CHINA

TRADE SUMMARY

The U.S. goods trade deficit with China was $375.2 billion in 2017, a 8.1 percent increase ($28.2 billion) over 2016. U.S. goods exports to China were $130.4 billion, up 12.8 percent ($14.8 billion) from the previous year. Corresponding U.S. imports from China were $505.6 billion, up 9.3 percent. China was the United States' 3rd largest goods export market in 2017.

U.S. exports of services to China were an estimated $56.0 billion in 2017 and U.S. imports were $17.6 billion. Sales of services in China by majority U.S.-owned affiliates were $55.2 billion in 2015 (latest data available), while sales of services in the United States by majority China-owned firms were $5.7 billion.

U.S. foreign direct investment (FDI) in China (stock) was $92.5 billion in 2016 (latest data available), a 9.4 percent increase from 2015. U.S. direct investment in China is led by manufacturing, wholesale trade, and nonbank holding companies.

KEY TRADE BARRIERS

The United States continues to pursue vigorous engagement to increase the benefits that U.S. businesses, workers, farmers, ranchers, service providers and consumers derive from trade and economic ties with China. At present, China's trade policies and practices in several specific areas cause particular concern for the U.S. Government and U.S. stakeholders. The key concerns in each of these areas are summarized below. For more detailed information on these concerns, see the 2017 USTR Report to Congress on China's WTO Compliance, issued on January 19, 2018, at:
https://ustr.gov/sites/default/files/files/Press/Reports/China percent202017 percent20WTO percent20Report.pdf.

INDUSTRIAL POLICIES

Overview

China continued to pursue a wide array of industrial policies in 2017 that seek to limit market access for imported goods, foreign manufacturers and foreign services suppliers, while offering substantial government guidance, resources and regulatory support to Chinese industries. The beneficiaries of these constantly evolving policies are not only state-owned enterprises but also other domestic companies attempting to move up the economic value chain.

Technology Transfer

At the beginning of 2017, longstanding and serious U.S. concerns regarding technology transfer remained unaddressed, despite repeated, high-level bilateral commitments by China to remove or no longer pursue problematic policies and practices. At the same time, new concerns have continued to emerge. In August 2017, USTR initiated an investigation under Section 301 of the Trade Act of 1974, as amended, focused on policies and practices of the government of China related to technology transfer, intellectual property and innovation. Specifically, in its initiation notice, USTR identified four categories of reported Chinese government conduct that would be the subject of its inquiry, including but not limited to: (1) the use of a variety of tools to require or pressure the transfer of technologies and intellectual property to Chinese companies, (2) depriving U.S. companies of the ability to set market-based terms in licensing negotiations with Chinese companies, (3) intervention in markets by directing or unfairly facilitating the acquisition of U.S. companies and assets by Chinese companies to obtain cutting-edge technologies and intellectual property, and (4) conducting or supporting unauthorized intrusions into U.S. commercial computer networks or cyber-enabled theft for commercial gains. On March 22, 2018, USTR issued a report supporting findings that the four categories of acts, policies and practices covered in the investigation are unreasonable or discriminatory and burden and/or restrict U.S. commerce.

Made in China 2025 Industrial Plan

In May 2015, China's State Council released *Made in China 2025*, a 10-year plan spearheaded by the Ministry of Industry and Information Technology (MIIT) and targeting 10 strategic industries, including advanced information technology, automated machine tools and robotics, aviation and spaceflight equipment, maritime engineering equipment and high-tech vessels, advanced rail transit equipment, new energy vehicles (NEVs), power equipment, farm machinery, new materials, biopharmaceuticals and advanced medical device products. While ostensibly intended simply to raise industrial productivity through more advanced and flexible manufacturing techniques, *Made in China 2025* is emblematic of China's evolving and increasingly sophisticated approach to "indigenous innovation," which is evident in numerous supporting and related industrial plans. Their common, overriding aim is to replace foreign technology, products and services with Chinese technology, products and services in the China market through any means possible so as to ready Chinese companies for dominating international markets.

