsibilities were divided among three Chinese agencies: the Ministry of Commerce (MOFCOM), responsible for reviewing mergers; the National Development and Reform Commission (NDRC), responsible for reviewing monopoly activities, abuse of dominance, and abuse of administrative power involving pricing; and the State Administration for Industry and Commerce (SAIC), which oversees certain activities that are not price-related. An Anti-Monopoly Commission was established to coordinate

⁸⁰ USCBC, *2013 China Business Environment Survey Results: Tempered Optimism Continues amid Moderating Growth, Rising Costs, and Persistent Market Barriers*, October 10, 2013, p. 6.

⁸¹ The Wall Street Journal, *U.S. Firms Feel Unwelcome in China, According to Survey*, September 2, 2014.

⁸² Amcham China, *Press Release*, September 2, 2014.

⁸³ A 2005 article in China's *People's Daily*, a state-run newspaper, defined a socialist market economy as a “fundamental economic system in which the public ownership economy plays the leading role and co-exists and shares opportunities with the economy in various other ownerships.” See *People's Daily Online*, “China has socialist market economy in place,” July 13, 2005, at http://english.people.com.cn/200507/13/eng20050713_195876.html.

anti-monopoly policies among the three agencies.⁸⁴ U.S. government agencies provided technical assistance to Chinese anti-monopoly agencies starting in 2008.⁸⁵

Foreign business groups have become increasingly vocal regarding the increased enforcement of China's AML.⁸⁶ An August 2014 European Chamber of Commerce press release stated that it had "received numerous alarming anecdotal accounts from a number of sectors that administrative intimidation tactics are being used to impel companies to accept punishments and remedies without full hearings. Practices such as informing companies not to challenge the investigations, bring lawyers to hearings or involve their respective governments or chambers of commerce are contrary to best practices." It further stated that, while a number of Chinese companies had also been investigated for anti-competitive violations, questions were increasingly being raised over whether foreign firms were being disproportionately targeted in the investigations:

In some of the industries under investigation, domestic companies have not been targeted for similar violations. Furthermore, in some cases that involve joint ventures, it has only been the foreign partner that has been named as being a party to the investigations. A core tenet of a globalized economy is that all business operators, regardless of nationality, should be held accountable to the same criteria and be treated equally. Competition law should not be used as an administrative instrument to harm targeted companies or serve other aims, such as administratively forcing price reductions.⁸⁷

A September 2014 report by the USCBC reached a similar conclusion, stating that "China's increased level of competition enforcement activity and the high-profile reporting of competition investigations have prompted increasing attention, questions, and concerns among US companies." The USBC noted that a 2013 survey found that 86% of the companies surveyed indicated they are at least somewhat concerned about China's enforcement of its competition laws, and 56% stated it was a primary concern.⁸⁸ In addition, 21% reported they had undergone MOFCOM merger reviews, and 18% said they had experienced a competition-related investigation. The USCBC identified a number of challenges faced by foreign firms in response to China's competition enforcement policy, including obtaining fair treatment and nondiscrimination, lack of due process and regulatory transparency,⁸⁹ lengthy time periods for

⁸⁴ Office of the U.S. Trade Representative (USTR), *2012 Report to Congress on China's WTO Compliance*, December 2012, p. 1.

⁸⁵ According to the USTR, the U.S. officials urged China to implement its AML in a manner consistent with global best practices and with a focus on consumer welfare and the protection of the competitive process, rather than consideration of industrial policy or other noncompetition objectives; and to ensure that implementation of the law did not create new trade and investment barriers or result in less favorable treatment to foreign goods and services.

⁸⁶ China has reportedly investigated over 30 foreign firms for violating its AML, several of which are in the automotive (including auto and auto parts producers) and technology sectors. Examples of U.S. firms that have been subject to AML investigations include Microsoft, Qualcomm, InterDigital, and GM.

⁸⁷ The European Chamber in China, Press Release, "European Chamber releases statement on China AML-related investigations," August 13, 2014, available at http://www.europeanchamber.com.cn/en/press-releases/2132/european_chamber_releases_statement_on_china_aml_related_investigations.

⁸⁸ USCBC, *Competition Policy and Enforcement in China*, September 3, 2014, p. 11.

⁸⁹ This includes pressures on foreign firms to admit guilt and restrictions on the ability to have appropriate legal representation during raids and proceedings.

merger reviews, the role of noncompetitive factors in competition enforcement,⁹⁰ how remedies and fines are determined, and the broad definition of monopoly agreements.⁹¹

An analysis by the U.S. Chamber of Commerce of China's enforcement of its AML stated that while the law has been used to enhance the overall competitive environment, "in many cases involving foreign companies, China's anti-monopoly enforcement agencies (AMEAs) have skewed the implementation of the AML and related statutes to support China's industrial policy goals, including through discrimination and protectionism." It further stated that the AML appears to "promote industrial policy goals, even at the expense of competition—the very goal that other countries' competition laws are designed to enforce." In addition, the Chamber claimed that the NDRC had forced foreign firms to reduce prices, even when it appeared that such prices were the result of market forces rather than noncompetitive conduct.⁹²

During the July 2014, U.S.-China Strategic Economic Dialogue (S&ED), China pledged that economic efficiency, rather than the promotion of individual competitors or industries would be the focus of China's AML and that enforcement would be fair, objective, transparent, and nondiscriminatory.

The Chinese government on several occasions has denied that it is targeting foreign firms in its AML investigations, noting that action has been taken against a number of Chinese firms, including SOEs.⁹³ In September 2014, Chinese Premier Li Keqiang stated that foreign firms accounted for only 10% of recent anti-trust investigations.⁹⁴

On February 9, 2015, Qualcomm Incorporated announced that it had reached a resolution with China's NDRC over its determination that Qualcomm had violated China's AML. Qualcomm agreed to pay a \$975 million fine and to reduce license fees in China.

Negotiations for a Bilateral Investment Treaty

The United States and China have held negotiations on reaching a bilateral investment treaty (BIT) with the goal of expanding bilateral investment opportunities. U.S. negotiators hope such a treaty would improve the investment climate for U.S. firms in China by enhancing legal protections and dispute resolution procedures, and by obtaining a commitment from the Chinese government that it would treat U.S. investors no less favorably than Chinese investors.

In April 2012, the Obama Administration released a "Model Bilateral Investment Treaty" that was developed to enhance U.S. objectives in the negotiation of new BITs.⁹⁵ The new BIT model establishes mechanisms to promote greater transparency, labor and environment requirements,

⁹⁰ For example, Chinese regulators may consider how a foreign firm's activities may affect Chinese industrial policy goals, such as promoting indigenous innovation.

⁹¹ USCBC, *Competition Policy and Enforcement in China*, September 3, 2014, p. 1.

⁹² The U.S. Chamber of Commerce, *Competing Interests in China's Competition Law Enforcement: China's Anti-Monopoly Law and the Role of Industrial Policy*, September 9, 2014, p. 1.

⁹³ *China Daily*, "China not targeting foreign firms in probes," September 5, 2014, at http://usa.chinadaily.com.cn/business/2014-09/05/content_18554519.htm.

⁹⁴ *China Daily*, "Premier: China's anti-trust probes do not target foreign firms," September 10, 2014.

⁹⁵ The Administration began efforts to review and revise the U.S. BIT model in 2009. The previous BIT model dated to 2004. The Administration's review process likely meant that negotiations with China for a BIT were somewhat limited.

disciplines to prevent parties from imposing domestic technology requirements, and measures to boost the ability of investors to participate in the development of standards and technical regulations on a nondiscriminatory basis.

During the July 10-11, 2013, session of the S&ED, China indicated its intention to negotiate a high-standard BIT with the United States that would include all stages of investment and all sectors, a commitment U.S. official described as “a significant breakthrough, and the first time China has agreed to do so with another country.”⁹⁶ A press release by the Chinese Ministry of Commerce stated that China was willing to negotiate a BIT on the basis of nondiscrimination and a negative list, meaning the agreement would identify only those sectors not open to foreign investment on a nondiscriminatory basis (as opposed to a BIT with a positive list which would only list sectors open to foreign investment).

During the July 9-10, 2014, S&ED session, the two sides agreed to a broad timetable for reaching agreement on core issues and major articles of the treaty text and committed to initiate the “negative list” negotiation early in 2015.⁹⁷ The last round of U.S.-China BIT talks reportedly occurred on November 17, 2014, in Washington, DC.⁹⁸

At the 19th session of BIT negotiations held (June 8-12, 2015), each side submitted their first negative list proposals. At June 2015 S&ED session, China agreed to submit an improved negative list by early September 2015.

Major U.S.-China Trade Issues

China’s economic reforms and rapid economic growth, along with the effects of globalization, have caused the economies of the United States and China to become increasingly integrated.⁹⁹ Although growing U.S.-China economic ties are considered by most analysts to be mutually beneficial overall, tensions have risen over a number of Chinese economic and trade policies that many U.S. critics charge are protectionist, economically distortive, and damaging to U.S. economic interests. According to the USTR, most U.S. trade disputes with China stem from the consequences of its incomplete transition to a free market economy. Major areas of concern for U.S. stakeholders include China’s:

⁹⁶ U.S. Department of the Treasury, *Remarks of Treasury Secretary Jacob J. Lew at the Close of the Fifth U.S.-China Strategic and Economic Dialogue*, July 13, 2013.

⁹⁷ U.S. Department of the Treasury, *U.S.-China Joint Fact Sheet Sixth Meeting of the Strategic and Economic Dialogue*, July 11, 2014.

⁹⁸ Chinese Ministry of Commerce, *News Release*, November 19, 2014, at <http://english.mofcom.gov.cn/article/newsrelease/significantnews/201411/20141100806822.shtml>.

⁹⁹ The impact of globalization has been a somewhat controversial topic in the United States. Some argue that it has made it easier for U.S. firms to shift production overseas, resulting in lost jobs in the United States (especially in manufacturing) and lower wages for U.S. workers. Others contend that globalization has induced U.S. firms to become more efficient and to focus a greater share of their domestic manufacturing on higher-end or more technologically advanced production (while sourcing lower-end production abroad), making such firms more globally competitive. The result has been that the United States continues to be a major global manufacturer in terms of value-added, but there are fewer U.S. workers in manufacturing.

- Extensive network of industrial policies that seek to promote and protect domestic sectors and firms, especially SOEs, deemed by the government to be critical to the country's future economic growth;
- Targeting foreign firms with anti-competitive investigations in order to limit foreign market share of various industries in China;
- Failure to provide adequate protection of U.S. intellectual property rights (IPR) and (alleged) government-directed cybersecurity attacks against U.S. firms;
- Mixed record on implementing its obligations in the World Trade Organization (WTO) and its failure to date to join the WTO's Government Procurement Agreement (GPA); and
- Intervention in currency markets to limit the appreciation of the renminbi (RMB) against the dollar (and other major currencies) in order to make China's exports more globally competitive.

