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China-U.S. Trade Issues

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China-U.S. Trade Issues

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 $343 billion in 2006. China is also now the 2nd largest U.S. trading partner, its 2nd largest source of U.S. imports, and its 4th largest export market. With a huge population and a rapidly expanding economy, China is a potentially huge market for U.S. exporters.

Several Members have called upon the Bush Administration to take a more aggressive stance against certain Chinese trade policies, fueled by concerns over (1) the continued rise in the trade imbalance, (2) competitive challenges posed by cheap Chinese imports, and (3) U.S. jobs lost to unfair Chinese trade practices. 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 action helped induce 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 (that includes the dollar). However, many U.S. policymakers charge that these reforms have not gone far enough and that the yuan (despite modest appreciation) remains highly undervalued.

It has been five years since China joined the World Trade Organization (WTO). U.S. officials have raised a number of concerns over China's mixed record of WTO compliance. Of particular concern has been China's failure to implement an effective strategy to combat rampant intellectual property rights (IPR). 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. Another U.S. concern is over China's use of industrial policies that attempt to promote the development of domestic firms at the expense of foreign companies. On March 30, 2006, the United States initiated a WTO case against China over its discriminatory tax treatment of imported auto parts, and on February 5, 2007, it initiated a WTO case regarding various Chinese subsidy policies.

Several bills have been introduced in Congress to address Chinese economic policies deemed harmful to U.S. economic interests, including China's currency policy. In response to growing congressional concerns over these issues, on December 14-15, 2006, the Bush Administration held its first round of talks with China under the "Strategic Economic Dialogue" (SED), a high-level government forum established to discuss major long-term economic issues, including China's currency policy and its protection of IPR.

This report examines major U.S.-China trade issues and will be updated as events warrant.

Contents

U.S. Trade with China 1
Major U.S. Exports to China 3
Major U.S. Imports from China 5

Major U.S.-China Trade Issues 7
China's Currency Policy 7
The Bush Administration's Response 8
China Changes its Currency Policy 9
Most Recent Developments 9
China and the World Trade Organization 10
WTO Implementation Issues 11
U.S. WTO Cases Against China 13
Violations of U.S. Intellectual Property Rights 13
Chinese Acquisition of U.S. Companies 16
Congressional Concern Over the CNOOC Bid 17
Textile and Apparel Products 17

U.S.-China Trade Legislation in the 110th Congress 18

List of Tables

Table 1. U.S. Merchandise Trade with China: 1980-2006 2
Table 2. U.S. Trade Balances with Major Trading Partners: 2006 2
Table 3. Major U.S. Exports to China: 2002-2006 3
Table 4. U.S. Merchandise Exports to Major Trading Partners in 2001 and 2006 4
Table 5. Top Five U.S. Imports from China: 2002-2006 6
Table 6. Major Foreign Suppliers of U.S. Computer Equipment Imports: 2000-2006 7

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; in 2006, China ranked as the 4th largest export market and its 2nd largest source of imports. 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 (at $233 billion in 2006), China's refusal to adopt a floating currency, and failure to fully implement its WTO obligations, especially in regards to IPR protection. Several Members have called on the Administration to take a tougher stance against China to induce it to eliminate economic policies deemed harmful to U.S. economic interests and/or are inconsistent with WTO rules.

This report provides an overview of U.S.-China economic relations, surveys major trade disputes, and lists major legislation in the 110th that seeks to 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 $343 billion in 2006, making China the 2nd largest U.S. trading partner. Over the past few years, U.S. trade with China has grown at a faster pace than that with 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.

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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. For more information on China's economy, see CRS Report RL33534, *China's Economic Conditions*, by Wayne M. Morrison.

That deficit rose from $30 billion in 1994 to an estimated $232 billion in 2006 (see **Table 1**). The U.S. trade deficit with China is now larger than that of any other U.S. trading partner. It was more than two and a half times larger than the U.S. deficit with Japan (the second largest U.S. bilateral trade deficit), and nearly twice as large as that with the 27 countries that make up the European Union (see **Table 2**).