Made in China 2025 seeks to build up Chinese companies in the 10 targeted, strategic industries at the expense of, and to the detriment of, foreign industries and their technologies through a multi-step process over 10 years. The initial goal of *Made in China 2025* is to ensure, through various means, that Chinese companies develop, extract or acquire their own technology, intellectual property (IP) and know-how and their own brands. The next goal of *Made in China 2025* is to substitute domestic technologies, products and services for foreign technologies, products and services in the China market. The final goal of *Made in China 2025* is to capture much larger worldwide market shares in the 10 targeted, strategic industries.

Many of the policy tools being used by the Chinese government to achieve the goals of *Made in China 2025* raise serious concerns. These tools are largely unprecedented, as other WTO Members do not use them, and include a wide array of state intervention and support designed to promote the development of Chinese industry in large part by restricting, taking advantage of, discriminating against or otherwise creating disadvantages for foreign enterprises and their technologies, products and services. Indeed, even facially neutral measures can be applied in favor of domestic enterprises, as past experience has shown, especially at sub-central levels of government.

Made in China 2025 also differs from industry support pursued by other WTO Members by its level of ambition and, perhaps more importantly, by the scale of resources the government is investing in the pursuit of its industrial policy goals. In this regard, even if the Chinese government fails to achieve the industrial policy goals set forth in *Made in China 2025*, it is still likely to create or exacerbate market distortions and create severe excess capacity in many of the targeted industries. The United States continues to monitor and analyze Chinese policies and practices in key industrial sectors, specifically those outlined in *Made in China 2025*, which are important pillars of the U.S. and global economies, to ensure a level playing field.

Indigenous Innovation

Policies aimed at promoting "indigenous innovation" continue to represent an important component of China's industrialization efforts. Through intensive, high-level bilateral engagement with China since 2010, the United States has attempted to address these policies, which provide various preferences when IP is owned or developed in China, both broadly across sectors of China's economy and specifically in the government procurement context.

For example, at the May 2012 U.S.-China Strategic and Economic Dialogue (S&ED) meeting, China committed to treat IP owned or developed in other countries the same as IP owned or developed in China. The United States also used the 2012 U.S.-China Joint Commission on Commerce and Trade (JCCT) process to press China to revise or eliminate specific measures that appeared to be inconsistent with this commitment. Throughout 2013 and 2014, the United States and China intensified their discussions. At the December 2014 JCCT meeting, China clarified and underscored that it will treat IP owned or developed in other countries the same as domestically owned or developed IP. Once again, however, these commitments were not fulfilled. China continues to pursue myriad policies that require or favor the ownership or development of IP in China.

The United States secured a series of similar commitments from China in the government procurement context, where China agreed to de-link indigenous innovation policies at all levels of the Chinese government from government procurement preferences, including through the issuance of a State Council measure mandating that provincial and local governments eliminate any remaining linkages by December 2011. Many years later, however, this promise had not been fulfilled.

At the November 2016 JCCT meeting, in response to U.S. concerns regarding the continued issuance of scores of inconsistent measures, China announced that its State Council had issued a document requiring all agencies and all sub-central governments to "further clean up related measures linking indigenous innovation policy to the provision of government procurement preference." Again, the United States should not have to seek the same promises over and over through multiple negotiations.

Investment Restrictions

China seeks to protect many domestic industries through a restrictive investment regime, which adversely affects foreign investors in key services sectors, agriculture, extractive industries and certain manufacturing sectors. Many aspects of China's current investment regime continue to cause foreign investors great concern, including a lack of substantial liberalization evidenced by the continued application of foreign equity caps and joint venture requirements, the maintenance of a case-by-case administrative approval system for a broad range of investments, the evolving potential for a new and overly broad national security review mechanism, and the increasingly adverse impact of China's *Cybersecurity Law* and related implementing measures.

