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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 several years. Total U.S.-China trade, which totaled only $5 billion in 1980, rose to $285 billion in 2005. China is now the third largest U.S. trading partner, its second largest source of imports, and its fourth largest export market. With a huge population and a rapidly expanding economy, China is becoming a large market for U.S. exporters. Yet, U.S.-China commercial ties have been strained by a number of issues, including a surging U.S. trade deficit with China (which totaled $202 billion in 2005), China's refusal to float its currency, and failure to fully comply with its World Trade Organization (WTO) commitments, especially its failure to provide protection for U.S. intellectual property rights (IPR).

The continued rise in the U.S.-China trade imbalance, complaints from several U.S. manufacturing firms over the competitive challenges posed by cheap Chinese imports, and concerns that U.S. manufacturing jobs are being lost due to unfair Chinese trade practices have led several Members to call on the Bush Administration to take a more aggressive stance against certain Chinese trade policies deemed to be unfair. For example, some Members argue that China manipulates its currency vis-a-vis the dollar to make its exports cheaper, and imports more expensive, than they would be under a floating system. The threat of congressional legislation led China in July 2005 to appreciate its currency by 2.1% and to switch to an exchange rate system based on a basket of currencies (including the dollar). However, many U.S. policymakers charge that these reforms have not gone far and have warned of potential congressional action if China fails to make further reforms.

China joined the WTO in 2001, and U.S. officials continue to closely monitor China's compliance with its WTO commitments. A major concern to U.S. policymakers regarding China's WTO commitments has been its failure to implement an effective strategy to combat widespread IPR piracy in China. Although China has enacted a number of strict IPR laws and regulations, U.S. firms charge that enforcement is lax and ineffective and costs U.S. firms billions of dollars in lost sales annually. On October 26, 2005, the United States initiated a special process under WTO rules to obtain detailed information on China's IPR enforcement efforts. If China fails to comply with this request, the United States might choose to bring a dispute resolution case against it in the WTO. In addition, on March 30, 2006, the United States initiated a WTO case against China over its discriminatory tax treatment of imported auto parts.

This report replaces IB91121, *U.S.-China Trade Issues*, by Wayne M. Morrison, and will be update as events warrant.

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# China-U.S. Trade Issues

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 economic ties. In 1978 China was the 32nd largest U.S. export market and its 57th largest source of its imports, but by 2005, these rankings rose to 2nd and 4th respectively. In recent years, China has been the fastest growing U.S. export market and the importance of this market is expected to grow even further as living standards continue to improve in China and a sizable middle class begins to emerge.

Yet, bilateral trade relations have grown increasingly strained in recent years over a number of issues, including a large and growing U.S. trade deficit with China ($202 billion in 2005), China's policy of pegging its currency to the dollar and refusal to adopt a floating currency, its poor record of protecting U.S. intellectual property rights (IPR), failure to fully implement its WTO commitments, and use of a number of unfair trade practices (such as use of subsidies and dumping) that are perceived by many Members as negatively various U.S. manufacturing sectors. Numerous bills have been introduced in the 109th Congress that would address these issues, including some that impose significant sanctions against China.

This report provides an overview of U.S.-China trade relations, surveys major trade disputes, and lists congressional legislation that would address these issues.

## U.S. Trade with China[1]

U.S.-China trade rose rapidly after the two nations established diplomatic relations (January 1979), signed a bilateral trade agreement (July 1979), and provided mutual most- favored-nation (MFN) treatment beginning in 1980. Total trade (exports plus imports) between the two nations rose from $5 billion in 1980 to $20 billion in 1990 to $285 billion in 2005. China is now the third-largest U.S. trading partner. Over the past few years, U.S. trade with China has grown at a faster pace than that of any other major U.S. trading partner.

The U.S. trade deficit with China has grown significantly in recent years, due largely to a surge in U.S. imports of Chinese goods relative to U.S. exports to China. That deficit rose from $30 billion in 1994 to $202 billion in 2005 (see **Table 1**). The U.S. trade deficit with China is now larger than that of any other U.S. trading partner,

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[1] For additional statistics on U.S.-China trade, see CRS Report RL31403, *China's Trade with the United States and the World*, by Thomas Lum and Dick K. Nanto. For general information on U.S. China ties, see CRS Report RL32804, *China-U.S. Relations: Current Issues and Implications for U.S. Policy*, by Kerry Dumbaugh.

and in 2005 it was nearly equal to the combined U.S. trade deficits with Japan, Canada, and Mexico ($209 billion).

**Table 1. U.S. Merchandise Trade with China: 1980-2005**

($ in billions)

| Year | U.S. Exports | U.S. Imports | U.S. Trade Balance |
|---|---|---|---|
| 1980 | 3.8 | 1.1 | 2.7 |
| 1985 | 3.9 | 3.9 | 0 |
| 1990 | 4.8 | 15.2 | -10.4 |
| 1995 | 11.7 | 45.6 | -33.8 |
| 2000 | 16.3 | 100.1 | -83.8 |
| 2001 | 19.2 | 102.3 | -83.1 |
| 2002 | 22.1 | 125.2 | -103.1 |
| 2003 | 28.4 | 152.4 | -124.0 |
| 2004 | 34.7 | 196.7 | -162.0 |
| 2005 | 41.8 | 243.5 | -201.6 |

**Source:** USITC DataWeb.

## Major U.S. Exports to China

U.S. exports to China in 2005 were $41.8 billion, up 20.5% over 2004 levels (compared with the rise of total exports to the world at 10.8%) , making China the 4th largest U.S. export market (it was 5th in 2004). U.S. exports to China in 2005 accounted for 4.6% of total U.S. exports (compared to 3.9% in 2003). The top five U.S. exports to China in 2005 were aerospace products, semiconductors and electronic components, waste and scrap, soybeans, and resins and plastic materials (see **Table 2**).