Chinese "State Capitalism"

Currently, a significant share of China's economy is thought to be driven by market forces. According to a 2010 WTO report, the private sector now accounts for more than 60% of China's gross domestic product (GDP).¹⁰⁰ However, the Chinese government continues to play a major role in economic decision-making. For example, at the macroeconomic level, the Chinese government maintains policies that induce households to save a high level of their income, much of which is deposited in state-controlled Chinese banks. This enables the government to provide low-cost financing to Chinese firms, especially SOEs. At the microeconomic level, the Chinese government (at the central and local government level) seeks to promote the development of industries that are deemed critical to the country's future economic development by using various policies, such as subsidies, tax breaks, preferential loans, trade barriers, FDI restrictions, discriminatory regulations and standards, export restrictions on raw materials (such as rare earths), technology transfer requirements imposed on foreign firms, public procurement rules that give preferences to domestic firms, and weak enforcement of IPR laws.

Many analysts contend that the Chinese government's intervention in various sectors through industrial policies has intensified in recent years. The December 2013 U.S. Trade Representative's (USTR's) report on China's WTO trade compliance states:

During most of the past decade, the Chinese government emphasized the state's role in the economy, diverging from the path of economic reform that had driven China's accession to the WTO. With the state leading China's economic development, the Chinese government pursued new and more expansive industrial policies, often designed to limit market access for imported goods, foreign manufacturers and foreign service suppliers, while offering substantial government guidance, resources and regulatory support to Chinese industries, particularly ones dominated by state-owned enterprises. This heavy state role in the economy, reinforced by unchecked discretionary actions of Chinese government regulators,

¹⁰⁰ World Trade Organization, *Trade Policy Review Body, Trade Policy Review, Report by the Secretariat, China*, Revision, 2010, Part 2, p. 1.

generated serious trade frictions with China's many trade partners, including the United States.¹⁰¹

The extent of SOE involvement in the Chinese economy is difficult to measure due to the opaque nature of the corporate sector in China and the relative lack of transparency regarding the relationship between state actors (including those at the central and noncentral government levels) and Chinese firms. According to one study by the U.S.-China Economic and Security Review Commission:

The state sector in China consists of three main components. First, there are enterprises fully owned by the state through the State-owned Assets and Supervision and Administration Commission (SASAC) of the State Council and by SASACs of provincial, municipal, and county governments. Second, there are SOEs that are majority owners of enterprises that are not officially considered SOEs but are effectively controlled by their SOE owners. Finally, there is a group of entities, owned and controlled indirectly through SOE subsidiaries based inside and outside of China. The actual size of this third group is unknown. Urban collective enterprises and government-owned township and village enterprises (TVEs) also belong to the state sector but are not considered SOEs. The state-owned and controlled portion of the Chinese economy is large. Based on reasonable assumptions, it appears that the visible state sector—SOEs and entities directly controlled by SOEs, accounted for more than 40 percent of China's nonagricultural GDP. If the contributions of indirectly controlled entities, urban collectives, and public TVEs are considered, the share of GDP owned and controlled by the state is approximately 50 percent.¹⁰²

According to the Chinese government, at the end of 2011, there were 144,700 state-owned or state-controlled enterprises, excluding financial institutions, with total assets worth \$13.6 trillion.¹⁰³ Chinese SOEs have undergone significant restructuring over the years. More than 90% of SOEs have reportedly become corporations or shareholding companies.¹⁰⁴ The Chinese government has identified a number of industries where the state should have full control or where the state should dominate. These include autos, aviation, banking, coal, construction, environmental technology, information technology, insurance, media, metals (such as steel), oil and gas, power, railways, shipping, telecommunications, and tobacco.¹⁰⁵

Many SOEs are owned or controlled by local governments. According to one analyst:

The typical large industrial Chinese company is ...wholly or majority-owned by a local government which appoints senior management and provides free or low-cost land and utilities, tax breaks, and where possible, guarantees that locally made products will be favored by local governments, consumers, and other businesses. In return, the enterprise provides the local state with a source of jobs for local workers, tax revenues, and dividends.¹⁰⁶

¹⁰¹ U.S. Trade Representative, *2013 USTR Report to Congress on China's WTO Compliance*, December 2013, p. 2.

¹⁰² U.S.-China Economic and Security Review Commission, *An Analysis of State-owned Enterprises and State Capitalism in China*, by Andrew Szamoszegi and Cole Kyle, October 26, 2011, p. 1.

¹⁰³ *Xinhua Agency*, October 24, 2012.

¹⁰⁴ *Xinhua News Agency*, October 24, 2010.

¹⁰⁵ Testimony for the U.S.-China Economic and Security Review Commission by Derek Scissors, Ph.D., *Chinese State Owned Enterprises and the US Policy on China*, February 12, 2012.

¹⁰⁶ Anderson, G.E., Ph.D., *Designated Drivers, How China Plans to Dominate the Global Auto Industry*, 2012, p. 2.

China's banking system is largely dominated by state-owned or state-controlled banks. In 2011, the top five largest banks in China, all of which were shareholding companies with significant state ownership, accounted for 57.5% of Chinese banking assets. The Chinese government also has four banks that are 100% state-owned and holds shares in a number of joint stock commercial banks.¹⁰⁷ SOEs are believed to receive preferential credit treatment by government banks, while private firms must often pay higher interest rates or obtain credit elsewhere. According to one estimate, SOEs accounted for 85% (\$1.4 trillion) of all bank loans in 2009.¹⁰⁸

Not only are SOEs dominant players in China's economy, many are becoming quite large by global standards. In 2013, 84 Chinese companies (excluding Hong Kong firms) made *Fortune Magazine's Global 500* list of the world's largest firms based on revenues. Of the 84 Chinese companies listed, 77 firms or 88.1% were state-owned or state-controlled enterprises (defined as where the state owned 50% of the company). Of the 10 non-SOE companies listed, at least 3 are partially owned by the government. For example, the government owns 26.5% of the Bank of Communications, 15.7% of China Minsheng Banking Corp., and 20% of Shanghai Pudong Development Bank.¹⁰⁹ Another company, Huawei (a major telecommunications company) describes itself as an employee-owned firm. However, many U.S. analysts contend that Huawei has strong links with the Chinese government, including the Chinese People's Liberation Army (PLA), and has not published a full breakdown of its ownership structure. In addition, in the past, the Chinese government reportedly ordered state banks to extend loans to the company early in its development so that it could compete against foreign firms in the domestic telecommunications market.¹¹⁰

China's Plan to Modernize the Economy and Promote Indigenous Innovation

Many of the industrial policies that China has implemented or formulated since 2006 appear to stem largely from a comprehensive document issued by China's State Council (the highest executive organ of state power) in 2006 titled the *National Medium-and Long-Term Program for Science and Technology Development (2006-2020)*, often referred to as the MLP. The MLP appears to represent an ambitious plan to modernize the structure of China's economy by transforming it from a global center of low-tech manufacturing to a major center of innovation (by the year 2020) and a global innovation leader by 2050.¹¹¹ It also seeks to sharply reduce the country's dependence on foreign technology. The MLP includes the stated goals of "indigenous innovation, leapfrogging in priority fields, enabling development, and leading the future."¹¹² Some of the broad goals of the MLP state that by 2020:

¹⁰⁷ Lund University, *Lending for Growth? An Analysis of State-Owned Banks in China*, by Fredrik N.G. Anderson, Katarzyna Burzynska, and Sonja Oppen, June 2013, p. 41.

¹⁰⁸ The Economist, *State Capitalism's Global Reach, New Masters of the Universe, How State Enterprise is Spreading*, January 21, 2012.

¹⁰⁹ Lund University, *Lending for Growth? An Analysis of State-Owned Banks in China*, by Fredrik N.G. Anderson, Katarzyna Burzynska, and Sonja Oppen, June 2013, p. 41.

¹¹⁰ McGregor, Richard, *The Party, the Secret World of China's Communist Rulers*, 2010, p. 204.

¹¹¹ As some observers describe it, China wants to go from a model of "made in China" to "innovated in China."

¹¹² The MLP identifies main areas and priority topics, including energy, water and mineral resources, the environment, agriculture, manufacturing, communications and transport, information industry and modern service industries, population and health, urbanization and urban development, public security, and national defense. The report also identifies 16 major special projects and 8 "pioneer technologies."

- The progress of science and technology will contribute 60% or above to China's development.
- The country's reliance on foreign technology will decline to 30% or below (from an estimated current level of 50%).
- Gross expenditures for research and development (R&D) would rise to 2.5% of gross domestic product (from 1.3% in 2005). Priority areas for increased R&D include space programs, aerospace development and manufacturing, renewable energy, computer science, and life sciences.¹¹³

The document states that “China must place the strengthening of indigenous innovative capability at the core of economic restructuring, growth model change, and national competitiveness enhancement. Building an innovation-oriented country is therefore a major strategic choice for China's future development.” This goal, according to the document, is to be achieved by formulating and implementing regulations in the country's government procurement law to “encourage and protect indigenous innovation,” establishing a coordination mechanism for government procurement of indigenous innovative products, requiring a first-buy policy for major domestically made high-tech equipment and products that possess proprietary intellectual property rights, providing policy support to enterprises in procuring domestic high-tech equipment, and developing “relevant technology standards” through government procurement.

Reaction by U.S. Stakeholders

Beginning in 2009, several U.S. companies began to raise concerns over a number of Chinese government circulars that would establish an “Indigenous Innovation Product Accreditation” system. For example, in November 2009, the Chinese government released a “Circular on Launching the 2009 National Indigenous Innovation Product Accreditation Work,” requiring companies to file applications by December 2009 for their products to be considered for accreditation as “indigenous innovation products.” Similar proposed circulars were issued at the provincial and local government levels as well. U.S. business representatives expressed deep concern over the circulars, arguing that they were protectionist in nature because they extended preferential treatment for Chinese government procurement to domestic Chinese firms that developed and owned intellectual property (IP) and thus largely excluded foreign firms.¹¹⁴ AmCham China described China's attempt to link IP ownership with market access as “unprecedented worldwide.”¹¹⁵ A letter written by the U.S. Chamber of Commerce and 33 business associations to the Chinese government on December 10, 2009, stated that the indigenous innovations circulars would “make it virtually impossible for any non-Chinese companies to participate in China's government procurement market—even those that have made substantial and long-term investments in China, employ Chinese citizens, and pay taxes to the Chinese government.”¹¹⁶ Such groups contend that a large share of their technology is developed

¹¹³ *R&D Magazine*, December 22, 2009.

¹¹⁴ U.S. business representatives also claim that the Chinese government is using tax incentives, standards setting and requirements, security regulations, subsidies, technology transfer requirements, and other measures to promote the goals of indigenous innovation.

¹¹⁵ AmCham China, *2011 White Paper*, April 26, 2011, p. 66.