In addition, foreign enterprises report that Chinese government officials may condition investment approval on a requirement that a foreign enterprise transfer technology, conduct research and development in China, satisfy performance requirements relating to exportation or the use of local content, or make valuable, deal-specific commercial concessions. The United States has repeatedly raised concerns with China about its restrictive investment regime. To date, this sustained bilateral engagement has not led to a significant relaxation of China's investment restrictions, nor has it appeared to curtail *ad hoc* actions by Chinese government officials. Shortly after President Trump's visit to Beijing in November 2017, China did announce that it would be relaxing certain restrictions on foreign investment in banking services, life insurance services, and securities and asset management services in the future. It remains to be seen if these promises will be fulfilled.

Secure and Controllable Information and Communications Technology Policies

In 2017, as China issued a series of draft and final measures to implement the *Cybersecurity Law* adopted in November 2016, global concerns regarding China's approach to cybersecurity policy increased. China's approach is to impose severe restrictions on a wide range of U.S. and other foreign information and communications technology (ICT) products and services with an apparent goal of supporting its technology localization policies by encouraging the replacement of foreign ICT products and services with domestic ones. Stakeholders and governments around the world expressed serious concerns about requirements that ICT equipment and other ICT products and services in critical sectors be "secure and controllable," as these requirements are used by the Chinese government to disadvantage non-Chinese firms in multiple ways.

Separate from the *Cybersecurity Law*, China has referenced its "secure and controllable" requirements in a variety of measures dating back to 2013. Through these measures, China has mandated that Chinese information technology (IT) users purchase Chinese products and favor Chinese service suppliers, imposed local content requirements, imposed domestic research and development (R&D) requirements, considered the location of R&D as a cybersecurity risk factor and required the transfer or disclosure of source code or other IP. In addition, in 2015, China enacted a *National Security Law* and a *Counterterrorism Law*, which include provisions citing not only national security and counterterrorism objectives but also economic and industrial policies. The State Council also published a plan in 2015 that sets a timetable for adopting "secure and controllable" products and services in critical government ministries by 2020.

Meanwhile, sector-specific policies under this broad framework continue to be proposed and deployed across China's economy. A high profile example from December 2014 was a proposed measure drafted by the China Banking Regulatory Commission (CBRC) that called for 75 percent of ICT products used in the banking system to be "secure and controllable" by 2019 and that would have imposed a series of criteria that would shut out foreign ICT providers from China's banking sector. Not long afterwards, a similar measure was proposed for the insurance sector.

In 2015, the United States, in concert with other governments and stakeholders around the world, raised serious concerns about China's "secure and controllable" regime at the highest levels of government within China. During the state visit of President Xi in September 2015, the U.S. and Chinese Presidents committed to a set of principles for trade in information technologies. The issue also was raised in connection with the June 2015 S&ED meeting and the November 2015 JCCT meeting, with China making a series of additional important commitments with regard to technology policy. China reiterated many of these commitments at the November 2016 JCCT meeting, where it affirmed that its "secure and controllable" policies are not to unnecessarily limit or prevent commercial sales opportunities for foreign ICT suppliers or unnecessarily impose nationality-based conditions and restrictions on commercial ICT purchases, sales or uses. China also agreed that it would notify relevant technical regulations to the WTO Committee on Technical Barriers to Trade (TBT Committee).

Again, however, it appears that China does not intend to honor its promises. The numerous draft and final cybersecurity implementation measures issued by China in 2017 raise serious questions about China's approach to cybersecurity regulation. China's measures do not appear to be consistent with the non-discriminatory, non-trade restrictive approach to which China has committed. Accordingly, throughout the past year, the United States conveyed its serious concerns about China's approach to cybersecurity regulation through written comments on draft measures, bilateral engagement under the auspices of the United States-China Comprehensive Economic Dialogue (CED) and multilateral engagement at WTO committee meetings in an effort to persuade China to revise its policies in this area to ensure that they are consistent with its WTO obligations and bilateral commitments. These efforts are ongoing.