**Table 2. Major U.S. Exports to China: 2001-2005**

($ in billions and % change)

| NAIC Commodity Groupings | 2001 | 2002 | 2003 | 2004 | 2005 | 2004-2005 % Change | 2000-2005 % Change |
|---|---|---|---|---|---|---|---|
| **Total all commodities** | **19.2** | **22.1** | **28.4** | **34.7** | **41.8** | **20.5** | **117.7** |
| Aerospace products and parts (mainly aircraft) | 2.6 | 3.6 | 2.7 | 2.1 | 4.5 | 114.8 | 74.0 |
| Semiconductors and other electronic components | 1.7 | 2.2 | 3.0 | 3.6 | 4.0 | 12.6 | 138.7 |
| Waste and scrap | 1.1 | 1.2 | 1.9 | 2.5 | 3.7 | 36.3 | 232.5 |
| Oilseeds and grains (mainly soybeans) | 1.0 | 0.9 | 2.9 | 2.8 | 2.3 | -17.3 | 125.5 |
| Resin, synthetic rubber, & artificial & synthetic fibers & filament | 0.8 | 0.9 | 1.2 | 1.6 | 2.1 | 30.4 | 175.8 |

**Source:** U.S. International Trade Commission Database.

**Note:** Commodities sorted by top five exports in 2005 using NAIC classification, four-digit level.

Over the past few years, China has been the fastest growing U.S. export market as can be seen in **table 3**. U.S. exports to China rose by 20.5% in 2005 over the previous year, and by 117.7% from 2001 to 2005. These were much faster increases than with any other top 10 U.S. export market (2005) or the world as a whole. U.S. exports to China during January-March 2006 were up by 39.3% over the same period in 2005.

**Table 3. U.S. Merchandise Exports to Major Trading Partners in 2001, 2005, and January-March 2006**

($billions and % Change)

| | 2001 | 2005 | Percent Change From 2004-2005 (%) | Percent Change From 2001-2005 (%) | Percent Change From Jan-Mar. 2006 over Jan-Mar. 2005 (%) |
|---|---|---|---|---|---|
| Canada | 163.7 | 211.4 | 12.6 | 29.1 | 10.9 |
| Mexico | 101.5 | 120.0 | 8.4 | 18.2 | 16.5 |
| Japan | 57.6 | 55.4 | 1.9 | -3.8 | 9.5 |
| **China** | **19.2** | **41.8** | **20.5** | **117.7** | **39.3** |
| United Kingdom | 40.8 | 38.6 | 7.4 | -5.4 | 16.1 |
| Germany | 30.1 | 34.1 | 8.8 | 13.3 | 14.3 |
| South Korea | 22.2 | 27.7 | 5.1 | 24.8 | 16.5 |
| Netherlands | 19.5 | 26.5 | 9.1 | 35.9 | 7.1 |
| France | 19.9 | 22.4 | 5.5 | 12.6 | 10.3 |
| Taiwan | 18.2 | 22.1 | 1.5 | 21.4 | -7.1 |
| World | 731.0 | 904.4 | 10.8 | 23.7 | 14.2 |

Ranking based on top 10 U.S. export markets in 2005.
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. China's goal of modernizing its infrastructure and upgrading its industries is predicted to generate substantial demand for foreign goods and services. According to a U.S. Department of Commerce report: "China's unmet infrastructural needs are staggering. Foreign capital, expertise, and equipment will have to be brought in if China is to build all the ports, roads, bridges, airports, power plants, telecommunications networks and rail lines that it needs." Finally, economic growth has substantially improved the purchasing power of Chinese citizens, especially those living in urban areas along the east coast of China. China's growing economy and large population make it a potentially enormous market. To illustrate:

- China currently has the world's largest mobile phone network, and one of the fastest-growing markets, with 377 million cellular phone users as of 2005 (48 million new subscribers were projected to be added in 2006).

- Boeing Corporation predicts that China will be the largest market for commercial air travel outside the U.S. for the next 20 years; during this period, China will buy 2,300 aircraft valued at $183 billion. By 2023, Chinese carriers are expected to be flying more than 2,801 airplanes, making China the largest commercial aviation market outside the United States. On April 11, 2006, Boeing announced it had signed a general purchase agreement with China for 80 Boeing 737s.

- In 2002, China replaced Japan as the world's second-largest PC market. China also became the world's second-largest Internet user (after the United States) with 111 million users at the end of 2005.

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

However, some U.S. trade analysts contend that China continues to pursue industrial policies aimed at promoting the development of industries that have been deemed by the government as critical for Chinese future economic development. They claim such policies seek to restrict imports of finished products, thus forcing foreign firms to invest in China to gain access to the domestic market. They note a significant level of U.S. exports to China are raw materials, parts, and components used to produce finished goods for export.

## Major U.S. Imports from China

China is a relatively large source of many U.S. imports, especially labor-intensive products. In 2005, imports from China totaled $243 billion, accounting for 14.6% of total U.S. imports in 2005 (up from 6.5% in 1996). U.S. imports from China rose by 23.8% in 2005 over the previous year. The importance (ranking) of China as a source of U.S. imports has risen dramatically, from 8th largest in 1990, to 4th in 2000, to 2nd in 2004 (and 2005).

As indicated in **Table 4**, the top five U.S. imports from China in 2005 were computers and parts, miscellaneous manufactured articles (such as toys, games, etc.), apparel, audio and video equipment, and communications equipment. Throughout the 1980s and 1990s, nearly all of U.S. imports from China were low-value, labor-intensive products such as toys and games, footwear, and textiles. However, over the past few years, an increasing proportion of U.S. imports from China has comprised of more technologically advanced products, such as computers, which rose by 20.3% from 2004-2005.