¹¹⁶ A copy of the letter can be found at <http://online.wsj.com/public/resources/documents/chinaprocmntletter1210.pdf>.

globally and thus it would be difficult to attribute the share of technology developed in China needed to obtain accreditation.¹¹⁷

A 2011 AmCham China survey found that 40% of respondents believed that China's indigenous innovation policies would hurt their businesses and 26% said their businesses were already being hurt by such policies. At a November 2011 WTO review of China's IPR policies, the U.S. WTO representative stated that China's policies of adopting indigenous innovation had "created a troubling trend toward increased discriminatory policies which were aimed at coercing technology transfer." He stated that "Chinese regulations, rules and other regulatory measures frequently called for technology transfer, and in certain cases, conditioned, or proposed to condition, the eligibility for government benefits or preferences on intellectual property being owned or developed in China, or being licensed, in some cases exclusively, to a Chinese party."¹¹⁸

China's Response to U.S. Concerns

The Chinese government responded to U.S. concerns over its indigenous innovation policies by arguing that they did not discriminate against foreign firms or violate global trade rules.¹¹⁹ However, during the visit of (then) Chinese President Hu Jintao to the United States in January 2011, the Chinese government stated that it would not link its innovation policies to the provision of government procurement preferences.¹²⁰ During the May 2011 session of the U.S.-China Strategic and Economic Dialogue (S&ED), China pledged that it would eliminate all of its indigenous innovation products catalogs.¹²¹ During the November 2011 talks held under the U.S.-China Joint Commission on Commerce and Trade (JCCT), the Chinese government announced that the State Council had issued a measure requiring governments of provinces, municipalities, and autonomous regions to eliminate by December 1, 2011, any catalogues or other measures linking innovation policies to government procurement preferences.¹²² This occurred after foreign business groups raised concerns that discriminatory indigenous innovation policies might continue to be implemented at the local level even after Hu Jintao's commitment. For example, The U.S.-China Business Council (USCBC) reported in February 2011 that it had identified 22 municipal and provincial governments that had issued at least 61 indigenous innovation catalogues. U.S. business representatives sought to ensure that Beijing's pledge on indigenous innovation would apply at all levels of government in China.

In May 2013, the USCBC reported that, although the central government had largely been successful in ensuring that sub-national governments complied with Hu Jintao's January 2011

¹¹⁷ Some U.S. business representatives argue that one of the main goals of China's indigenous innovation regulations is to induce foreign firms to boost their R&D activities in China in order to qualify for government contracts.

¹¹⁸ Transitional Review Under Section 18 of the Protocol on the Accession of the People's Republic of China, Report to the General Council by the Chair, November 17, 2011, p. 4.

¹¹⁹ Wall Street Journal, *China Defends Rule On 'Indigenous' Tech*, December 15, 2009.

¹²⁰ The White House, *U.S. - China Joint Statement*, January 19, 2011.

¹²¹ According to a U.S. fact sheet on the meeting "China pledged to eliminate all of its government procurement indigenous innovation products catalogs and revise Article 9 of the draft Government Procurement Law Implementing Regulations (which have preferences in government procurement to national indigenous innovation products), in fulfillment of President Hu's January 2011 commitment not to link Chinese innovation policies to government procurement preferences. See U.S. Department of the Treasury, *The 2011 U.S.-China Strategic and Economic Dialogue U.S. Fact Sheet – Economic Track*, May 10, 2011.

¹²² U.S. Department of Commerce, *22nd U.S.-China Joint Commission on Commerce and Trade Fact Sheet*, November 21, 2011.

commitments, 13 provinces had not yet issued any measures to comply.¹²³ In addition, an October 2012 USCBC survey found that 85% of respondents said they had seen little impact on their businesses resulting from China's commitments delinking indigenous innovation with government procurement.¹²⁴

Remaining U.S. Concerns

While many U.S. business leaders have applauded China's pledge to delink indigenous innovation from government procurement, some remain wary that China will implement new policies that attempt to provide preferences to local Chinese firms over foreign firms. According to Adam Segal with the Council on Foreign Relations: "Even if China reverses certain policies under U.S. pressure, it will remain dedicated to those goals. U.S. policy is likely to become a game of Whac-a-Mole, beating down one Chinese initiative on indigenous innovation only to see another pop up."¹²⁵ U.S. business groups are also concerned with how the MLP blueprint will affect China's commitment to enforcing foreign IPR. They note, for example, that the MLP states: "Indigenous innovation refers to enhancing original innovation, integrated innovation, and re-innovation based on assimilation and absorption of imported technology, in order to improve our national innovation capability." To some, this seems to indicate that China intends to take existing technology, make some changes and improvements on it, and then claim it as its own without acknowledging or compensating the original IPR holders. A 2011 report by the U.S. Chamber of Commerce stated that China's indigenous innovation policies led many international technology companies to conclude that the MLP is a "blueprint for technology theft on a scale the world has never seen before."¹²⁶

U.S. officials have attempted to convince Beijing that, while its desire to increase innovation in China is a commendable goal, its efforts to limit the participation of foreign firms in such efforts, or attempting to condition market access in China to the development of IPR by foreign firms in China will hinder, not promote, the advancement of innovation in China. The direction China takes on this issue could have a significant impact on U.S. economic interests as noted by a study by the U.S. International Trade Commission (USITC):

To the extent that China's policies succeed in accelerating technological progress, productivity, and innovation in the Chinese economy, they could provide spillover benefits for other countries. But if indigenous innovation policies act as a form of technological import substitution, systematically favoring Chinese domestic firms over foreign firms in relevant industries, they would be expected to have a negative effect on foreign firms and economies roughly analogous to what would occur if China simply imposed a protective

¹²³ U.S.-China Business Council, *Status Report: China's Innovation and Government Procurement Policies*, May 1, 2013, at <https://www.uschina.org/files/public/documents/2013/05/innovation-status-report.pdf>.

¹²⁴ U.S.-China Business Council, USCBC 2012 China Business Environment Survey Results: Continued Growth and Profitability; Tempered Optimism Due to Rising Costs, Competition, and Market Barriers, October 2012, p. 6, available at <https://www.uschina.org/info/members-survey/2012/pdfs/uscbc-2012-member-survey-results.pdf>.

¹²⁵ Foreign Affairs, *China's Innovation Wall: Beijing's Push for Homegrown Technology*, September 28, 2010.

¹²⁶ U.S. Chamber of Commerce, *China's Drive for 'Indigenous Innovation' - A Web of Industrial Policies*, February 2011, p. 4.

tariff on imports of goods in the relevant sectors or levied a discriminatory excise tax on the sales of FIEs in the Chinese market.¹²⁷

Intellectual Property Rights (IPR) Issues

U.S. business and government representatives have voiced growing concern over economic losses suffered by U.S. firms as a result of IPR infringement in China (and elsewhere), including those that have resulted from cyberattacks. U.S. innovation and the intellectual property that is generated by such activities have been cited by various economists as a critical source of U.S. economic growth and global competitiveness.¹²⁸ For example, according to the Department of Commerce, in 2010, U.S. IP-intensive industries supported at least 40 million jobs and contributed \$5.1 trillion (or 34.8%) to U.S. gross domestic product (GDP).¹²⁹ A study by NDP Consulting estimated that in 2008, workers in IP-intensive production earned 60% more than workers at similar levels in non-IP industries.¹³⁰ A study on the Apple iPod concluded that Apple's innovation in developing and engineering the iPod and its ability to source most of its production to low-cost countries, such as China, have helped enable it to become a highly competitive and profitable firm as well as a creator of high-paying jobs (such as engineers engaged in the design of Apple products) in the United States.¹³¹

Lack of effective and consistent protection of IPR has been cited by U.S. firms as one of the most significant problems they face in doing business in China. Other U.S. firms have expressed concern over pressures they often face from Chinese government entities to share technology and IPR with a Chinese partner. Although China has significantly improved its IPR protection regime over the past few years, U.S. IP industries complain that piracy rates in China continue to remain unacceptably high and economic losses are significant, as illustrated by studies and estimates made by several stakeholders:

- A May 2013 study by the Commission on the Theft of American Intellectual Property estimated the annual cost to the U.S. economy of global IPR theft at \$300 billion, of which China accounted for 50% (\$150 billion) to 80% (\$240 billion) of those losses.¹³²
- A 2013 AmCham China survey found that 72% of respondents said that China's IPR enforcement was either ineffective or totally ineffective.¹³³

¹²⁷ USITC, China: Intellectual Property Infringement, Indigenous Innovation Policies, and Frameworks for Measuring the Effects on the U.S. Economy (Investigation No. 332-514, USITC Publication 4199, November 2010, pp. 6-7.

¹²⁸ See CRS Report RL34292, *Intellectual Property Rights and International Trade*, by Shayerah Ilias Akhtar and Ian F. Fergusson.

¹²⁹ U.S. Department of Commerce, *Intellectual Property and the U.S. Economy: Industries in Focus*, March 2012, available at <http://www.esa.doc.gov/sites/default/files/reports/documents/ipandtheuseconomyindustriesinfocus.pdf>.

¹³⁰ Nam Pham, *The Impact of Innovation and the Role of Intellectual Property Rights on U.S. Productivity, Competitiveness, Jobs, Wages and Exports*, 2010, NDP Consulting.

¹³¹ Communications of the ACM, *Who Captures Value in a Global Innovation Network? The Case of Apple's iPod*, March 2009.

¹³² The Commission on the Theft of American Intellectual Property, *the Report of the Commission on the Theft of Intellectual Property*, May 2013.

¹³³ AmCham China, *China Business Climate Survey Report*, 2013, p. 11.

- The USITC estimated that U.S. intellectual property-intensive firms that conducted business in China lost \$48.2 billion in sales, royalties, and license fees in 2009 because of IPR violations there. It also estimated that an effective IPR enforcement regime in China that was comparable to U.S. levels could increase employment by IP-intensive firms in the United States by 923,000 jobs.¹³⁴
- The Business Software Alliance (BSA) estimated the commercial value of illegally used software in China at \$8.9 billion in 2011 (up from \$6.7 billion in 2007) and that the software piracy rate in China was 77% (down from 82% in 2007).¹³⁵ BSA further estimated that legitimate software sales in China were only \$2.7 billion, compared to legal sales of \$41.7 billion in the United States.
- The U.S. Customs and Border Protection reported that China accounted for 72% of pirated goods seized by the agency in FY2012 (based on domestic value). The value of seized goods originating from China and Hong Kong was \$1.1 billion.¹³⁶ Handbags and wallets accounted for nearly half the estimated value of seized goods originating in China.