Table 1. U.S. Merchandise Trade with China: 1980-2006
($ 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
2006	55.2	287.8	-232.6

Source: USITC DataWeb.

Table 2. U.S. Trade Balances with Major Trading Partners: 2006
($ in billions)

Country or Trading Group	U.S. Trade Balance
World	-818.0
China	-232.6
European Union (EU27)	-117.3
Organization of Petroleum Exporting Countries (OPEC)	-104.9
Japan	-88.4
Canada	-73.2
Mexico	-64.1
Association of Southeast Asian Nations (ASEAN)	-53.9

Source: USITC DataWeb.

Major U.S. Exports to China

U.S. exports to China in 2006 were an estimated $55.2 billion, up 32% over 2005 levels, making China the 4th largest U.S. export market (it was 5th in 2004). It could overtake Japan to become the 3rd largest export market in 2007. U.S. exports to China in 2006 accounted for 5.3% of total U.S. exports (compared to 3.9% in 2003). The top five U.S. exports to China in 2006 semiconductors and electronic components, aircraft and parts, waste and scrap, oilseeds and grain, and resins and synthetic rubber and fibers (see **Table 3**).

Over the past few years, China has been the fastest growing U.S. export market among major U.S. export markets as can be seen in **Table 4**. U.S. exports to China rose by nearly 188% over the past six years (2001-2006). If these trends continue, China could replace Japan as the third largest U.S. export market in 2007.

Table 3. Major U.S. Exports to China: 2002-2006

($ in billions and % change)

NAIC Commodity Groupings	2002	2003	2004	2005	2006	2005-2006 % Change
Total all commodities	**22.1**	**28.4**	**34.7**	**41.8**	**55.2**	**32.1%**
Semiconductors and other electronic components	2.2	3.0	3.6	4.0	6.8	70.1
Aerospace products and parts (mainly aircraft)	3.6	2.7	2.1	4.5	6.3	39.1
Waste and scrap	1.2	1.9	2.5	3.7	6.1	65.4
Oilseeds and grains (mainly soybeans)	0.9	2.9	2.8	2.3	2.6	10.9
Resin, synthetic rubber, & artificial & synthetic fibers & filament	0.9	1.2	1.6	2.1	2.5	19.8

Source: U.S. International Trade Commission Database.
Note: Commodities sorted by top five exports in 2006 using NAIC classification, four-digit level.

Table 4. U.S. Merchandise Exports to Major Trading Partners in 2001 and 2006

($ in billions and % change)

	2001	2006	Percent Change From 2005-2006 (%)	Percent Change From 2001-2006 (%)
Canada	163.7	230.3	8.9	40.7
Mexico	101.5	134.2	11.8	32.2
Japan	57.6	59.6	7.7	3.5
China	**19.2**	**55.2**	**32.0**	**187.5**
United Kingdom	40.8	45.4	17.5	11.3
Germany	30.1	41.3	21.0	37.2
South Korea	22.2	32.5	32.5	46.4
Netherlands	19.5	31.1	17.4	59.5
Singapore	17.7	24.7	19.6	39.5
France	19.9	24.2	8.1	21.6
World	731.0	1,037.3	14.7	41.9

Source: USITC DataWeb.
Note: Ranked by top 10 U.S. export markets in 2006.

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 an estimated 432 million cellular phone users (as of August 2006), compared to 87 million users in 2000.

- 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, and that figure rose to 136 million users in 2006.

- 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 7.2 million units (2006) to 20.7 million units. According to some estimates, China is now the world's second largest market for new cars. General Motors announced that it sold 877 thousand vehicles in China in 2006, up 32% from 2005, while Ford stated its Chinese sales were 167 thousand vehicles, up 87%.