**Table 4. Top Five U.S. Imports from China: 2001-2005**
($billions and % change)

| NAIC Commodity | 2001 | 2002 | 2003 | 2004 | 2005 | 2004-2005 % Change | 2001-2005 % Change |
|---|---|---|---|---|---|---|---|
| **Total All Commodities** | **102.3** | **125.2** | **152.4** | **196.7** | **243.5** | **23.8** | **138.0** |
| Computer equipment | 8.2 | 12.0 | 18.7 | 29.5 | 35.5 | 20.3 | 332.9 |
| Miscellaneous manufactured commodities (e.g., toys, games, etc.) | 16.5 | 19.5 | 21.8 | 23.7 | 26.4 | 11.5 | 60.0 |
| Apparel | 7.2 | 7.7 | 9.0 | 10.5 | 16.4 | 55.4 | 127.8 |
| Audio and video equipment | 6.3 | 8.9 | 10.0 | 12.6 | 15.6 | 23.3 | 147.6 |
| Communications equipment | 3.1 | 4.4 | 5.9 | 9.0 | 14.1 | 56.6 | 354.8 |

**Source:** U.S. International Trade Commission Trade Data Web.
**Note:** Commodities sorted by top five imports in 2005 using NAIC classification, four-digit level.

Many analysts contend that the sharp increase in U.S. imports from China is largely the result of movement in production facilities from other Asian countries to China.[2] That is, various products that used to be made in Japan, Taiwan, Hong Kong, etc., and then exported to the United States are now being made in China (in many cases, by foreign firms in China) and exported to the United States. An illustration of this shift can be seen in **Table 5** on U.S. imports of computer equipment and parts from 2000-2005. In 2000, Japan was the largest foreign supplier of U.S. computer equipment (with a 19.6% share of total shipments), while China ranked 4th (at 12.1% share). In just five years, Japan's ranking fell to 4th, the value of its shipments dropped by over half, and its share of shipments declined to 7.8% (2005); Singapore and Taiwan also experienced significant declines in their computer equipment shipments to the United States over this period. In 2005, China was by far the largest foreign supplier of computer equipment with a 45.4% share of total imports. While U.S. imports of computer equipment from China rose by 327.7% over the past six years, the total value of U.S. imports from the world of these commodities rose by only 14.2%. Many analysts contend that a large share of the increase in Chinese computer production has come from foreign computer companies who have manufacturing facilities to China.

[2] Chinese data indicate that the share of China's exports produced by foreign-invested enterprises (FIEs) in China rose from 1.9% in 1986 to 58% in 2005.

**Table 5. Major Foreign Suppliers of U.S. Computer Equipment Imports: 2000-2005**

($billions and % change)

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2000-2005 % change |
|---|---|---|---|---|---|---|---|
| Total | 68.5 | 59.0 | 62.3 | 64.0 | 73.9 | 78.2 | 14.2 |
| China | 8.3 | 8.2 | 12.0 | 18.7 | 29.5 | 35.5 | 327.7 |
| Malaysia | 4.9 | 5/0 | 7.1 | 8.0 | 8.7 | 9.9 | 102.0 |
| Mexico | 6.9 | 8.5 | 7.9 | 7.0 | 7.4 | 6.7 | -2.9 |
| Japan | 13.4 | 9.5 | 8.1 | 6.3 | 6.3 | 6.1 | -54.5 |
| Singapore | 8.7 | 7.1 | 7.1 | 6.9 | 6.6 | 5.9 | -32.1 |
| Taiwan | 8.3 | 7.0 | 7.1 | 5.4 | 4.1 | 2.9 | -65.1 |

**Source:** U.S. International Trade Commission Trade Data Web.
**Note:** Ranked according to top 6 suppliers in 2005.

# Major U.S.-China Trade Issues

Although China's economic reforms and rapid economic growth have expanded U.S.-China commercial relations in recent years, tensions have arisen over a wide variety of issues, including the growth and size of the U.S. trade deficit with China (which many Members contend is an indicator that the trade relationship is unfair), China's currency policy (which many Members blame for the size of the U.S. trade deficit with China and the loss of manufacturing jobs in the United States), China's mixed record on implementing its obligations in the WTO, failure to provide adequate protection of U.S. intellectual property rights (IPR), and over the challenges posed by China's rising economic power  Several bills have been introduced to respond to several of these issues (see section on legislation).

## China's Currency Policy[3]

Between 1994 and July 2005, China pegged its currency, the yuan, to the U.S. dollar at about 8.28 yuan to the dollar. In order to maintain the rate of exchange with the dollar, the government has maintained restrictions and controls over capital transactions and through large scale purchases of U.S. dollars. For example, most firms in China are required to exchange a large share of their hard currency earnings to the central government in exchange for yuan.

Many U.S. policymakers and business representatives have charged that China's currency is significantly undervalued vis-à-vis the U.S. dollar (with estimates ranging from 15 to 40%), making Chinese exports to the United States cheaper, and U.S.

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[3] For additional information on this issue, see CRS Report RS21625, *China's Currency Peg: A Summary of the Economic Issues*, by Wayne Morrison and Marc Labonte; and CRS Report RL32165, *China's Exchange Rate Peg: Economic Issues and Options for U.S. Trade Policy*, by Wayne Morrison and Marc Labonte.

exports to China more expensive, than they would be if exchange rates were determined by market forces. They complain that this policy has particularly hurt several U.S. manufacturing sectors (such as textiles and apparel, furniture, plastics, machine tools, and tool and dye), which are forced to compete against low-cost imports from China, and has contributed to the growing U.S. trade deficit with China. They have called on the Bush Administration to pressure China either to appreciate its currency or to allow it to float freely in international markets.