Chinese officials contend that they have significantly improved their IPR protection regime, but argue that the country lacks the resources and a sophisticated legal system to effectively deal with IPR violations. They also contend that IPR infringement is a serious problem for domestic Chinese firms as well. However, some analysts contend that China's relatively poor record on IPR enforcement can be partially explained by the fact that Chinese leaders want to make China a major producer of capital-intensive and high-technology products, and thus, they are tolerant of IPR piracy if it helps Chinese firms become more technologically advanced. According to an official at the U.S. Chamber of Commerce:

The newer and emerging challenge to U.S. IPR is not a function of China's lack of political will to crackdown on infringers. Rather, it is a manifestation of a coherent, and government-directed, or at least government-motivated, strategy to lessen China's perceived reliance on foreign innovations and IP. China is actively working to create a legal environment that enables it to intervene in the market for IP, help its own companies to "re-innovate" competing IPR as a substitute to American and other foreign technologies, and potentially misappropriate U.S. and other foreign IP as components of its industrial policies and internal market regulation.... The common themes throughout these policies are: 1) undermine and displace foreign IP; 2) leverage China's large domestic market to develop national champions and promote its own IP, displacing foreign competitors in China; and 3) building on China's domestic successes by displacing competitors in foreign markets.¹³⁷

An illustration of alleged IPR theft in China involves American Superconductor Corporation (AMSC). On September 14, 2011, AMSC announced that it was filing criminal and civil

¹³⁴ The United States International Trade Commission, *China: Effects of Intellectual Property Infringement and Indigenous Innovation Policies on the U.S. Economy*, USITC Publication 4226, May 2011, p. xiv.

¹³⁵ BSA, *Shadow Market, 2011 BSA Global Software Piracy Study, Ninth Edition*, May 2012, at http://portal.bsa.org/globalpiracy2011/downloads/study_pdf/2011_BSA_Piracy_Study-Standard.pdf.

¹³⁶ U.S. Customs and Border Protection, *Intellectual Property Rights, Fiscal Year 2012 Seizure Statistics*, February 2013, available at http://www.cbp.gov/linkhandler/cgov/trade/priority_trade/ipr/ipr_communications/seizure/fy2012_final_stats.ctt/fy2012_final_stats.pdf.

¹³⁷ Testimony of Jeremie Waterman, Senior Director, Greater China, U.S. Chamber of Commerce, before the U.S. International Trade Commission, *Hearing on China: Intellectual Property Infringement, Indigenous Innovation Policies, and Frameworks for Measuring the Effects on the U.S. Economy*, June 15, 2010.

complaints in China against Sinovel Wind Group Co. Ltd. (Sinovel), China's largest wind turbine producer, and other parties, alleging the illegal use of AMSC's intellectual property. According to an AMSC press release, Sinovel illegally obtained and used AMSC's wind turbine control software code to upgrade its 1.5 megawatt wind turbines in the field to meet proposed Chinese grid codes and to potentially allow for the use of core electrical components from other manufacturers.¹³⁸ In addition, AMSC claimed that Sinovel had refused to pay for past shipments from AMSC and was now refusing to honor contracts for future shipments of components and spare parts as well.¹³⁹ AMSC has brought several civil cases against Sinovel, seeking to recover more than \$1.2 billion for contracted shipments and damages caused by Sinovel's contract breaches.¹⁴⁰

According to a specialist in intellectual property at Tufts University, "Chinese companies, once they acquire the needed technology, will often abandon their Western partners on the pretext the technology or product failed to meet Chinese governmental regulations. This is yet another example of a Chinese industrial policy aimed at procuring, by virtually any means, technology in order to provide Chinese domestic industries with a competitive advantage."¹⁴¹

Market access in China remains a significant problem for many U.S. IP industries (such as music and films) and is considered to be a significant cause of high IPR piracy rates. For example, until recently, China limited imports of foreign films to 20 per year. During the visit to the United States by then-Chinese Vice President Xi Jinping (February 13-17, 2012), China agreed that it would allow more American exports to China of 3D, IMAX, and similar enhanced format movies on favorable commercial terms; strengthen the opportunities to distribute films through private enterprises rather than the state film monopoly; and ensure fairer compensation levels for U.S. blockbuster films distributed by Chinese SOEs.¹⁴²

The USTR's 2014 Special 301 report stated that China had made comprehensive improvements to its trade laws and regulations, and that some IPR stakeholders reported positive results from China's judicial system. However, IPR infringement remains a significant problem for all forms of IPR in China, including patents, copyrights, trademarks, trade secrets, and technical data.¹⁴³ As a result, sales of U.S. IPR-intensive goods and services in China remain disproportionately low relative to other countries.¹⁴⁴ The USTR stated that commercial trade secret theft against U.S. firms by Chinese entities, both in and outside China in order to commercially benefit Chinese firms, remain a significant U.S. concern (discussed in more detail below).

¹³⁸ AMSC claims Sinovel had obtained the intellectual property from a former AMSC employee who was now under arrest in Austria for economic espionage and fraudulent manipulation of data.

¹³⁹ AMSC Press Release, "AMSC Filing Criminal and Civil Complaints Against Sinovel," September 14, 2011.

¹⁴⁰ AMSC, Press Release, April 10, 2012, at http://files.shareholder.com/downloads/AMSC/2346100399x0x558743/f01e0c5a-a526-4102-a818-f61f2d71ef79/AMSC_News_2012_4_10_Commercial.pdf.

¹⁴¹ "Data Theft Case May Test U.S. China Ties," *Boston Globe*, September 19, 2011.

¹⁴² The White House, *Press Release*, February 17, 2012, at <http://www.whitehouse.gov/the-press-office/2012/02/17/united-states-achieves-breakthrough-movies-dispute-china>.

¹⁴³ USTR, *2014 Special 301 Report*, April 2014, p. 30, available at <http://www.ustr.gov/sites/default/files/USTR%202014%20Special%20301%20Report%20to%20Congress%20FINAL.pdf>.

¹⁴⁴ The International Intellectual Property Alliance (IIPA), which represents U.S. IPR-related firms, has noted that, despite some improvements in 2013, "the market in China for music, software, publications, films, and video games remains stunted by a combination of piracy and stifling market access and discriminatory barriers. See IIPA, *2014 Special 301 Report on Copyright Protection and Enforcement*, February 7, 2014, p. 1.

Technology Transfer Issues

When China entered the WTO in 2001, it agreed that foreign firms would not be pressured by government entities to transfer technology to a Chinese partner as part of the cost of doing business in China. However, many U.S. firms argue that this is a common Chinese practice, although this is difficult to quantify because, oftentimes, U.S. business representatives appear to try to avoid negative publicity regarding the difficulties they encounter doing business in China out of concern over retaliation by the Chinese government.¹⁴⁵ In addition, Chinese officials reportedly pressure foreign firms through oral communications to transfer technology (for example as a condition to invest in China), avoiding putting such requirements in writing in order to evade being accused of violating WTO rules.

In 2011, then-U.S. Treasury Secretary Timothy Geithner charged that “we're seeing China continue to be very, very aggressive in a strategy they started several decades ago, which goes like this: you want to sell to our country, we want you to come produce here. If you want to come produce here, you need to transfer your technology to us.” A 2012 AmCham China survey reported that 33% of its respondents stated that technology transfer requirements were negatively affecting their businesses.¹⁴⁶ A 2010 study by the U.S. Chamber of Commerce stated that growing pressure on foreign firms to share technology in exchange for market access in China was forcing such firms to “anguish over balancing today’s profits with tomorrow’s survival.”¹⁴⁷

However, a 2011 survey by the USCBC found that technology transfer requirements by Chinese entities (both government and private) did not rank among the top 10 challenges faced by the Council’s members in 2010. Among U.S. firms where technology was an issue, when asked if their company had been asked to transfer technology to China over the past three years, 18% answered yes. Among the respondents that had been asked to transfer technology, 20% said the pressure came from a government entity, while 80% said that it came from a Chinese company.¹⁴⁸ Of the respondents who said they were asked to transfer technology, 40% stated that they found the requests acceptable, 30% refused the requests, 15% negotiated to mitigate the amount of technology transfer, and 10% said they had to transfer the technology requested in order to gain access to the Chinese market. As noted by the USCBC:

The PRC [People’s Republic of China] certainly has a long-term strategy to bring in foreign technology. But technology is not simply “given to China.” Instead, technology is typically licensed to a China-based entity in which the foreign company has an ownership stake. In many cases the foreign company owns 100 percent of the entity in China; in some cases, the foreign company must form a joint venture with a Chinese partner. In exchange, the company determines a value of the technology to be transferred and negotiates a payment—the technology is rarely “given” for free.¹⁴⁹

¹⁴⁵ China denies that public officials exert such pressure and that any technology transfers that do occur in China are the result of commercial agreements between companies.

¹⁴⁶ AmCham China, *2012 China Business Climate Survey Report*, March 2012, available at <http://www.amchamchina.org/businessclimate2012>.

¹⁴⁷ U.S. Chamber of Commerce, *China’s Drive for ‘Indigenous Innovation’ - A Web of Industrial Policies*, July 29, 2010.

¹⁴⁸ However, the Council notes that since the Chinese government maintains approval authority for investment decisions, which may be used by Chinese firms as leverage when attempting to negotiate technology transfer agreements with U.S. firms.

¹⁴⁹ U.S.-China Business Council, *USCBC 2011 China Business Environment Survey Results: Market Growth* (continued...)

Press reports indicate that the USTR's office is currently seeking information from U.S. manufacturers on examples of efforts by the Chinese government to force the transfer of technology from U.S. companies operating in China. This issue was discussed during President Obama's meeting with then-Chinese Vice President Xi Jinping on February 14, 2012.¹⁵⁰ A White House Factsheet of the meeting stated: "China reiterates that technology transfer and technological cooperation shall be decided by businesses independently and will not be used by the Chinese government as a pre-condition for market access."

In the 112th Congress, S. 2063 (Webb) would have prohibited the transfer by a U.S. commercial entity of any proprietary technology or intellectual property that was researched, developed, or commercialized using a contract, grant, loan, loan guarantee, or other financial assistance provided or awarded by the U.S. government to certain foreign entities (such as those that are owned or controlled by a foreign government) unless the Secretary of Commerce determined (and issued a waiver) that the transfer would not compromise the U.S. economic interests or competitiveness.

Cyber Security Issues

Cyberattacks against U.S. firms have raised concerns over the potential large-scale theft of U.S. IPR and its economic implications for the United States. A 2011 report by McAfee (a U.S. global security technology company) stated that its investigation had identified targeted intrusions into more than 70 global companies and warned that "every conceivable industry with significant size and valuable intellectual property has been compromised (or will be shortly), with the great majority of the victims rarely discovering the intrusion or its impact."¹⁵¹ Many U.S. analysts and policymakers contend that the Chinese government is a major source of cybereconomic espionage against U.S. firms. For example, Representative Mike Rogers, chairman of the House Permanent Select Committee on Intelligence, stated at an October 4, 2011, hearing that

Attributing this espionage isn't easy, but talk to any private sector cyber analyst, and they will tell you there is little doubt that this is a massive campaign being conducted by the Chinese government. I don't believe that there is a precedent in history for such a massive and sustained intelligence effort by a government to blatantly steal commercial data and intellectual property. China's economic espionage has reached an intolerable level and I believe that the United States and our allies in Europe and Asia have an obligation to confront Beijing and demand that they put a stop to this piracy.¹⁵²

A 2011 report by the U.S. Office of the Director of National Intelligence (DNI) stated: "Chinese actors are the world's most active and persistent perpetrators of economic espionage. U.S. private sector firms and cyber security specialists have reported an onslaught of computer network intrusions that have originated in China, but the IC (Intelligence Community) cannot confirm who was responsible." The report goes on to warn that

(...continued)

Continues, Companies Expand, But Full Access Elusive for Many, November 2011, p. 20.