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 major source of many U.S. imports, especially labor-intensive products. In 2006, imports from China totaled $288 billion, accounting for 15.5% of total U.S. imports in 2006 (up from 6.5% in 1996). U.S. imports from China rose by 18.2% in 2006 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 2004-2006. The top five U.S. imports from China in 2006 were computers and parts, miscellaneous manufactured articles (such as toys, games, etc.), apparel, audio and video equipment, and communications equipment (see **Table 5**).

Table 5. Top Five U.S. Imports from China: 2002-2006
($ in billions and % change)

NAIC Commodity	2002	2003	2004	2005	2006	2005-2006 % Change
Total All Commodities	**125.2**	**152.4**	**196.7**	**243.5**	**287.8**	**18.2%**
Computer equipment	12.0	18.7	29.5	35.5	40.0	12.9
Miscellaneous manufactured commodities (e.g., toys, games, etc.)	19.5	21.8	23.7	26.4	28.9	9.2
Apparel	7.7	9.0	10.5	16.4	19.2	17.5
Audio and video equipment	8.9	10.0	12.6	15.6	18.8	22.9
Communications equipment	4.4	5.9	9.0	14.1	18.0	27.3

Source: U.S. International Trade Commission Trade Data Web.
Note: Commodities sorted by top five imports in 2006 using NAIC classification, four-digit level.

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.

Many analysts contend that the sharp increase in U.S. imports from China is largely the result of movement in production facilities from other (primarily) 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 6** on U.S. imports of computer equipment and parts from 2000-2006. 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 (with a 12.1% share). In just six years, Japan's ranking fell to 4th, the value of its shipments dropped by over half, and its share of shipments declined to 7.5% (2006). China was by far the largest foreign supplier of computer equipment in 2006 with a 47.8% share of total U.S. imports. While U.S. imports of computer equipment from China rose by 382% over the past six years, the total value of U.S. imports from the world of these commodities rose by only 22%. Many analysts contend that a large share of the increase in Chinese computer production has come from foreign computer companies that have manufacturing facilities in 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 2006.

Table 6. Major Foreign Suppliers of U.S. Computer Equipment Imports: 2000-2006
($ in billions and % change)

	2000	2001	2002	2003	2004	2005	2006	2000-2006 % change
Total	68.5	59.0	62.3	64.0	73.9	78.4	83.8	22.3%
China	8.3	8.2	12.0	18.7	29.5	35.5	40.0	381.9
Malaysia	4.9	5.0	7.1	8.0	8.7	9.9	11.1	126.5
Mexico	6.9	8.5	7.9	7.0	7.4	6.7	6.6	-4.3
Japan	13.4	9.5	8.1	6.3	6.3	6.1	6.3	-53.0
Singapore	8.7	7.1	7.1	6.9	6.6	5.9	5.6	-35.6

Source: U.S. International Trade Commission Trade Data Web.
Note: Ranked according to top 6 suppliers in 2006.

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 industrial policies used to promote and protect domestic industries. 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 a target rate of exchange with the dollar, the government has maintained restrictions and controls over capital transactions and has made large scale purchases of U.S. dollars.

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%). They charge that China's currency policy makes Chinese exports to the United States cheaper, and U.S. exports to China more expensive, than they would be if exchange rates were determined by market forces. They complain that

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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.

this policy has particularly hurt several U.S. manufacturing sectors (such as textiles and apparel, furniture, plastics, machine tools, and steel), which are forced to compete against low-cost imports from China, and that this has contributed to the growing U.S. trade deficit with China. They have called on the Bush Administration to pressure China either to significantly appreciate its currency or to let it 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 (estimated to have reached nearly $1.1 trillion at the end of 2006) 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 and by balancing economic growth to include great domestic consumption.

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, which totaled $350 billion at the end of December 2006.