Chinese officials argue that its currency policy is not meant to favor exports over imports, but instead to foster economic stability. They have expressed concern that abandoning its currency policy could cause an economic crisis in China and would especially hurt its export industries sectors at a time when painful economic reforms (such as closing down inefficient state-owned enterprises and restructuring the banking system) are being implemented. Chinese officials view economic stability as critical to sustaining political stability; they fear an appreciated currency could reduce jobs and lower wages in several sectors and thus cause worker unrest.

U.S. critics of China's currency policy contend that the low value of the yuan has forced other East Asian economies to keep the value of their currencies low vis-à-vis the U.S. dollar in order to compete with Chinese products. They further note that while China is still a developing country, it has been able to accumulate massive foreign exchange reserves ($819 billion at end of 2005) and thus has the resources to maintain the stability of its currency if it were fully convertible. They also argue that appreciating the yuan would greatly benefit China by lowering the cost of imports. Several bills have been introduced in Congress to address this issue (see legislation section below). On the other hand, some analysts have indicated concern that pushing China to appreciate its currency could cause it to decrease purchases of U.S. Treasury securities, which might result in higher U.S. interest rates. China is the second largest foreign purchaser (after Japan) of U.S. Treasury securities ($265 billion at end of February 2006).

**The Bush Administration's Response.** President Bush has criticized China's currency peg, stating that exchange rates should be determined by market forces, and he has raised the issue during meetings with high level Chinese officials (including Chinese President Hu Jintao. Initially, the Bush Administration rejected calls from several Members to apply direct pressure on China to force it to abandon its currency peg. Instead, the Administration sought to encourage China to reform its financial system under the auspices of a joint technical cooperation program, agreed to on October 14, 2003.

The Administration's position on China's currency peg appears to have toughened in April 2005, when (then) U.S. Treasury Secretary John Snow stated at a G-7 meeting that "China is ready now to adopt a more flexible exchange rate." In its May 17, 2005 report on exchange rate policies, the Treasury Department stated that China's currency peg policy "is a substantial distortion to world markets" and that "China is now ready to move to a more flexible exchange rate and should move now." The report warned that the Treasury Department would closely monitor China's progress over the next six months.

**China Changes its Currency Policy.** On July 21, 2005, the Chinese government announced that the yuan's exchange rate would become "adjustable, based on market supply and demand with reference to exchange rate movements of currencies in a basket," (which include the U.S. dollar, the Japanese yen, the euro, the South Korean won, and a number of other currencies), and that the exchange rate of the yuan to the U.S. dollar would be immediately adjusted from 8.28 to 8.11, an appreciation of about 2.1%. Congressional reaction to China's announcement was mixed — many welcomed the move, but some referred to it as merely a good first step and called on China to further appreciate the yuan. However, on July 26, 2005, China's Central Bank stated it had no immediate plans for further revaluations and that reforms would be done in a "gradual" way.

In its November 28, 2005 report to Congress on exchange rate policies, the Treasury Department did not cite China as a country that manipulates its currency, but concluded that it had failed to fully implement its commitment to make its new exchange rate mechanism more flexible and to increase the roll of market forces. Instead, the report stated that China's new currency appears to strongly resemble the previous mechanism of pegging the yuan to the dollar. However, the report stated that Treasury would not cite China as a manipulator because of China's assurances that it was committed to "enhanced, market-determined currency flexibility" and that it would put greater emphasis on promoting domestic sources of growth, including financial reform. Many Members of Congress have expressed disappointment with China's July 2005 reforms, as well as the conclusions of the November 2005 U.S. Treasury report. On April 17, 2006, Deputy U.S. Secretary of State Robert Zoellick complained that China was moving "agonizingly slow" in making its currency more flexible.

On May 10, 2006, the Treasury Department issued its semi-annual exchange rate report, which stated that, while China had moved too slowly in making its exchange rate regime more flexible, it would not be designated as a country that manipulates its currency.

A number of bills have been introduced Generally speaking three major approaches have been suggested. One approach would raise U.S. tariffs on Chinese imports by a rate comparable to the estimated level of the yuan's undervaluation (27.5% is the most common estimate used by sponsors of such legislation. A second approach would change U.S. law to redefine, or more clearly define, what constitutes currency manipulation and therefore pressure the Administration to utilize U.S. trade law and international finance bodies (such as the WTO and International Monetary Fund) to address China's currency policy. A third approach would change U.S. trade law to enable U.S. firms to utilize U.S. countervailing laws (dealing with government subsidies) against nonmarket economies (these proposals are described in the legislation section below).

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

- Reduce the average tariff for industrial goods and agriculture products to 8.9% and 15%, respectively (with most cuts made by 2004 and all cuts completed by 2010).

- Limit subsidies for agricultural production to 8.5% of the value of farm output and eliminate export subsidies on agricultural exports.

- Within three years of accession, grant full trade and distribution rights to foreign enterprises (with some exceptions, such as for certain agricultural products, minerals, and fuels).

- Provide non-discriminatory treatment to all WTO members. Foreign firms in China will be treated no less favorably than Chinese firms for trade purposes. 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. That agreement establishes basic standards on IPR protection and rules for enforcement.

- Accept a 12-year safeguard mechanism (available to other WTO members as well) in cases where a surge in Chinese exports cause or threaten to cause market disruption to domestic producers.

- Fully open the banking system to foreign financial institutions withing five years. Joint ventures in insurance and telecommunication will be permitted (with various degrees of foreign ownership allowed).