¹⁵⁰ Inside Trade, *USTR Seeks Info From Manufacturers On Forced Technology Transfer To China*, January 31, 2012.

¹⁵¹ The report did not identify China (or any country) as the source of the intrusions. McAfee, *Revealed: Operation Shady Rat, An Investigation of Targeted Intrusions Into More Than 70 Global Companies, Governments, and Nonprofit Organizations During the Last Five Years*, 2011.

¹⁵² House Permanent Select Committee on Intelligence, *Chairman Mike Rogers Opening Statement at the Hearing on Cyber Threats and Ongoing Efforts to Protect the Nation*, October 4, 2011.

China will continue to be driven by its longstanding policy of “catching up fast and surpassing” Western powers. The growing interrelationships between Chinese and U.S. companies—such as the employment of Chinese-national technical experts at U.S. facilities and the off-shoring of U.S. production and R&D to facilities in China—will offer Chinese government agencies and businesses increasing opportunities to collect sensitive US economic information.¹⁵³

On February 19, 2013, Mandiant, a U.S. information security company, issued a report documenting extensive economic cyber espionage by a Chinese unit (which it designated as APT1) with alleged links to the Chinese People’s Liberation Army (PLA) against 141 firms, covering 20 industries, since 2006. The report stated:

Our analysis has led us to conclude that APT1 is likely government-sponsored and one of the most persistent of China’s cyber threat actors. We believe that APT1 is able to wage such a long-running and extensive cyber espionage campaign in large part because it receives direct government support. In seeking to identify the organization behind this activity, our research found that People’s Liberation Army (PLA’s) Unit 61398 is similar to APT1 in its mission, capabilities, and resources. PLA Unit 61398 is also located in precisely the same area from which APT1 activity appears to originate.¹⁵⁴

On March 11, 2013, Tom Donilon, National Security Advisor to President Obama, stated in a speech that the United States and China should engage in a constructive dialogue to establish acceptable norms of behavior in cyberspace; that China should recognize the urgency and scope of the problem and the risks it poses to U.S. trade relations and the reputation to Chinese industry; and that China should take serious steps to investigate and stop cyber espionage.¹⁵⁵ Following a meeting with Chinese President Xi Jinping in June 2013, President Obama warned that if cybersecurity issues are not addressed and if there continues to be direct theft of United States property, then “this was going to be a very difficult problem in the economic relationship and was going to be an inhibitor to the relationship really reaching its full potential.”¹⁵⁶

On May 19, 2014, the U.S. Department of Justice issued a 31-count indictment against five members of the Chinese People’s Liberation Army (PLA) for cyber espionage and other offenses that allegedly targeted five U.S. firms and a labor union for commercial advantage, the first time the Federal government has initiated such action against state actors. The named U.S. victims were Westinghouse Electric Co. (Westinghouse); U.S. subsidiaries of SolarWorld AG (SolarWorld); United States Steel Corp. (U.S. Steel); Allegheny Technologies Inc. (ATI); the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Workers International Union (USW); and Alcoa Inc. The indictment appears to indicate a high level of U.S. government concern about the extent of Chinese state-sponsored cyber commercial theft against U.S. firms. It is not clear how the U.S. indictment will impact U.S.-China relations.¹⁵⁶

China strongly condemned the U.S. indictment and announced that it would suspend its participation in the U.S.-China Cyber Working Group, established in 2013. Some Members of

¹⁵³ DNI, Office of the National Counterintelligence Executive, *Foreign Spies Stealing U.S. Economic Secrets in Cyberspace, Report to Congress on Foreign Economic Collection and Industrial Espionage: 2009-2011*, October 2011.

¹⁵⁴ Mandiant, *APT1: Exposing One of China’s Cyber, Espionage Units*, February 19, 2013, p. 2.

¹⁵⁵ U.S. Asia Society, Complete Transcript: Thomas Donilon at Asia Society, New York March 11, 2013.

¹⁵⁶ U.S. Department of Justice, at <http://www.justice.gov/iso/opa/resources/5122014519132358461949.pdf>.

Congress have called on the USTR to initiate a case against China in the World Trade Organization (WTO). Others have called for new measures to identify foreign governments that engage in cyber espionage and to impose sanctions against entities that benefit from that theft. Bills in Congress to address foreign economic and industrial cyber theft include H.R. 2281, S. 111, S. 884, and S. 2384. Some analysts warn that growing U.S.-China disputes over cybertheft could significantly impact commercial ties. The Obama Administration is seeking ways to enhance U.S. commercial cybersecurity at home, develop bilateral and global rules governing cyber theft of commercial trade secrets, strengthen U.S. trade policy tools, and deepen cooperation with trading partners that share U.S. concerns.

China's Obligations in the World Trade Organization

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 was reached that required China to make immediate and extensive reductions in various trade and investment barriers, while allowing it to maintain some level of protection (or a transitional period of protection) for certain sensitive sectors. China's WTO membership was formally approved at the WTO Ministerial Conference in Doha, Qatar, on November 10, 2001. On November 11, 2001, China notified the WTO that it had formally ratified the WTO agreements, and on December 11, 2001, it formally joined the WTO.¹⁵⁷ Under the WTO accession agreement, China agreed to the following:

- Reduce the average tariff for industrial goods from 17% to 8.9%, and average tariffs on U.S. priority agricultural products from 31% to 14%.
- Limit subsidies for agricultural production to 8.5% of the value of farm output, eliminate export subsidies on agricultural exports, and notify the WTO of all government subsidies on a regular basis.
- 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 nondiscriminatory treatment to all WTO members, such as treating foreign firms in China no less favorably than Chinese firms for trade purposes.
- End discriminatory trade policies against foreign invested firms in China, such as domestic content rules and technology transfer requirements.
- Implement the WTO's Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement upon accession (which sets basic standards on IPR protection and rules for enforcement).
- Fully open the banking system to foreign financial institutions within five years (by the end of 2006).

¹⁵⁷ Following China's WTO accession, the United States, in January 2002, granted China permanent normal trade relations (PNTR) status (prior to that time, that status was on a conditional basis) to ensure that the United States and China had a formal trade relationship under the rules of the WTO.

- Allow joint ventures in insurance and telecommunication (with various degrees of foreign ownership allowed).

WTO Implementation Issues

Getting China into the WTO under a comprehensive trade liberalization agreement was a major U.S. trade objective during the late 1990s. Many U.S. policymakers at the time maintained that China's WTO membership would encourage the Chinese government to deepen market reforms, promote the rule of law, reduce the government's role in the economy, further integrate China into the world economy, and enable the United States to use the WTO's dispute resolution mechanism to address major trade issues. As a result, it was hoped, China would become a more reliable and stable U.S. trading partner. U.S. trade officials contend that in the first years after it joined the WTO, China made noteworthy progress in adopting economic reforms that facilitated its transition toward a market economy and increased its openness to trade and FDI. However, beginning in 2006, progress toward further market liberalization appeared to slow. By 2008, U.S. government and business officials noted evidence of trends toward a more restrictive trade regime.¹⁵⁸ The USTR's 12th annual report to China on WTO compliance (issued in December 2013) identified several areas of concern, including¹⁵⁹

- Failure by the Chinese government to maintain an effective IPR enforcement regime;
- Industrial policies and national standards that attempt to promote Chinese firms (while discriminating against foreign firms);
- Restrictions on trading and distribution rights;
- Discriminatory and unpredictable health and safety rules on imports (especially agricultural products);
- Burdensome regulations and restrictions on services; and
- Failure to provide adequate transparency of trade laws and regulations.

As of March 2015, the United States has brought 16 dispute settlement cases against China, several of which have been resolved or ruled upon.¹⁶⁰ China has brought nine WTO cases against the United States as well.¹⁶¹ The U.S. cases are summarized below.

- On February 11, 2015, the USTR initiated a WTO dispute settlement case against China over its use of certain measures providing subsidies contingent upon export performance to enterprises in several industries in China. According to the USTR, China provides export subsidies through "Common Service Platforms" to manufacturers and producers across seven economic sectors (including textiles,

¹⁵⁸ China generally implemented its tariff reductions on schedule.

¹⁵⁹ USTR, *2013 Report to Congress on China's WTO Compliance*, December 2013.

¹⁶⁰ For an overview of the WTO's dispute settlement process, see CRS Report RS20088, *Dispute Settlement in the World Trade Organization (WTO): An Overview*, by Daniel T. Shedd, Brandon J. Murrill, and Jane M. Smith.

¹⁶¹ The United States has been the largest target of China's dispute settlement cases in the WTO. Most of these cases have challenged certain U.S. applications of antidumping and countervailing measures.

- agriculture, chemicals, and advanced materials and metals) and dozens of sub-sectors located in more than 150 industrial clusters.¹⁶²
- On September 17, 2012, the USTR announced that it had initiated a WTO dispute settlement case against China over its export subsidies to auto and auto parts manufacturers in China.¹⁶³
 - On March 13, 2012, the United States, Japan, and the European Union jointly initiated a dispute settlement case against China's restrictive export policies (such as quotas, tariffs, and minimum export prices) on rare earths and two other minerals. On March 23, 2014, a WTO panel ruled that China's restrictions on rare earth elements and two other metals were inconsistent with its WTO obligations and this was largely upheld by the WTO Appellate Body in August.
 - In July 2012, the United States initiated a WTO case against China for what it claimed to be a WTO-inconsistent use of antidumping and countervailing measures (duties of up to 21.5%) against certain imported U.S.-made vehicles. On May 23, 2014, a WTO dispute settlement panel ruled that several of these measures were inconsistent with China's WTO obligations.
 - In May 2012, the United States initiated a WTO dispute settlement case against China's improper use of anti-dumping and countervailing duties on broiler products. On August 5, 2013, the USTR announced that a WTO dispute settlement panel had found largely in favor of the United States. China agreed to comply with the panel's ruling. However, in July 2014, the USTR expressed concern that China had not come into compliance with the panel's ruling.
 - On September 15, 2010, the USTR's office announced it was bringing a WTO dispute settlement case against China over its discrimination against U.S. suppliers of electronic payment services (EPS). The United States charged that China permits only a Chinese entity (China UnionPay) to supply electronic payment services for payment card transactions denominated and paid in RMB in China, that service suppliers of other Members can only supply these services for payment card transactions paid in foreign currency, that China requires all payment card processing devices to be compatible with that entity's system and that payment cards must bear that company's logo, and that the Chinese entity has guaranteed access to all merchants in China that accept payment cards, while service suppliers of other WTO members must negotiate for access to merchants.¹⁶⁴ On July 16, 2012, the USTR announced that the United States had largely prevailed in the dispute. However, in July 2013, the United States argued that China has not complied with the WTO's findings.
 - On September 15, 2010, the USTR's office announced it was bringing a WTO case against China over its improper application of antidumping duties and countervailing duties on imports of grain oriented flat-rolled electrical steel from the United States. A WTO panel in June 2012 ruled largely in favor of the U.S.