Subsidies

China continues to provide substantial subsidies to its domestic industries, which have caused injury to U.S. industries. Some of these subsidies also appear to be prohibited under WTO rules. To date, the United States has been able to address some of these subsidies through countervailing duty proceedings conducted by the U.S. Commerce Department and dispute settlement cases at the WTO. The United States and other WTO Members also have continued to press China to notify all of its subsidies to the WTO in accordance with its WTO obligations while also submitting counter notifications listing hundreds of subsidy programs that China has failed to notify. Since joining the WTO 16 years ago, China has not yet submitted to the WTO a complete notification of subsidies maintained by the central government, and it did not notify a single sub-central government subsidy until July 2016, when it provided information largely only on sub-central government subsidies that the United States had challenged as prohibited subsidies in a WTO case.

Excess Capacity

Because of its state-led approach to the economy, China is the world's leading offender in creating non-economic capacity, as evidenced by unprecedentedly severe excess capacity situations in several industries. China also is well on its way to creating severe excess capacity in other industries through its pursuit of industrial plans such as *Made in China 2025*, pursuant to which the Chinese government is doling out hundreds of billions of dollars to support Chinese companies and requiring them to achieve preset targets for domestic market share – at the expense of imports – and global market share in each of 10 advanced manufacturing industries.

In manufacturing industries like steel and aluminum in particular, China's economic planners and their government actions and financial support have contributed to massive excess capacity in China, with the resulting over-production distorting global markets and hurting producers and workers in both the United States and third country markets such as Canada and Mexico, where U.S. exports compete with Chinese exports. While China recognizes the severe excess capacity problem in these industries, among others, and has taken some steps to try to address this problem, there have been mixed results.

From 2000 to 2014, China accounted for more than 75 percent of global steelmaking capacity growth, even though China has no comparative advantage with regard to the energy and raw material inputs that make up the majority of costs for steelmaking. Currently, China's capacity represents about one-half of global capacity and twice the combined steelmaking capacity of the European Union (EU), Japan, the United States and Russia. Meanwhile, China's steel exports grew to be the largest in the world, at 91 million metric tons (MT) in 2014, a 50-percent increase over 2013 levels, despite sluggish steel demand abroad. In 2015, Chinese exports reached a historic high of 110 million MT, causing increased concerns about the detrimental effects that these exports would have on the already saturated world market for steel. China's steel exports continued to grow in the first half of 2016, before beginning to decline in the second half of the year, a trend that continued into 2017.

Similarly, production of primary aluminum in China increased by more than 50 percent between 2011 and 2015, and it has continued to grow in subsequent years despite a severe drop in global aluminum prices beginning in 2015. Large new facilities have been built with government support, and China's primary aluminum production now accounts for more than one-half of global production. As a consequence, China's aluminum excess capacity has been contributing to a severe decline in global aluminum prices, harming U.S. plants and workers.

Not unlike the situations in the steel and aluminum industries, China's production of soda ash has increased as domestic demand has stagnated. As a result, China's soda ash exports increased 23 percent in 2015 as compared to the previous year, and this trend continued in 2016. Further, China's soda ash production, which totaled 26 million MT in 2016, is projected to grow at nearly three percent annually through 2020, which is more than double China's projected 1.2 percent annual increase in domestic demand over that same time period. It also is estimated that China's excess soda ash capacity will continue to grow in the coming years, reaching over 10.5 million MT by 2019.

Excess capacity in China – whether in the steel industry or other industries like aluminum or soda ash – hurts U.S. industries and workers not only because of direct exports from China to the United States, but because lower global prices and a glut of supply make it difficult for even the most competitive producers to remain viable. Domestic industries in many of China's trading partners have continued to respond to the effects of the trade-distortive effects of China's excess capacity by petitioning their governments to impose trade remedies such as antidumping and countervailing duties.

Export Restraints

China continues to deploy a combination of export restraints, including export quotas, export licensing, minimum export prices, export duties and other restrictions, on a number of raw material inputs where it holds the leverage of being among the world's leading producers. Through these export restraints, it appears that China is able to provide substantial economic advantages to a wide range of downstream producers in China at the expense of foreign downstream producers, while creating pressure on foreign downstream producers to move their operations, technologies and jobs to China.