## WTO Implementation Issues

China has made great strides in implementing key aspects of its WTO commitments. For example, its average overall tariff has dropped to from 15.6% in 2001 to 9.9% in 2006. However, there have been several areas where China's implementation is considered to be incomplete. The USTR's fourth annual China WTO compliance report (issued in December 2005 identified several areas of concern, including failure by the Chinese government to maintain an effective IPR

enforcement regime (discussed below), discriminatory import policies, burdensome regulations and restrictions on services, discriminatory health and safety rules on imports (especially agricultural products), restrictions on trading rights and distribution, failure to provide adequate transparency of trade laws and regulations, and industrial policies that discriminate against foreign companies.

The USTR's report stated that China's failure to comply with key areas of its WTO commitments largely stemmed from its incomplete transition to a market based economy. A significant part of the economy, including the banking system and state owned enterprises (SOEs), are controlled by the central government — remnants of the old command economy that existed before reforms began in 1979. Although China agreed to make SOEs operate according to free market principles when it joined the WTO, U.S. officials contend that SOEs are still being subsidized, especially through the banking system. A large share of China's exports come from SOEs, therefore, the Chinese government use of subsidies is seen as damaging to U.S. firms.

When China joined the WTO, it agreed to provide a full description of all its subsidy programs, but to date has failed to fully do so. In addition, China agreed to make its state-owned enterprises operate according to market principles; yet such firms continue to receive direction and guidance from the central government. Finally, China agreed to end various policies used to promote the development of domestic industries (such as domestic content rules, technology transfer requirements, and discriminatory policies on imported products), but these practices continue: For example:

- In July 2005, the Chinese government issued new guidelines on steel production, which reportedly includes provisions for the preferential use of domestically produced steel-manufacturing equipment and domestic technologies; extensive government involvement in determining the number, size, location, and production quantities of steel producers in China; technology transfer requirements on foreign investment, and restrictions on foreign majority ownership. On June 14, 2006, Assistant U.S. Trade Representative for China Tim Stratford stated that China's steel guidelines were "troubling, because it attempts to dictate industry outcomes and involves the government in making decisions that should be left to the marketplace.[4]" The U.S. steel industry has expressed growing fears that Chinese government policies have led to overinvestment and overcapacity in China's domestic steel industry, which could lead it to flood world markets with cheap steel.[5] Such concerns led the

[4] Statement of Timothy, Stratford, Assistant U.S. Trade Representative for China Affairs, before the Congressional Steel Caucus, June 14, 2006.

[5] China is now the world's largest steel producer, accounting for 31% of the world's steel production. Its steel production levels rose by 25% over the previous year. According to U.S. officials, China's excess steel capacity in 2006 could be larger than total U.S. steel production.

USTR to begin a Steel Dialogue with China (which first met in March 2006) to discuss issues of concern to the U.S. steel industry.

- China's Automotive Industrial Policy, issued by the government in May 2004 includes provisions discouraging the importation of auto parts and encouraging the use of domestic technology, while requiring new automobile and automobile engine plants to include substantial investment in research and development facilities. New auto parts regulations that went into effect in April 2005 discriminate against imported auto parts by assessing an additional charge on imported parts if they are incorporated into a vehicle that does not meet minimum levels of domestic content.[6] On March 30, 2006, the USTR initiated a WTO case against China for its use of discriminatory regulations on imported auto parts, stating that the purpose of these rules was to discourage domestic producers from using imported parts and encouraging foreign firms to move production to China.

- 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% VAT rate 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.

**Most Recent Developments on Market Access.** A number of market access issues were discussed during the latest round of meetings held under the auspices of the U.S.-China Joint Commission on Commerce and Trade (JCCT) held on April 11, 2006.[7] China pledged to expand market access for U.S. beef (by conditionally resuming imports that were suspended in December 2003), telecommunications services, and medical equipment and to begin negotiations to join the WTO Government Procurement Agreement. On June 30th, 2006, China announced a partial opening of its beef market to U.S. boneless beef under 30 months of age. However, U.S. officials have expressed disappointment that China has failed

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[6] China applies higher tariffs on imported auto parts when a specific combination of parts is used to produce cars in China, or if the value of these parts amounts to 60 percent or more of the cost of a car made in China. This policy increases tariffs on some auto parts from a range of 10 to 15 percent to 28 percent, which is the tariff China currently applies to imports of completed autos. (Source: *Inside U.S.-China Trade*, April 6, 2006).

[7] The JCCT was established in 1983 to provide a forum for high level bilateral economic and trade discussions.

to develop a science-based trading protocol for importing beef from the United States, which would enable the United States to resume all beef trade with China.

## Violations of U.S. Intellectual Property Rights

The United States has pressed China to improve its IPR protection regime since the late 1980s. In 1991, the United States (under a Section 301 case) threatened to impose $1.5 billion in trade sanctions against China if it failed to strengthen its IPR laws. Although China later implemented a number of new IPR laws, it often failed to enforce them, which led the United States to once again threaten China with trade sanctions. The two sides reached a trade agreement in 1995, which pledged China to take immediate steps to stem IPR piracy by cracking down on large-scale producers and distributors of pirated materials and prohibiting the export of pirated products, establishing mechanisms to ensure long-term enforcement of IPR laws and providing greater market access to U.S. IPR-related products.

Under the terms of China's WTO accession (see above), China agreed to immediately bring its IPR laws in compliance with the WTO agreement on Trade Related Aspects of Intellectual Property Rights (TRIP). The USTR has stated on a number of occasions that China has made great strides in improving its IPR protection regime, noting that it has passed several new IPR-related laws, closed or fined several assembly operations for illegal production lines, seized millions of illegal audio-visual products, curtailed exports of pirated products, expanded training of judges and law enforcement officials on IPR protection, and expanded legitimate licensing of film and music production in China. However, the USTR has indicated that much work needs to be done to improve China's IPR protection regime.