¹⁶² USTR *Press Release*, February 11, 2015, at <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2015/february/united-states-launches-challenge>.

¹⁶³ For additional information about this issue, see CRS Report R43071, *U.S.-Chinese Motor Vehicle Trade: Overview and Issues*, by Bill Canis and Wayne M. Morrison.

¹⁶⁴ WTO, *Dispute Settlement—Certain Measures Affecting Electronic Payments, Current Status*, August 31, 2012.

position and this was generally upheld by a WTO Appellate Body in October 2012. However, on December 24, 2013, the USTR stated that China had failed to remove the duties and on February 13, 2014, it requested the establishment of a WTO compliance panel.

- On June 23, 2009, the United States brought a case against China's export restrictions (such as export quotas and taxes) on raw materials (bauxite, coke, fluorspar, magnesium, manganese, silicon metal, silicon carbide, yellow phosphorus, and zinc). The United States charged that such policies are intended to lower prices for Chinese firms (steel, aluminum, and chemical sectors) in order to help them obtain an unfair competitive advantage. China claims that these restraints are intended to conserve the environment and exhaustible natural resources. In July 2011, a WTO panel issued a report that China's export taxes and quotas on raw materials violated its WTO commitments. It further found that China failed to show that restrictions were linked to conservation of exhaustible natural resources for some of the raw materials or to protect the health of its citizens (by reducing pollution).¹⁶⁵ China appealed the WTO panel's ruling. However, on January 30, 2012, a WTO Appellate Body affirmed that China's export quotas and export taxes on certain raw materials violated its WTO commitments.
- On December 22, 2010, the USTR's office announced that it would bring a WTO case against China over a government program that extended subsidies to Chinese wind power equipment manufacturers that use parts and components made in China rather than foreign-made parts and components. On June 7, 2011, the USTR's office announced that China had agreed to end these subsidies. However, the USTR noted that it had taken significant investigatory efforts by the U.S. government, working with industry and workers, to uncover China's wind subsidies because of the lack of transparency in China. The USTR further noted that, under the terms of China's WTO accession, it was required to fully report its subsidy programs to the WTO, which, to date, it has failed to do.¹⁶⁶
- On December 19, 2008, the USTR filed a WTO case against China over its support for "Famous Chinese" brand programs, charging that such programs utilize various export subsidies (including cash grant rewards, preferential loans, research and development funding to develop new products, and payments to lower the cost of export credit insurance) at the central and local government level to promote the recognition and sale of Chinese brand products overseas. On December 18, 2009, the USTR announced that China had agreed to eliminate these programs.
- On March 3, 2008, the USTR requested WTO dispute resolution consultations with China regarding its discriminatory treatment of U.S. suppliers of financial information services in China. On November 13, 2008, the USTR announced that China had agreed to eliminate discriminatory restrictions on how U.S. and other foreign suppliers of financial information services do business in China.

¹⁶⁵ A summary of the WTO panel report can be found at http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds394_e.htm#bkmk394r.

¹⁶⁶ USTR *Press Release*, June 7, 2011, available at <http://www.ustr.gov/about-us/press-office/press-releases/2011/june/china-ends-wind-power-equipment-subsidies-challenged>.

- On April 10, 2007, the USTR filed a WTO case against China, charging that it failed to comply with the TRIPS agreement (namely in terms of its enforcement of IPR laws). On January 26, 2009, the WTO ruled that many of China's IPR enforcement policies failed to fulfill its WTO obligations. On June 29, 2009, China announced that it would implement the WTO ruling by March 2010.
- On April 10, 2007, the USTR filed a WTO case against China charging that it failed to provide sufficient market access to IPR-related products, namely in terms of trading rights and distribution services. In August 2009, a WTO panel ruled that many of China's regulations on trading rights and distribution of films for theatrical release, DVDs, music, and books and journals were inconsistent with China's WTO obligation. China appealed the decision, but lost, and in February 2010 stated that it would implement the WTO's ruling.
- On February 5, 2007, the USTR announced it had requested WTO dispute consultations with China over government regulations that give illegal (WTO-inconsistent) import and export subsidies to various industries in China (such as steel, wood, and paper) that distort trade and discriminate against imports.¹⁶⁷ China's WTO accession agreement required it to immediately eliminate such subsidies. On November 29, 2007, China formally agreed to eliminate the subsidies in question by January 1, 2008.
- On March 30, 2006, the USTR initiated a WTO case against China over its use of discriminatory regulations on imported auto parts, which often applied the high tariff rate on finished autos (25%) to certain auto parts (which generally average 10%). The USTR charged that the purpose of China's policy was to discourage domestic producers from using imported parts and to encourage foreign firms to move production to China. On February 13, 2008, a WTO panel ruled that China's discriminatory tariff policy was inconsistent with its WTO obligations (stating that the auto tariffs constituted an internal charge rather than ordinary customs duties, which violated WTO rules on national treatment). China appealed the decision, but a WTO Appellate Body largely upheld the WTO panel's decision.
- 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. The United States claimed that China applied a 17% value-added tax (VAT) on semiconductor chips that were designed and made outside China, but gave VAT rebates to domestic producers. Following consultations with the Chinese government, the USTR announced on July 8, 2004, that China agreed to end its preferential tax policy by April 2005. However, the USTR has expressed concern over new forms of financial assistance given by the Chinese government to its domestic semiconductor industry.

During his State of the Union Address in January 2012, President Obama announced plans to create a new Trade Enforcement Unit "charged with investigating unfair trade practices in countries like China." On February 28, 2012, President Obama issued an executive order

¹⁶⁷ Some programs gave tax preferences, tariff exemptions, discounted loans, or other benefits to firms that met certain export performance requirements, while others gave tax breaks for purchasing Chinese-made equipment and accessories over imports.

establishing the Interagency Trade Enforcement Center within the USTR's office. Many analysts contend that the new enforcement unit could result in a sharp increase in the number of WTO dispute settlement cases brought by the United States against China.

China's Accession to the WTO Government Procurement Agreement (GPA)

Government procurement policies are largely exempt from WTO rules, except for those members which have signed the GPA.¹⁶⁸ When China joined the WTO, it indicated its intention to become a member of WTO's GPA as soon as possible, but, to date, has failed to submit an offer acceptable to current GPA members.

China's accession to the GPA is a major U.S. priority. China reports its annual government procurement spending at \$179 billion (2011).¹⁶⁹ U.S. officials estimate this figure could be as high as \$200 billion.¹⁷⁰ A study by the European Union Chamber of Commerce in China estimates that this figure could be well over \$1 trillion if all levels of government are included, plus SOEs.¹⁷¹ China currently maintains a number of restrictive government procurement practices and policies that favor domestic Chinese firms. Because of China's rapidly growing economy and significant infrastructure needs, China's accession to the GPA could result in significant new opportunities for U.S. firms.

China did not formally enter into negotiations to join the GPA until 2007, and its initial offer was deemed unacceptable by the other WTO GPA parties. China promised to revise its GPA offer, but did not do so until July 2010. That offer was deemed an improvement over the previous offer but was not accepted, in part because it excluded purchases by local and provincial governments as well as SOEs. A revised offer in December 2011 only covered public entities in three cities and two provinces.¹⁷² Commenting on China's last offer, the USTR's office stated:

China began its negotiations to join the GPA four years ago this month. Since that time, China has submitted three offers, each an improvement over the last. But China still has some distance to go before the procurement that it is offering is comparable to the extensive procurement that the United States and other Parties cover under the GPA. For example, we are urging China to cover state-owned enterprises, add more sub-central entities and services reduce its thresholds for the size of covered contracts, and remove other broad exclusions.¹⁷³

¹⁶⁸ The GPA is a plurilateral agreement among 43 WTO members (including the United States, Japan, and the 28 members of the European Union) that effectively provides market access for various nondefense government procurement projects to signatories to the agreement. Each member of the Agreement submits lists of government entities and goods and services (with thresholds and limitations) that are open to bidding by firms of the other GPA members. WTO members that are not signatories to the GPA, including those that are GPA observers (such as China), do not enjoy any rights under the GPA. Nor are non-GPA signatories in the WTO generally obligated to provide access to their government procurement markets.

¹⁶⁹ Xinhua News Agency, June 29, 2012, at http://news.xinhuanet.com/english/china/2012-06/29/c_131685154.htm.

¹⁷⁰ Testimony of Karen Laney, Acting Director of Operations, U.S. International Trade Commission before the Subcommittee on Terrorism, Nonproliferation, and Trade, Committee on Foreign Affairs, on *China's Indigenous Innovation, Trade, and Investment Policies*, March 9, 2011.

¹⁷¹ European Chamber of Commerce in China, *Public Procurement in China: European Business Experiences Competing for Public Contracts in China*, 2011, p. 15, at <http://www.eurochamber.com.cn/en/publications-public-procurement-study-european-business-experiences-competing-for-public-contracts-in-china>.

¹⁷² Inside U.S. Trade, December 8, 2011.

¹⁷³ USTR Press Release, December 2011.

China submitted a new offer in November 2012. According to press reports, the U.S. representative to the WTO GPA Committee stated that China's offer was "only another step but far from what we had expected." In particular, the United States and other GPA parties want China to improve its offer by including coverage of SOEs, lowering thresholds above which the GPA's nondiscrimination disciplines apply, removing several broad exclusions to coverage, and expanding coverage of sub-central entities. Some Members also stated opposition to China's proposal that it be allowed a five-year implementation period.¹⁷⁴ During the July 2013 S&ED talks, China pledged to submit a new revised GPA offer by the end of 2014 that would include lowering thresholds and increased coverage of sub-central entities. On December 22, 2014, China submitted its fifth offer to join the WTO's Government Procurement Agreement. On February 11, 2015, China's offer was examined by existing GPA members. China announced that it would be difficult or impossible for it to make significant further additions to entity coverage.

China's Currency Policy¹⁷⁵

Unlike most advanced economies (such as the United States), China does not maintain a market-based floating exchange rate. For several years, China pegged its currency directly to the U.S. dollar. Each day China's central bank announced a central rate of exchange between the renminbi (RMB) and the dollar and would buy and sell as much currency as needed to reach a targeted exchange rate within a specific band. In order to maintain the targeted exchange rate with the dollar (and other currencies), the Chinese government imposed restrictions and controls over capital flows in and out of China.¹⁷⁶ Currency intervention by the Chinese government contributed to a sharp rise in Chinese foreign exchange reserves, some of which were invested in U.S. dollar assets, such as U.S. Treasury securities.