The Bush Administration's Response. President Bush has criticized China's currency policy on a number of occasions, 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 policy 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 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, then Deputy U.S. Secretary of State Robert Zoellick complained that China was moving "agonizingly slow" in making its currency more flexible. In September 2006, Senators Schumer and Graham stated that they were disappointed with the results of China's move to make its currency more flexible, and threatened to bring up their bill (S. 295) on China's currency. However, the two Senators later announced that they had been persuaded by the Bush Administration not to pursue a vote on the bill in order to give Secretary of Treasury Henry Paulson more time to negotiate with China on its currency policy.

Most Recent Developments. On September 29, 2006, President Bush and President Hu agreed to establish a Strategic Economic Dialogue (SED) in order to have discussions on major economic issues at the "highest official level." According to a U.S. Treasury Department press release, the intent of the SED is 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.[4] The first meeting (chaired by Secretary of Treasury Paulson and Chinese Vice Premier Wu Yi) was held on December 14-15, 2006. China's currency policy was a major item of discussion (along with macroeconomic policies, IPR protection, the rule of law, trade and investment barriers, energy, the environment, and health care). On December 19, 2006, the Treasury Department's report on exchange rate policies called China's currency policy "a core issue" in the U.S.-China relationship. The report noted that China had made progress in 2006 with making its currency more flexible, but was

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[4] U.S. Treasury Department press release, December 15, 2006.

cautious and "considerably less than needed."[5] Between July 2005 (when currency was revalued at 8.11 yuan to the dollar) and March 14, 2007 (when the exchange rate was 7.74 yuan per dollar), the yuan has appreciated by about 4.6%.[6]

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.

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[5] U.S. Treasury Department, *Report to Congress on International Economic and Exchange Rate Policies*, December 19, 2006, p. 2.

[6] Source: Calculated from Bank of China data.

- 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 (i.e., by the end of 2006). 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 and a number of non-tariff measures have been eliminated. However, there have been several areas where China's implementation is considered to be incomplete. The USTR's fifth annual China WTO compliance report (issued in December 2006) 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 imports.

The USTR's 2006 report stated that China's failure to comply with key areas of its WTO commitments largely stemmed in part 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. In addition, China is attempting to promote the development of several industries (such as autos, steel, telecommunications, and high technology products) deemed by the government as important to China's future economic development and has implemented policies to promote and protect them.

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 subsidies. Some major issues of concern to the United States include the following:

- In December 2006, the Chinese government designated seven industries (military equipment, power generation and distribution, oil, telecommunications, coal, civil aviation, and shipping) as critical

to the nation's economic security and stated it must retain "absolute control" and limit foreign participation.[7]

- On June 30, 2006, China announced a partial opening of its beef market (which had been completely closed to U.S. imports in 2003 due to concerns over mad cow disease). However, U.S. officials have expressed disappointment that China has failed 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.

- 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.[8]" 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.[9] Such concerns led the 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.[10]

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[7] China Daily, "Nation Lists Sectors Critical to National Economy," December 19, 2006.

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

[9] 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.

[10] China applies higher tariffs on imported auto parts when a specific combination of parts

(continued...)

U.S. WTO Cases Against China. To date, the United States has initiated three WTO dispute resolution cases against 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.

- 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 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.[11] China's WTO accession agreement required it to immediately eliminate such subsidies.

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

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[10] (...continued)
is used to produce cars in China, or if the value of these parts amounts to 60% 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% to 28% (which is the tariff China currently applies to imports of completed autos). Source: *Inside U.S.-China Trade*, April 6, 2006.

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

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 China's IPR rates on copyright products range from 85 to 92% and cost U.S. copyright firms $2.6 billion in lost sales in 2005.[12] In addition, China accounts for a significant share of imported counterfeit products seized by the U.S. Customs and Border Protection: $126 million, or 81% of total good seized in FY2006 (compared to $64 million, or 69% of total in FY2005).

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

- During the April 2004 U.S.-China Joint Commission on Commerce and Trade (established in 1983) meeting, 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

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

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

- On October 26, 2005, the United States initiated a special process under WTO rules to obtain detailed information on China's IPR enforcement efforts. However, on December 22, 2005, China responded by challenging the legal basis for such a request in the WTO and subsequently refused to provide the data.