U.S. business groups continue to complain about significant IPR problems in China, especially of illegal reproduction of software, retail piracy, and trademark counterfeiting. It is estimated that counterfeits constitute between 15 and 20% of all products made in China and totals and accounts for about 8% of China's GDP. Chinese enforcement agencies and judicial system often lack the resources (or the will) needed to vigorously enforce IPR laws; convicted IPR offenders generally face minor penalties. In addition, while market access for IPR-related products has improved, high tariffs, quotas, and other barriers continue to hamper U.S. exports; such trade barriers are believed to be partly responsible for illegal IPR-related smuggling and counterfeiting in China. Industry analysts estimate that IPR piracy in China cost U.S. copyright firms $2.3 billion in lost sales in 2005.[8] The piracy rate for IPR-related products in China (such as motion pictures, software, and sound recordings) is estimated at around 90%.[9] In addition, China accounts for a significant share of imported counterfeit products seized by U.S. Customs and Border Protection: $64 million, or 69% of total goods seized, in FY2005.

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[8] International Intellectual Property Alliance(IIPA), 2006 Special 301 Report: People's Republic of China, February 2006 (available at [http://www.iipa.com]).

[9] The IIPA estimated China's piracy rates in 2005 in the following areas : motion pictures (93%), records and music (85%), business software (88%), and entertainment software (92%).

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

- In April 2004, the Chinese government pledged to "significantly reduce" IPR infringement levels by increasing efforts to halt production, imports, and sales of counterfeit goods and lowering the threshold for criminal prosecution of IPR violations.

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

- On December 16, 2004, General Motors Daewoo Auto & Technology Company (a division of General Motors) filed a case in China against Chery Automobile Co. Ltd. (a Chinese firm) for allegedly violating its IPR by copying one of its car models (the Chevrolet Spark) to produce the Chery QQ. The two companies reportedly settled the issue in November 2005. [10] However, case has raised concern in the United States because Chery is planning to export its vehicles to the United States beginning in 2007.

- On February 9, 2005, the International Intellectual Property Alliance and the U.S. Chamber of Commerce urged the USTR to initiate WTO consultations with China for its poor record on IPR enforcement.

- On April 29, 2005, the USTR announced that it had placed China on the Special 301 "Priority Watch List," due to "serious concerns"over China's compliance with its WTO IPR obligations and China's failure to fully implement its pledges on IPR made in April 2004 to make a significant reduction in IPR piracy. The USTR urged China to launch more criminal piracy cases and to improve market access for IPR-related products, and warned that it was considering taking a case to the WTO if IPR enforcement did not soon show significant improvement.

- During the JCCT July 2005 meeting, China agreed to boost enforcement of IPR, such as increasing criminal prosecutions of IPR offenders, improving cooperation among Chinese enforcement officials and between U.S. and Chinese IPR officials, and taking special steps to halt movie and internet piracy. It also pledged to improve government coordination of enforcement efforts, and to ensure the use by all levels of the Chinese government (including state-owned firms) of legitimate software products. In addition, the

[10] *Asia Wall Street Journal*, November 21, 2005.

Chinese government agreed to delay implementing proposed regulations restricting government purchases of foreign-made software.

**Most Recent Action on IPR.** On October 26, 2005, the United States initiated a special process under WTO rules to obtain detailed information on China's IPR enforcement efforts. On December 22, 2005, China responded by challenging the legal basis for such a request in the WTO. U.S. officials have stated, that failure by China to provide the requested information could lead the United States to bring a trade dispute resolution case against China in the WTO over its lack if IPR protection. During the JCCT meeting on April 11, 2006, China pledged to improve IPR protection by requiring computers manufactured in China to contain legitimate software. On April 19, 2006, Chinese president Hu asserted that licensed computer software was being introduced in all levels of government and that in 2006, this would be extended to include large enterprises.

## Chinese Acquisition of U.S. Companies

China's rise as an economic power has raised a number of concerns among U.S. policymakers. Of particular concern over the past year has been efforts by Chinese companies with substantial state ownership to make bids to take over major U.S. companies. Many Members believe these takeovers could pose risks to U.S. economic and national security interests. Some of these major takeover bids include:

- On December 8, 2004, Lenovo Group Limited, a computer company primarily owned by the Chinese government, signed an agreement with IBM Corporations to purchase IBM's personal computer division for $1.75 billion. On April 30, 2005, the acquisition was completed.

- On June 20, 2005, Haier Group, a major Chinese home appliances manufacturer, made a $1.28 billion bid to take over Maytag Corporation. The bid was withdrawn on July 19, 2005.

- On June 23, 2005, the China National Offshore Oil Corporation (CNOOC), through its Hong Kong subsidiary (CNOOC Ltd.), made a bid to buy a U.S. energy company, UNOCAL, for $18.5 billion. On August 2, 2005, CNOOC withdrew its bid.

Congressional concern over Chinese efforts to purchase U.S. concerns is driven in part by the perception that China does not play by the rules in international trade policy. For example, most of China's major companies are state-owned or are largely owned by the state.[11] Many U.S. analysts believe that Chinese state firms are heavily subsidized by the government (primarily through the banking system where loans often go unpaid) and that the government has a plan to direct companies under its control to purchase major international companies to obtain their brand names and thus become global companies. Some analysts believe that the Chinese government

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[11] CNOOC, for example, is 70% owned by the Chinese government.

may also be involved in financing takeover bids. Finally, many Members contend that Chinese firms should not be allowed to take over U.S. firms because, in most cases, China does not allow foreign firms to take over major Chinese companies (rather it sometimes permits minority ownership in some companies).