Starting around 1998, the Chinese government set the central target exchange rate at around 8.28 yuan (the base unit of the RMB) per dollar, and this rate was generally maintained consistently through June 2005.¹⁷⁷ Due in part to pressure from its trading partners, including the United States, the Chinese government in July 2005, announced reforms to its currency policy. China immediately appreciated the RMB to the dollar by 2.1% and moved to a "managed float" exchange rate system, based on a basket of major foreign currencies that included the U.S. dollar and other major currencies (although the composition of that basket has not been made public).

From July 2005 to July 2008, the official exchange rate went from 8.27 to 6.83 yuan per dollar. However, once the effects of the global financial crisis became apparent, the Chinese government halted its appreciation of the RMB and subsequently kept the yuan/dollar exchange rate relatively constant at 6.83 from July 2008 to June 2010 in order to help limit the impact of the sharp decline in global demand for Chinese products. Currency appreciation was resumed in June 2010, although at a slower pace than in previous years.

From June 2005 through December 2014, the RMB appreciated by 34% on a nominal basis against the dollar, although the rate of appreciation has slowed in recent years (see **Figure 8**). In

¹⁷⁴ *Inside U.S. Trade*, December 12, 2012.

¹⁷⁵ For additional information on this issue, see CRS Report RS21625, *China's Currency Policy: An Analysis of the Economic Issues*, by Wayne M. Morrison and Marc Labonte.

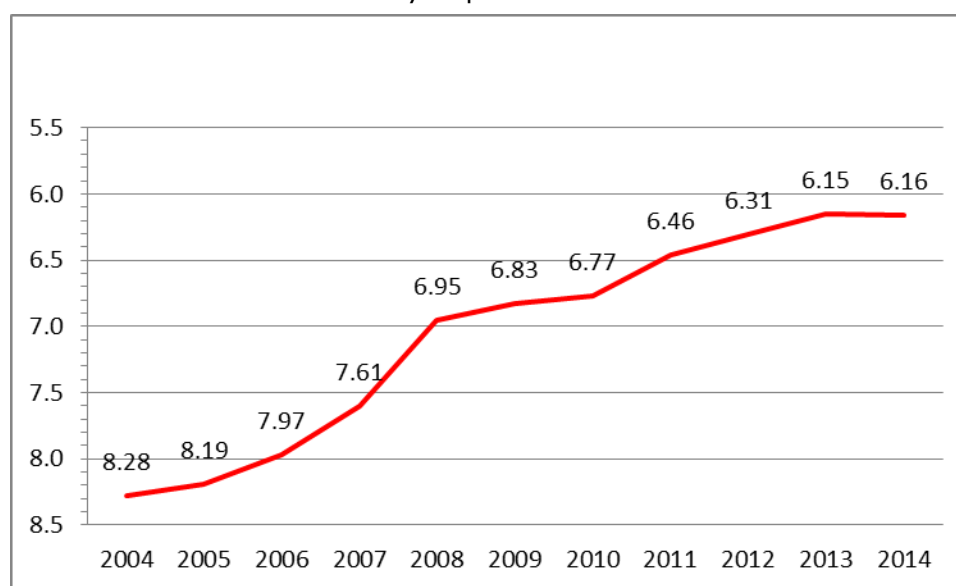
¹⁷⁶ Much of China's trade is believed to be in U.S. dollars (e.g., exporters are often paid in dollars). The central government requires firms to exchange most of their dollars for RMB.

¹⁷⁷ The official name of China's currency is the renminbi, which is denominated in units of yuan.

2014, the RMB on average depreciated by 0.2% against the dollar over 2013 levels. The RMB's exchange rate with the dollar in June 2015 was 6.20, down by 0.2% from the December 2014 rate. Some analysts speculate that the Chinese government has sought to slow, and sometimes reverse, the pace of RMB appreciation, due to concerns over a slowing Chinese economy (and its impact on exporters) and to deter illegal capital inflows from outside speculators who expect that the RMB will continue to rise and hope to profit from it. The Chinese government appears to be concerned that such inflows by speculators could lead to volatile and unpredictable movements in the RMB's value.

Opinions on the RMB's valuation against the dollar and other currencies differ significantly. The International Monetary Fund (IMF) in May 2015 assessed the RMB to be "no longer undervalued"¹⁷⁸ while in October 2014 the Department of the Treasury stated that the RMB remained "significantly undervalued."¹⁷⁹

Figure 8. Average Annual RMB Exchange Rate with the Dollar: 2004-2014
yuan per dollar



Source: Global Insight.

Notes: Y axis values are in reverse order. A rising line indicates RMB appreciation against the dollar and a falling line indicates RMB depreciation.

U.S. officials have urged China to continue efforts to rebalance its economy by boosting consumer demand (which would increase import demand) and decreasing the reliance on exports and fixed investment for economic growth. They argue that doing so would enable the Chinese government to move more quickly toward adopting a market-based exchange rate since the

¹⁷⁸ IMF, *Press Release*, May 26, 2015, available at <https://www.imf.org/external/np/sec/pr/2015/pr15237.htm>.

¹⁷⁹ U.S. Department of the Treasury, *Semiannual Report on International Economic and Exchange Rate Policies*, April, 9, 2015, p. 3, available at <http://www.treasury.gov/resource-center/international/exchange-rate-policies/Documents/Report%20to%20Congress%20on%20International%20Economic%20and%20Exchange%20Rate%20Policies%2004092015.pdf>.

creation of new jobs in the nontrade sector would offset job losses in the trade sector resulting from an appreciation of the RMB.

Numerous bills have been introduced in Congress over the past few years that would seek to induce China to reform its currency policy or would attempt to address the perceived effects that policy has on the U.S. economy. For example, one bill in the 108th Congress would have imposed an additional duty of 27.5% on imported Chinese products unless China appreciated its currency to near market levels. In the 111th Congress, the House passed an amended version of H.R. 2378 (Tim Ryan), which would have made certain misaligned currencies (such as the RMB) actionable under U.S. countervailing duty cases on foreign government export subsidies (although the Senate did not take up the bill). In the 112th Congress, the Senate passed S. 1619, which would have provided for the identification of fundamentally misaligned currencies and required action to correct the misalignment for certain “priority” countries. In the 114th Congress, H.R. 820 and S. 433 would seek to treat certain undervalued currencies as an actionable subsidy under U.S. countervailing laws.

The U.S.-China Strategic and Economic Dialogue

On September 29, 2006, President George W. Bush and Chinese President Hu Jintao agreed to establish a Strategic Economic Dialogue (SED) to have discussions on major economic issues at the “highest official level.” According to a U.S. Department of the Treasury press release, the intent of the SED was to “discuss long-term strategic challenges, rather than seeking immediate solutions to the issues of the day,” in order to provide a stronger foundation for pursuing concrete results through existing bilateral economic dialogues.¹⁸⁰ The first meeting was held in December 2006. Four subsequent rounds of talks were held (the last was in December 2008).

While attending the G-20 summit in London on the global financial crisis on April 1, 2009, President Obama and Chinese President Hu agreed to continue the high-level forum, renaming it the U.S.-China Strategic and Economic Dialogue (S&ED). The new dialogue is based on two tracks. The first (the “Strategic Track”) is headed by the Secretary of State on the U.S. side and focuses on political and strategic issues, while the second track (the “Economic Track”) is headed by the U.S. Treasury Secretary on the U.S. side and focuses on financial and economic issues. Areas of discussion include economic and trade issues, counterterrorism, law enforcement, science and technology, education, culture, health, energy, the environment (including climate change), nonproliferation, and human rights.

One of the reported benefits of the U.S-China S&ED process is that it brings together top economic officials from both sides (as well as U.S. Cabinet officials and Chinese heads of ministries) on a regular basis, which enables both sides to identify their major positions and priorities on various issues and to develop long-term working relationships. Some in Congress have criticized the S&ED forum, arguing that it produces few concrete results, and that many of the results described in subsequent fact sheets that are jointly issued simply restate agreements or pledges China has already made. Others counter that U.S. engagement with China occurs on multiple levels throughout the year and that the S&ED meetings are in part a cumulative result of this process. In addition, the two sides hold annual meetings under the U.S.-China Joint Commission on Commerce and Trade (JCCT), established in 1983, which focuses primarily on

¹⁸⁰ U.S. Department of the Treasury, *Press Release*, December 15, 2006.

bilateral trade and investment issues. The JCCT maintains 16 working groups that meet throughout the year and cover such issues as IPR, information technology, pharmaceutical and medical devices, statistics, commercial law, agriculture, and trade and investment.

The June 2015 Economic Track

The session was held June 22-24, 2015, in Washington, DC. China pledged that it would improve transparency and expand consultations with the United States on proposed rules on information and communications technology (ICT). Many foreign ICT firms contend that such rules are discriminatory or could require them to turn over sensitive technologies and intellectual property to the Chinese government. On proposed ICT regulations in the banking sector, China pledged that it would seek and take into account comments from foreign and domestic parties on draft regulations and would ensure that such regulations are nondiscriminatory and do not impose nationality-based conditions or restrictions on foreign firms. The two sides also reaffirmed that reaching a BIT remained a high priority and pledged to intensify negotiations and exchange improved “negative list” offers (i.e., exceptions) in early September 2015. The U.S. side raised the issue of cybersecurity. U.S. Treasury Secretary Jacob Lew stated: “We have a shared interest and a joint responsibility to pursue policies that support the global economy as well as uphold and continue to improve the global economic and financial architecture. That includes responsibilities to abide by certain standards of behavior within cyberspace. We remain deeply concerned about government-sponsored cyber theft from companies and commercial sectors.” The cyber issue was also raised by President Obama when he met with a high-level Chinese delegation of government officials. Yet, China does not appear to have made any specific commitments on cyber theft issues.

The July 2014 Economic Track

The July 10-11, 2014, S&ED session addressed a number of issues. The most significant result of the session, according to some analysts, was an agreement to accelerate negotiations for a BIT and to begin the "negative list" negotiation early in 2015. China further pledged that it would:

- Ensure that economic efficiency, rather than the promotion of individual competitors or industries, would be the focus of China’s AML and that enforcement would be fair, objective, transparent, and nondiscriminatory.
- Continue moving to a market-determined exchange rate, increase exchange rate flexibility, reduce foreign exchange intervention to enhance the transparency of its foreign exchange holdings, and take steps to boost private consumption.
- Take a number of steps to reforms of SOEs and level the playing field for foreign-invested firms.
- Accelerate price reforms for petroleum, electricity, and natural gas and address excess production capacity in the steel sector.
- Liberalize FDI restrictions, including those on various services.
- Strengthen trade secrets and IPR protection.
- Promote regulatory transparency, and improve administrative licensing, enhance the availability of government documents, and boost regulations to improve drug safety.

- Continue to liberalize the financial sector and to further open up various sectors to foreign investment.

