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IN FOCUS

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U.S.-China Trade Issues

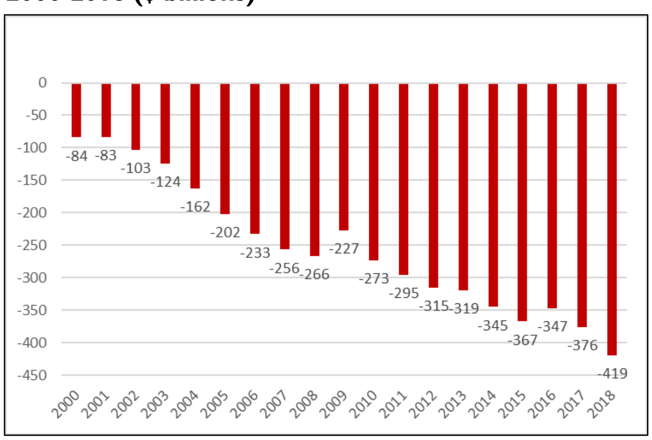
Background

The U.S.-China trade and economic relationship has expanded significantly over the past three decades. In 2018, China was the United States' largest U.S. merchandise trading partner (total trade at $660 billion), third-largest export market ($120 billion), and largest source of imports ($540 billion). China is also the largest foreign holder of U.S. Treasury securities (at $1.1 trillion as of April 2019 2018). However, tensions have grown sharply in recent years over a number of economic and trade issues.

Key U.S. Issues

The Trade Deficit. President Trump has complained about the U.S. bilateral trade imbalances with various countries, including China. The U.S. merchandise trade deficit with China in 2018 was $419 billion (up from $376 billion in 2017), and is by far the largest U.S. bilateral trade imbalance. Some U.S. policymakers view large U.S. bilateral trade deficits as an indicator of an "unfair" trade relationship. Others, however, view conventional bilateral trade deficit data as misleading, given the growth of global supply chains used by multinational firms. Products may be invented or developed in one country, assembled elsewhere (using imported components from multiple foreign sources), and then exported. Conventional U.S. trade data may not fully reflect the value added in each country or the main beneficiaries of global production and trade flows. In addition, most economists argue that the overall size of the U.S. trade imbalance deficit is largely a function of low U.S. domestic savings relative to its investment needs, rather than the result of foreign trade barriers.

Figure 1. U.S.-China Merchandise Trade Balances 2000-2018 ($ billions)



Source: USITC Dataweb.

Intellectual Property Rights (IPR) and Cybertheft. U.S. firms cite the lack of effective protection of IPR as one of the biggest impediments that they face in conducting business in China. A May 2013 study by the Commission on the Theft of American Intellectual Property estimated that China accounted for up to 80% (or $240 billion) of U.S. annual economic losses from global IPR theft. The U.S. Customs and Border Protection reported that China and Hong Kong together accounted for 78% of counterfeit goods it seized in FY2017. In May 2014, the U.S. Justice Department indicted five members of the Chinese People's Liberation Army for government-sponsored cyberespionage against U.S. companies and theft of proprietary information to aid state-owned enterprises. During Chinese President Xi Jinping's state visit to the United States in September 2015, the two sides reached an agreement on cybersecurity, pledging that neither country's government would conduct or knowingly support cyberenabled theft of intellectual property for commercial purposes and to establish a joint dialogue on cybercrime and related issues. In October 2018, Crowdstrike, a U.S. cybersecurity technology company, identified China as "the most prolific nation-state threat actor during the first half of 2018." It found that Chinese entities had made targeted intrusion attempts against multiple sectors of the economy. In November 2018, FBI Director Christopher Wray stated, "No country presents a broader, more severe threat to our ideas, our innovation, and our economic security than China." In December 2018, U.S. Assistant Attorney General John C. Demers stated that, from 2011 to 2018, China was linked to more than 90% of the Justice Department's cases involving economic espionage and two-thirds of its trade secrets cases.

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

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

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

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

Section 301 Case on China's IPR Policies. On August 14, 2017, President Trump issued a memorandum directing the USTR to determine if China's policies on IPR protection and forced technology requirements "may be harming American intellectual property rights, innovation, or technology development," and thus warranted a Section 301 investigation. On August 18, the USTR launched a Section 301 investigation, and on March 22, President Trump signed a *Memorandum on Actions by the United States Related to the Section 301 Investigation*. It listed four IPR-related policies that justified U.S. action, including China's forced technology transfer requirements, cyber-theft of U.S. trade secrets, discriminatory licensing requirements, and attempts to acquire U.S. technology to advance its industrial policies (such as the Made in China 2025 initiative). Subsequently, the Trump Administration has imposed increased 25% tariffs on three tranches of imports from China with combined worth about $250 billion. China in turn has raised tariffs (at rates ranging from 5% to 25%) on $110 billion worth of products from the United States (see **Table 1**). These tariff hikes appear to be affecting bilateral trade flows. During the first three months of 2019, total U.S.-China merchandise fell by 15% year-over-year. On May 10, 2019, President Trump tweeted that China had attempted to backtrack on previous trade commitments. He then ordered the U.S. Trade Representative to begin the process of levying increased 25% tariffs on nearly all remaining imports from China (worth $300 billion).

Table 1. U.S. Section 301 Tariff Hikes in Effect

Effective Date	Tariff Hike	Import Value	China's Reaction
July 6, 2018	25%	$34 billion	Full retaliation
August 23, 2018	25%	$16 billion	Full retaliation
September 24; then June 1 (by China) and June 15 (by U.S.)	10%, then 25%	$200 billion	5%-10% tariff hikes on $60 billion worth of imports; then some items raised to up to 25%

Source: USTR and Chinese Ministry of Commerce.

Advanced Technology Issues. The Trump Administration has raised national security concerns over global supply chains of advanced technology products, such as information, communications, and telecommunications (ICT) equipment, where China is a major global producer and supplier. China is the largest foreign supplier of ICT equipment to the United States. In 2018, U.S. ICT imports from China totaled $157 billion, or 60% of total U.S. ICT imports. Citing a "national emergency," President Trump, on May 15, 2019, issued Executive Order 13873 on Securing the Information and Communications Technology and Services Supply Chain. The order stated the Administration's view that U.S. purchases of ICT goods and services from "foreign adversaries" posed a national security risk to the United States and authorized the Federal government to ban certain ICT transactions deemed to pose an "undue risk." On the same day, the U.S. Commerce Department announced that it would add Chinese telecommunications firm Huawei and 68 of its non-U.S. affiliates to the Department's Bureau of Industry and Security Entity List, which would require an export license for the sale or transfer of U.S. technology to such entities.

Long-Term Challenges

U.S. policies have sought to induce China reduce the role of the state in the economy, remove trade and investment barriers, and boost its IPR protection. Supporters of the Trump Administration's use of Section 301increased tariffs (and other punitive commercial measures) against China contend that they will ultimate produce positive results, such as a more level playing field for U.S. firms doing business in China and greater market access for U.S. exporters. Critics of the Administration's commercial actions against China warn that a protracted and escalating trade dispute could occur, leading to numerous new rounds of tit-for-tat for retaliation, sharply reduced commercial flows, and a gradual decoupling of the two economies.

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