**Congressional Concern Over the CNOOC Bid.** CNOOC's bid to take over Unocal was particularly troublesome to many Members of Congress. On June 27, 2005, Representative Joe Barton, Chairman of the House Energy and Commerce Committee, and Representative Ralph Hall, chairman of the House Energy and Commerce Subcommittee on Energy and Air Quality sent a letter to President Bush expressing "deep concern" over CNOOC's bid to take over Unocal, describing it "a clear threat to the energy and national security of the United States." The letter went on to state that the transaction would put vital oil assets in the Gulf of Mexico and Alaska into the hands of a Chinese state controlled company, contrary to the goal of enhanced energy independence embodied in the House-passed energy bill (H.R. 6). Finally, the letter stated that the deal could transfer "a host of highly advanced technologies" to China. The letter concluded by urging the President to ensure that "vital U.S. energy assets are never sold to the Chinese government." In the Senate, letters written by Senators Conrad, Portman, and Grassley expressed concerns that CNOOC's bid to take over Unocal would be heavily subsidized by the Chinese government and urged the Administration to determine whether the CNOOC bid would be a violation of China's WTO commitments. Several bills were introduced on CNOOC's bid, including some that would have blocked the sale had it gone through.

CNOOC made a number of pledges to allay concerns, including promising that most of the oil and gas produced by UNOCAL in the United States would still be sold in the United States and that most Unocal jobs in the United States would be retained. The chairman of CNOOC stated that his company's main interest in UNOCAL was its large holdings of oil and gas in Asia, not the United States. However, on August 2, 2005, CNOOC announced it was withdrawing its bid, citing significant political opposition to the sale in the United States, which the company termed as "regrettable and unjustified."[12]

## Textile and Apparel Products

Various U.S. industry groups have called on the Administration to invoke special safeguard provisions (included in China's WTO accession package) that would enable the United States to restrict imports of certain Chinese products deemed harmful to U.S. industries. U.S. producers of textile and apparel products have been particularly vocal over the competitive pressures they face from China, especially since U.S. textile and apparel quotas on Chinese goods were eliminated in January 2005.[13] According to the U.S. Commerce Department, China is the United

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[12] For an overview of this issue, see CRS Report RL33093, *China and the CNOOC Bid for Unocal: Issues for Congress*, by Dick K. Nanto, James K. Jackson, and Wayne M. Morrison.

[13] For additional information on U.S.-China textile issues, see CRS Report RL32168, (continued...)

States' largest foreign supplier of textiles and apparel, accounting for one-third of total imports in 2005 (or $16.8 billion). U.S. textile and apparel imports from China were 43.7% higher than they were in 2004 (compared with an 8.3% growth in total U.S. imports of these products from the world). The sharp rise in textile and apparel imports from China led the Administration to seek an agreement with China to limit the level of its textile and apparel exports to the United States. On November 8, 2005, China agreed to restrict various textile and apparel exports to the United States (according to specified quota levels) from January 2006 through the end of 2008.

# U.S.-China Trade Legislation in the 109th Congress

A number of bills that would affect U.S.-China trade relations have been introduced in the 109th Congress. This section lists major bills and congressional action.

## Comprehensive China Trade Legislation

Legislation has been introduced that seeks to address a wide number of trade disputes in U.S.-China relations:

- H.R. 3283 (English) would apply U.S. countervailing laws (dealing with foreign government subsidies) to non-market economies; establish a comprehensive monitoring system to track China's compliance with specific WTO commitments and pledges made at JCCT meetings (such as on market access, IPR protection, and reporting subsidies), and to require reports to Congress on China's progress on meeting these commitments; tighten rules on anti-dumping duties to prevent non-payment; require the Treasury Department to define "currency manipulation," describe actions that would be considered to constitute manipulation, and report on China's new currency regime; increase funding for the USTR to improve monitoring and enforcement of U.S. trade agreements; and require the U.S. International Trade Commission to conduct a comprehensive study on U.S.-China trade and economic relations. The bill passed (255 to 168) on July 27, 2005. A similar bill has been introduced in the Senate, S.1421 (Collins).

- S. 2467 (Grassley) would require the Treasury Department to engage the International Monetary Fund (IMF) and other countries to resolve major currency imbalances with the dollar and would take specific action against countries that refuse to promote the fair valuation of their currency; require the Secretary of Treasury to identify "fundamentally misaligned currencies" that adversely affect the U.S. economy; and require the USTR's office to work more

[13] (...continued)
*Safeguards on Textile and Apparel Imports from China*, by Vivian C. Jones.

closely with Congress in identifying and resolving the most serious trade and investment barriers faced by U.S. firms.

- H.R. 3306 (Rangel) would apply U.S. countervailing laws to non-market economies; require the USTR to bring a case against China in the WTO over its currency practices; define currency manipulation in U.S. trade law as "protracted large-scale intervention by an authority to undervalue its currency in the exchange market;" narrow the discretion of the USTR and the President to deny relief for U.S. industries that are injured due to import surges from China; tighten rules on anti-dumping duties to prevent non-payment; and would reinstate "Super 301" to require the President to identify trade expansion priorities and to take action against countries that maintain the most significant barriers to U.S. exports.

- H.R. 4186 (Camp) would create a Chief Trade Prosecutor to ensure compliance with trade agreements. (The sponsors of the bill named China and Japan as the prime targets of their bill).

- S. 2317 (Baucus) would require the USTR to identify trade enforcement priorities and to take action with respect to priority foreign country trade practices, establishes within the USTR's office a Chief Enforcement Officer and a Trade Enforcement Working Group.