The May 2013 Economic Track

The fifth round of the S&ED talks was held in Washington, DC, on July 10-11, 2013. China pledged that it would:

- Negotiate a high-standard bilateral investment treaty with the United States that would include all stages of investment and all sectors based on a negative list approach;
- Submit a new and improved offer to join the WTO GPA by the end of 2013 that would include lowered thresholds and increased coverage of sub-central entities;
- Establish a pilot Free Trade Zone program in Shanghai which would enable foreign enterprises to compete on the same terms as Chinese firms across a wide range of services sectors;
- Affirmed its support for concluding negotiations by 2014 for new comprehensive international agreement setting guidelines on export financing by the major providers of export credits that would be consistent with international best practices;
- Eliminate preferential input pricing for energy, land, and water given to SOEs and develop a market-based mechanism for determining;
- Strengthening financial regulatory cooperation; and
- Continue to implement policies to boost private consumption such as raising social security and employment spending by two percentage points of total fiscal spending by the end of 2015.

The May 2012 Economic Track

The fourth S&ED round was held in Beijing on May 3 and 4, 2012, and focused largely on economic rebalancing and boosting foreign access to China's financial services sector.¹⁸¹ China pledged that it would:

- Increase the number of SOEs that pay dividends;
- Participate in negotiations (beginning in the summer of 2012) for new rules on official export financing with the United States and other major exporters;
- Provide nondiscriminatory treatment to all enterprises, regardless of type of ownership, in terms of credit, taxation, and regulatory policies so that U.S. firms can more easily compete against Chinese SOEs;
- Submit a new robust offer in 2012 to join the WTO's GPA and to intensify efforts to negotiate a BIT with the United States;

¹⁸¹ The session was somewhat overshadowed by events relating to Chinese human rights advocate Chen Guangcheng who had been temporarily sheltered at the U.S. embassy in Beijing prior to the session.

- Open up more sectors to FDI and improve the transparency of its investment approval process;
- Prioritize the protection of trade secrets, extend efforts to promote the use of legal software by Chinese enterprises, treat IPR owned or developed in other countries the same as IPR owned or developed in China, and hold discussions with U.S. officials on the implementation of China's commitment not to make technology transfer a pre-condition for doing business in China;
- Take steps to raise household income and lower prices of consumer goods, such as cutting import tariffs, reducing taxes on services, and raising deposit rates; and
- Expand market access to domestic financial markets by boosting the permitted level of foreign investment in its stock and bond markets, raising the permitted foreign equity stake in domestic securities joint ventures from 33% to 49%, and allowing foreign investors to establish joint venture brokerages to trade commodity and financial futures (with up to a 49% equity stake).

The May 2011 Economic Track

The third round of the S&ED was held in Washington, DC, on May 9-10, 2011. Prior to the meeting, U.S. officials identified several goals for the economic track of the S&ED, including ensuring that China followed through on previous economic and trade commitments (such as on IPR protection and indigenous innovation policies) and encouraging China to make a number of reforms to its financial sector (such as adopting market-based interest rates on bank deposits and expanding market access in China for U.S. financial firms). China pledged to continue to promote domestic consumption, improve IPR enforcement, eliminate all of its indigenous innovation products catalogues, improve transparency of its economic and trade policies, and provide significant new opportunities for U.S. financial services firms in China.

May 2010 Economic Track Session

The May 24-25, 2010, S&ED economic session focused heavily on the continuing efforts relating to the four pillars identified in the July 2009 session. Although few concrete accomplishments were announced at the end of the meetings, the two agreed to intensify talks on a number of bilateral economic and trade issues. The two sides pledged to

- Sign a cooperation protocol on small and medium-sized firms (SMEs);
- Boost economic cooperation at the central and local government level, such as promoting the establishment of state-to-province and city-to-city partnerships;
- Conduct “intensive expert and high-level discussions” as early as the summer of 2010 on innovation issues (such as China's indigenous innovation proposals) and take into account the results of these talks in formulating and implementing their innovation measures;¹⁸²

¹⁸² The United States also pledged that it would review Chinese concerns relating to U.S. restrictions on high technology exports to China resulting from the current U.S. export control regime.

- Improve cooperation to address health and safety issues relating to U.S. sales of soybeans to China;
- Establish a cooperative mechanism between the U.S. Export-Import Bank and the Export-Import Bank of China on trade finance, and develop initiatives to promote exports by SMEs;
- Explore the possibility of cooperating to enable the United States to treat China as a market economy, and treat certain Chinese firms as market-oriented industries, for the purpose of U.S. trade remedy laws; and
- Boost investment opportunities and transparency.¹⁸³

The July 2009 Economic Track Session

The first round of the S&ED was held in Washington, DC, on July 27-28, 2009, and involved 12 U.S. Cabinet officials and agency heads and 15 Chinese ministers, vice ministers, and agency heads. The session was focused heavily on issues relating to the global economic crisis. Then-Secretary of the Treasury Timothy Geithner stated: “Recognizing that cooperation between China and the United States will remain vital not only to the well-being of our two nations but also the health of the global economy, we agreed to undertake policies to bring about sustainable, balanced global growth once economic recovery is firmly in place.”

The two sides agreed to establish a framework of cooperation based on four pillars:

- Advancing macroeconomic and structural policies to achieve sustainable and balanced growth;
- Promoting more resilient, open, and market-oriented financial systems;
- Strengthening trade and investment ties; and
- Strengthening the international financial architecture.

These pillars appear to have been aimed at deepening bilateral cooperation in response to the global economic crisis, continuing commitments on both sides to promote policies that seek to achieve more balanced economic growth, encouraging China to continue economic and financial reforms, expanding China’s role and/or participation in international economic forums,¹⁸⁴ and attempting to avoid new forms of trade protection.

Some analysts have argued that the S&ED structure should be reformed. For example, a report by the Center for Strategic and International Studies (CSIS) argues that ceremony has come to overwhelm substance in the S&ED, that pressure for short-term deliverables at each event has

¹⁸³ The United States pledged that it welcomed investment from China and confirmed that review of foreign investment by the Committee on Foreign Investment in the United States ensures the consistent and fair treatment of all foreign investment without prejudice to the place of origin. China promised to revise its Catalogue Guiding Foreign Investment in Industries and encourage and expand areas open to foreign investment, including those relating to high-technology, energy, and the environment. China also pledged to streamline the process for investment approval.

¹⁸⁴ The United States is seeking to broaden China’s participation in international economic institutions in order to promote the goal of helping to make China a “responsible stakeholder” in the global economy. This implies that, since China greatly benefits from the global trading system and is a major global economy, it should shoulder a greater responsibility in maintaining and promoting that system (rather than just enjoying the benefits of that system).

detracted from the dialogue's objective of fostering long-term strategic cooperation, and that the structure of the S&ED has undermined the efforts of individual agencies to work on critical elements of the relationship.¹⁸⁵ Others have complained about the lack of benchmarks in the S&ED process to evaluate outcomes of China's commitments. Others complain that the S&ED process often fails to achieve results on major issues. For example, at the July 2013 S&ED, China made no specific commitment on halting cyber theft.

Other Developments in U.S.-China Commercial Ties

At the December 2014 session of the JCCT, China stated that it would approve the importation of new biotechnology varieties of U.S. soybeans and corn and improve IPR trademark protection for certain agricultural products; amend its trade secrets law and increase cooperation with the United States on enhancing sales of legitimate U.S. intellectual property-intensive goods and services in China; streamline China's processes and cut red tape for imports of pharmaceuticals and medical devices; and make improvements to its competition enforcement policies by improving transparency and ensuring equal treatment for foreign firms in anti-monopoly investigations with Chinese firms.

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 many observers argued contributed to a suspension in the ITA negotiations in November 2013. At the time, it was hoped that China's new position would help facilitate final adoption of the ITA agreement in the WTO (although a final agreement is still pending). According to a White House Fact Sheet, the ITA agreement would eliminate tariffs on approximately \$100 billion worth of U.S. information and communications exports ITA products, supporting up to 60,000 additional U.S. jobs.¹⁸⁶ The two sides also reached a new visa expansion agreement, which extends U.S./China visa validity for tourists, business travelers, and students.¹⁸⁷ The agreement is expected to boost Chinese tourism in the United States, increase U.S. trade and investment ties with China, and expand student exchanges.

¹⁸⁵ CSIS, *Crafting Asia Economic Strategy in 2013*, January 28, 2013, at <http://csis.org/publication/crafting-asia-economic-strategy-2013>.

¹⁸⁶ The White House, *Fact Sheet: Supporting Economic Growth at Home and Abroad by Eliminating Trade Barriers on Information Technology Products*, November 10, 2014, at <http://www.whitehouse.gov/the-press-office/2014/11/10/fact-sheet-supporting-economic-growth-home-and-abroad-eliminating-trade->.

¹⁸⁷ The White House, *Fact Sheet, Supporting American Job Growth And Strengthening Ties By Extending U.S./China Visa Validity for Tourists, Business Travelers, and Students*, November 10, 2014, at <http://www.whitehouse.gov/the-press-office/2014/11/10/fact-sheet-supporting-american-job-growth-and-strengthening-ties-extendi>.

Concluding Observations

China's rapid economic growth and emergence as a major economic power have given China's leadership increased confidence in its economic model. The key challenges for the United States are to convince China that (1) it has a stake in maintaining the international trading system, which is largely responsible for its economic rise, and to take a more active leadership role in maintaining that system; and (2) further economic and trade reforms are the surest way for China to expand and modernize its economy. For example, by boosting domestic spending and allowing its currency to appreciate, China would likely import more, which would help speed economic recovery in other countries, promote more stable and balanced economic growth in China, and lessen trade protectionist pressures around the world. Improving IPR protection in China and providing nondiscriminatory treatment to foreign IP firms would likely foster greater innovation in China and attract more FDI in high technology than has occurred under current policies. Lowering trade barriers on imports would increase competition in China, lower costs for consumers, and boost economic efficiency. Some observers contend that reformist-minded officials in China will continue to push for greater free-market reforms, while others argue that vested interests in China (such as SOEs and export-oriented firms) who benefit from the status-quo will make further economic reforms more difficult to realize.

There are a number of views in the United States over how to more effectively address commercial disputes with China:

- Take a more aggressive stand against China, such as increasing the number of dispute settlement cases brought against China in the WTO, threatening to impose trade sanctions against China unless it addresses policies (such as IPR theft) that hurt U.S. economic interests, and making greater use of U.S. trade remedy laws (such as anti-dumping and countervailing measures) to address China's "unfair" trade practices.
- Intensify negotiations through existing high-level bilateral dialogues, such as the U.S.-China S&ED, which was established to discuss long-term challenges in the relationship. In addition, seek to complete ongoing U.S. negotiations with China to reach a high-standard BIT, as well as to finalize negotiations in the WTO toward achieving China's accession to the GPA. Continue to encourage China to implement comprehensive economic reforms, such as diminishing the role of the state in the economy and implementing policies to boost domestic consumption.
- Encourage China to join the Trans-Pacific Partnership (TPP) negotiations and/or seek to negotiate a bilateral free trade agreement (FTA) with China that would require it to significantly improve IPR protection, lower trade and FDI barriers, and adopt new disciplines on the treatment of SOEs.¹⁸⁸

¹⁸⁸ The TPP is a proposed regional free trade agreement among 12 countries, including Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam.

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