In 2013, China removed its export quotas and duties on several raw material inputs of key interest to the U.S. steel, aluminum and chemicals industries after the United States won a dispute settlement case against China at the WTO. In 2014, the United States won a second WTO case, focusing on China's export restraints on rare earths, tungsten and molybdenum, which are key inputs for a multitude of U.S.-made products, including hybrid automobile batteries, wind turbines, energy-efficient lighting, steel, advanced electronics, automobiles, petroleum, and chemicals. China removed those export restraints in May 2015. In July 2016, the United States launched a third WTO case challenging export restraints maintained by China. The challenged export restraints include export quotas and export duties maintained by China on various forms of 11 raw materials, including antimony, chromium, cobalt, copper, graphite, indium, lead, magnesia, talc, tantalum and tin. These raw materials are key inputs in important U.S. manufacturing industries, including aerospace, automotive, construction and electronics. It is deeply concerning that the United States has been forced to bring multiple cases to address the same obvious WTO compliance issues.

Value-added Tax Rebates and Related Policies

As in prior years, in 2017, the Chinese government attempted to manage the export of many primary, intermediate and downstream products by raising or lowering the value-added tax (VAT) rebate available upon export. China sometimes reinforces its objectives by imposing or retracting export duties. These practices have caused tremendous disruption, uncertainty and unfairness in the global markets for some products, particularly downstream products where China is a leading world producer or exporter, such as products made by the steel, aluminum and soda ash industries. These practices, together with other policies, such as excessive government subsidization, also have contributed to severe excess capacity in these same industries. An apparently positive development took place at the July 2014 S&ED meeting, when China committed to improve its VAT rebate system, including by actively studying international best practices, and to deepen communication with the United States on this matter, including regarding its impact on trade. Once more, however, this promise remains unfulfilled. To date, China has not made any movement toward the adoption of international best practices.

Import Ban on Remanufactured Products

China prohibits the importation of remanufactured products, which it typically classifies as used goods. China also maintains restrictions that prevent remanufacturing process inputs (known as cores) from being imported into China's customs territory, except special economic zones. These import prohibitions and restrictions undermine the development of industries in many sectors in China, including mining, agriculture, healthcare, transportation and communications, because companies in these industries are unable to purchase high-quality, lower-cost remanufactured products produced outside of China. Nevertheless, China is apparently prepared to pay this price in order to limit imports of remanufactured goods.

Import Ban on Recoverable Materials

In 2017, China issued two measures that would limit or ban imports of numerous scrap and recovered materials, such as certain types of plastic, paper and metals. Similar restrictions do not appear to apply to domestically sourced scrap or recovered materials.

Standards

In the standards area, two principal types of Chinese policies harm U.S. companies. First, Chinese government officials in some cases reportedly have pressured foreign companies seeking to participate in the standards-setting process to license their technology or intellectual property on unfavorable terms. Second, China has continued to pursue unique national standards in a number of high technology areas where international standards already exist. The United States continues to press China to address these specific concerns, but to date this bilateral engagement has yielded minimal progress.

Currently, China is undergoing a large-scale reform of its standards system. As part of this reform, China is seeking to incorporate a "bottom up" strategy in standards development in addition to the existing "top down" system. In September 2017, China published a revised draft version of a new *Standardization Law* on which the United States submitted written comments. This draft of the law introduced a serious new concern with regard to preferences for Chinese technologies in standards development and failed to address other concerns detailed in U.S. written comments on the previous draft. The September 2017 draft, with only minor revisions, became final in November 2017 and went into effect in January 2018. At the same time, existing technical committees continue to develop standards, and more foreign participation is being allowed. For example, while the United States' substantive concerns with China's cybersecurity standards have not been addressed, the technical committee for cybersecurity standards has begun allowing foreign companies to participate in standards development and setting, with several U.S. and other foreign companies being allowed to vote and to participate at the working group level in standards development. Nevertheless, the United States remains very concerned about China's policies with regard to standards, as China prepares to develop implementing regulations for the *Standardization Law*.