- During the JCCT meeting on April 11, 2006, China pledged to improve IPR protection by requiring that computers manufactured

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

in China 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 state enterprises.

- On April 28, 2006, the USTR listed China as a Foreign Priority Country in its Special 301 report, and stated that, based on China's limited progress in improving its IPR enforcement regime, the USTR was close to filing a WTO dispute case against China. In addition, the USTR indicated that next year's Special 301 report would include a survey of China's IPR protection practices at the provincial level.[14] The 2006 report identified Guangdong Province, Beijing City, Zhejiang Province, and Fujian Province as "hot spots" that required additional attention and resources for IPR enforcement. The report stated that, despite some improvements, China had failed to meet its April 2004 commitments to substantially reduce the level of IPR piracy.

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

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[14] This appears to be motivated by the belief that since IPR enforcement is particularly bad at the local level, the designation or description of specific provinces might prompt officials there to boost their enforcement efforts.

owned by the state.[15] 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 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."[16]

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

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

[16] 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.

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.[17] According to the U.S. Commerce Department, China is the largest foreign supplier of textiles and apparel to the United States at $27.1 billion, accounting for 29% of total imports. U.S. textile and apparel imports from China rose by 20.8% in 2006 over the previous year, and by 211.5% over the past five years.[18] The sharp rise in textile and apparel imports from China, and U.S. industry contention that these imports were disrupting U.S. markets, led the Administration to seek an agreement with China to limit its 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 110th Congress

Several bills were introduced in the 109th Congress to address various concerns over China's economic policies, especially its currency policy. In the 110th Congress, bills that would affect U.S.-China commercial relations include:

- H.R. 275 (Christopher Smith), the Global Online Freedom Act, attempts to promote free expression and a free flow of information on the Internet by preventing U.S. companies from aiding regimes who restrict access to the Internet.

- H.R. 321 (English) would require the Treasury Department to determine if China manipulated its currency and to estimate the rate of that manipulation (if such a determination were made), which then would require the imposition of additional tariffs on Chinese products (equal to the estimated rate of manipulation). The bill also calls on the United States to file a WTO case against China over its currency policy and to work within the WTO to modify and clarify rules regarding currency manipulation.

- H.R. 388 (Kildee) would prohibit U.S. imports of Chinese autos as long as Chinese tariffs on autos are higher than U.S. tariffs.

- H.R. 571 (Tancredo) would raise tariffs on countries classified as non-market economies (including China).

- H.R. 782 (Tim Ryan) would make exchange rate "misalignment' actionable under U.S. countervailing duty laws, require the Treasury

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[17] For additional information on U.S.-China textile issues, see CRS Report RL32168, *Safeguards on Textile and Apparel Imports from China*, by Vivian C. Jones.

[18] For more detailed data on U.S. imports of textile and apparel products from China, see Department of Commerce, Office of Textiles and Apparel Office website at [http://www.otexa.ita.doc.gov/].

Department to determine whether a currency is misaligned in its semi-annual reports to Congress on exchange rates, prohibit the Department of Defense from purchasing certain products imported from China if it is determined that China's currency misalignment has disrupted U.S. defense industries, and would include currency misalignment as a factor in determining safeguard measures on imports of Chinese products that cause market disruption.

- H.R. 1002 (Spratt) would impose 27.5% in additional tariffs on Chinese goods unless the President certifies that China is no longer manipulating its currency.
- S. 364 (Rockefeller) would apply U.S. countervailing laws to non-market economies and make exchange rate manipulation actionable under those laws.
- S. 571 (Dorgan) would terminate China's permanent normal trade relations (PNTR) status and instead would re-apply provisions of U.S. trade law that would extend conditional normal trade relations (NTR) status to China, renewable on an annual basis, as specified under Title IV of the 1974 Trade Act, as amended.