## Bills Addressing China's Currency Policy

In addition to H.R. 3283, S. 2467, and H.R. 3306, the following bills would address China's currency policy:

- S. 14 (Stabenow), S. 295 (Schumer), and H.R. 1575 (Myrick) direct the Secretary of the Treasury to negotiate with China to accept a market-based system of currency valuation, and imposes an additional duty of 27.5% on Chinese goods imported into the United States unless the President submits a certification to Congress that China is no longer manipulating the rate of exchange and is complying with accepted market-based trading policies. H.R. 3004 (English) would require the Treasury Department to determine if China manipulated its currency and to impose additional tariffs on Chinese goods comparable to the rate of currency manipulation.

- S.Amdt. 309 (Schumer) to S. 600 would impose a 27.5% tariff on Chinese goods if China failed to substantially appreciate its currency to market levels. (The amendment contained the same language as S. 295). On April 6, 2005, the Senate failed (by a vote of 33 to 67) to reject the amendment, In response to the vote, the Senate leadership moved to allow a vote on S. 295 no later than July 27, 2005, as long as the sponsors of the amendment agree not to sponsor similar amendments for the duration of the 109th Congress. On June

30, 2006, the sponsors of S. 295 agreed to delay consideration of the bill after they received a briefing from Administration officials and were told that China was expected to make significant progress on reforming its currency over the next few months (which it did in July). On March 28, 2006, Senators Schumer and Graham stated that they would move to further delay taking up S. 295, based on their assessment during a trip to China that the Chinese government was serious about reforming its currency policy.

- H.R. 3157 (Dingell) and S. 377 (Lieberman) direct the President to negotiate with those countries determined to be engaged most egregiously in currency manipulation and to seek an end to such manipulation. If an agreement is not reached, the President is directed to institute proceedings under the relevant U.S. and international trade laws (such as the WTO) and to seek appropriate damages and remedies for affected parties.

- H.R. 2208 (Manzullo), S. 984 (Snowe), and S. 1048 (Schumer) adds changes to the criteria that the U.S. Treasury Department is required to consider when making a determination on currency manipulation (including a protracted large-scale intervention in one direction in the exchange markets) in its report to Congress on exchange rate policies.

- H.R. 2414 (Rogers, Mike) would require the Treasury Department to make a determination whether China's currency policy interferes with effective balance of payments adjustments or confers a competitive advantage in international trade that would not exist if the currency value were set by market forces. If such a determination were made, the President would be required to bring a WTO case against China to seek across-the-board tariffs on Chinese goods in order to offset the subsidy effects of undervaluation.

- H.R. 1216 (English) and S. 593 (Collins) would apply U.S. countervailing laws to nonmarket economies. H.R. 1498 (Tim Ryan) would apply U.S. countervailing laws to countries that manipulate their currencies.

- S.Res. 270 (Bayh) expresses the sense of the Senate that the IMF should investigate whether China is manipulating its currency.

## Other Bills

- H.Amdt. 381 (Sanders) to H.R. 3057 would prohibit the U.S. Export-Import Bank from financing the sale of U.S. nuclear power equipment to China. The amendment passed on June 28, 2005, by a vote of 313 to 114. A similar measure in the Senate (S.Amdt.1242 to H.R. 3057) failed to pass, by a margin of 37 to 62, on July 19, 2005.

- H.Con.Res. 203 (Rangel) expresses the sense of the Congress that the United States should seek a commitment from China to join the WTO Agreement on Government Procurement.

- H.Con.Res. 303 (DeFazio) urges the USTR to take action to ensure that the China complies with its IPR obligations to protect IPR.

- H.R. 738 (Sanders) would terminate NTR status for China, while S. 2267 (Dorgan) would revoke China's PNTR status.

- H.R. 4808 (Walter Jones) would prohibit imports of Chinese autos unless China maintained the same tariff rate on such vehicles as the United States.

- H.R. 4780 (Christopher Smith) would attempt to promote freedom of expression on the Internet in certain countries (including China). H.R. 4741 (Ros-Lehtinen) would promote the development and deployment of technologies to prevent internet jamming by various countries (such as China).

## Most Recent Developments in U.S.-China Trade Relations

On June 30th, 2006, China announced a partial opening of its beef market to U.S. boneless beef under 30 months of age. However, U.S. officials expressed disappointment that China had not yet developed a science-based trading protocol for importing beef from the United States, which would enable the United States to resume all beef trade with China.

On May 10, 2006, the Treasury Department issued its semi-annual report on exchange rate policies. The report stated that, while China had moved too slowly in making its exchange rate regime more flexible, it would not be designated as a country that manipulates its currency.

On April 13, 2006, Chinese Vice Premier Wu Yi stated that Chinese companies had signed contracts to purchase $16.2 billion worth of American goods and services, including airplanes, electronics, auto parts, heavy equipment, software, cotton, and soybeans.

On April 11, 2006, the 17th session of the U.S.-China Joint Commission on Commerce and Trade (JCCT) began. China pledged to expand market access for U.S. beef (by conditionally resuming imports that were suspended in December 2003), telecommunications services, and medical equipment; to improve IPR protection (such as requiring computers manufactured in China to use legitimate software); and to begin negotiations to join the WTO Government Procurement Agreement.

On March 30, 2006, the United States and European Union initiated a WTO case against China over its discriminatory tax treatment of imported auto parts.

On March 28, 2006, Senators Schumer and Graham stated that they would move to delay taking up S. 295 (a bill that would impose 27.5% tariffs on Chinese goods unless China appreciated its currency to market levels) in the Senate, based on their assessment during a trip to China that the Chinese government was serious about reforming its currency policy.

On February 14, 2006, the USTR issued a report describing the results of its "top-to-bottom" examination of U.S. trade policy towards China and outlining steps that would be taken to strengthen efforts to ensure China's compliance with its trade commitments. USTR Rob Portman stated that "overall, our U.S.-China trade relationship today lacks equity, durability, and balance in the opportunities it provides."