Notably, U.S. concerns about China's standards regime are not limited to the implications for U.S. companies' access to China's market. China's ongoing efforts to develop unique national standards aims eventually to serve the interests of Chinese companies seeking to compete globally, as the Chinese government's vision is to use the power of the large China market to promote or compel the adoption of Chinese standards in global markets.

Government Procurement

China made a commitment to accede to the WTO Agreement on Government Procurement (GPA) and to open up its vast government procurement market to the United States and other GPA Parties. To date, however, the United States, the EU, and other GPA Parties have viewed China's offers as highly disappointing in scope and coverage. China submitted its fifth revised offer in December 2014. This offer showed progress in a number of areas, including thresholds, entity coverage and services coverage. Nonetheless, it fell short of U.S. expectations and remains far from acceptable to the United States and other GPA Parties as significant deficiencies remain in a number of critical areas, including thresholds, entity coverage, services coverage and exclusions.

China’s current government procurement regime is governed by two important laws. The *Government Procurement Law*, administered by the Ministry of Finance, governs purchasing activities conducted with fiscal funds by state organs and other organizations at all levels of government in China. The *Tendering and Bidding Law* falls under the jurisdiction of the National Development and Reform Commission (NDRC) and imposes uniform tendering and bidding procedures for certain classes of procurement projects in China, notably construction and works projects, without regard for the type of entity that conducts the procurement. Both laws cover important procurements that GPA Parties would consider to be government procurement eligible for coverage under the GPA.

Trade Remedies

China’s regulatory authorities in some instances seem to be pursuing antidumping and countervailing duty investigations and imposing duties – even when necessary legal and factual support for the duties is absent – for the purpose of striking back at trading partners that have exercised their WTO rights against China. To date, the U.S. response has been the filing and prosecution of three WTO disputes. The decisions reached by the WTO in those three disputes confirm that China failed to abide by WTO disciplines when imposing the duties at issue.

INTELLECTUAL PROPERTY RIGHTS

Overview

After its accession to the WTO, China undertook a wide-ranging revision of its framework of laws and regulations aimed at protecting the intellectual property rights (IPR) of domestic and foreign rights holders, as required by the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (the TRIPS Agreement). Currently, China is in the midst of an extended round of revisions to these laws and regulations. Despite various plans and directives issued by the State Council in 2017, inadequacies in China’s IPR protection and enforcement regime continue to present serious barriers to U.S. exports and investment. As a result, China was again placed on the Priority Watch List in USTR’s 2017 Special 301 report. In addition, in January 2018, USTR announced the results of its 2017 Out-of-Cycle Review of Notorious Markets, which identifies online and physical markets that exemplify key challenges in the global struggle against piracy and counterfeiting. Several Chinese markets were among those named as notorious markets.

Trade Secrets

Serious inadequacies in the protection and enforcement of trade secrets in China have been the subject of high-profile attention and engagement between the United States and China in recent years. Thefts of trade secrets for the benefit of Chinese companies have occurred both within China and outside of China. Offenders in many cases continue to operate with impunity. Particularly troubling are reports that actors affiliated with the Chinese government and the Chinese military have infiltrated the computer systems of U.S. companies, stealing terabytes of data, including the companies’ intellectual property (IP), for the purpose of providing commercial advantages to Chinese enterprises.

In an effort to address these problems, the United States secured commitments from China to issue judicial guidance to strengthen its trade secrets regime. The United States also has secured commitments from China not to condone state-sponsored misappropriation of trade secrets for commercial use. In addition, the United States has urged China to make certain key amendments to its trade secrets-related laws and regulations, particularly with regard to a draft revision of the *Anti-unfair Competition Law*. The United States also has urged China to take actions to address inadequacies across the range of state-sponsored actors and to promote public awareness of trade secrets disciplines.