3-7-2008

China-U.S. Trade Issues

Wayne M. Morrison
Congressional Research Service; Foreign Affairs, Defense, and Trade Division

China-U.S. Trade Issues

Abstract

[Excerpt] 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 $387 billion in 2007. China overtook Japan to become the third largest U.S. export market, and overtook Canada to become the largest source of U.S. imports. With a huge population and a rapidly expanding economy, China is a potentially huge market for U.S. exporters. However, U.S.-China economic relations have become strained over a number of issues, including large and growing U.S. trade deficits with China (which hit $256 billion in 2007), China's failure to fully implement its World Trade Organization (WTO) commitments (especially in regards to protection of intellectual property rights), its refusal to adopt a floating currency system, its use of industrial policies and other practices deemed unfair and/or harmful to various U.S. economic sectors, and failure to ensure that its exports to the United States meet U.S. health and safety standards. The Bush Administration has come under increasing pressure from Congress to take a more aggressive stance against various Chinese economic and trade practices. In response, it filed a number of trade dispute resolution cases against China in the WTO, including China's failure to protect IPR and afford market access for IPR-related products, discriminatory regulations on imported auto parts, and import and export subsidies to various industries in China. In addition, the Administration reversed a long-standing policy that countervailing cases (dealing with government subsidies) could not be brought against non-market economies (such as China). In December 2006, the Administration began a "Strategic Economic Dialogue" (SED) with China to discuss major long-term economic issues between the two countries; the latest SED talks were held in December 2007. In response to growing concerns in the United States over the health, safety, and quality of certain Chinese products, the Administration in 2007 concluded agreements with China on toys, food and feed, drugs and medical devices, and tires. Numerous bills have been introduced in Congress that would impact U.S.-China economic relations. H.R. 321, H.R. 782, H.R. 1002, H.R. 2942, S. 364, S. 796, S. 1607, and S. 1677 seek to address China's currency policy. H.R. 388 would prohibit U.S. imports of Chinese autos as long as Chinese tariffs on autos are higher than U.S. tariffs. H.R. 708, H.R. 1229, and S. 974 would apply U.S. countervailing laws to China. H.R. 1958 and S. 571 would terminate China's permanent normal trade relations status. H.R. 275 would prohibit U.S. companies from aiding regimes that restrict Internet access. S. 1919 would limit the president's discretion on Section 421 investigations on import surges from China. H.R. 3273 would expand U.S. export promotion programs to boost exports to China. Finally, numerous bills have been introduced to address concerns over unsafe imports (including from China). This report examines major U.S.-China trade issues and will be updated as events warrant.

Keywords

United States, China, trade, commerce, public policy, economic growth, World Trade Organizations, Congress

Disciplines

Business | International Business

Order Code RL33536

CRS Report for Congress

China-U.S. Trade Issues

Updated March 7, 2008

Wayne M. Morrison
Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

Prepared for Members and
Committees of Congress

Congressional
Research
Service

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 $387 billion in 2007. China overtook Japan to become the third largest U.S. export market, and overtook Canada to become the largest source of U.S. imports.

With a huge population and a rapidly expanding economy, China is a potentially huge market for U.S. exporters. However, U.S.-China economic relations have become strained over a number of issues, including large and growing U.S. trade deficits with China (which hit $256 billion in 2007), China's failure to fully implement its World Trade Organization (WTO) commitments (especially in regards to protection of intellectual property rights), its refusal to adopt a floating currency system, its use of industrial policies and other practices deemed unfair and/or harmful to various U.S. economic sectors, and failure to ensure that its exports to the United States meet U.S. health and safety standards.

The Bush Administration has come under increasing pressure from Congress to take a more aggressive stance against various Chinese economic and trade practices. In response, it filed a number of trade dispute resolution cases against China in the WTO, including China's failure to protect IPR and afford market access for IPR-related products, discriminatory regulations on imported auto parts, and import and export subsidies to various industries in China. In addition, the Administration reversed a long-standing policy that countervailing cases (dealing with government subsidies) could not be brought against non-market economies (such as China). In December 2006, the Administration began a "Strategic Economic Dialogue" (SED) with China to discuss major long-term economic issues between the two countries; the latest SED talks were held in December 2007. In response to growing concerns in the United States over the health, safety, and quality of certain Chinese products, the Administration in 2007 concluded agreements with China on toys, food and feed, drugs and medical devices, and tires.

Numerous bills have been introduced in Congress that would impact U.S.-China economic relations. H.R. 321, H.R. 782, H.R. 1002, H.R. 2942, S. 364, S. 796, S. 1607, and S. 1677 seek to address China's currency policy. H.R. 388 would prohibit U.S. imports of Chinese autos as long as Chinese tariffs on autos are higher than U.S. tariffs. H.R. 708, H.R. 1229, and S. 974 would apply U.S. countervailing laws to China. H.R. 1958 and S. 571 would terminate China's permanent normal trade relations status. H.R. 275 would prohibit U.S. companies from aiding regimes that restrict Internet access. S. 1919 would limit the president's discretion on Section 421 investigations on import surges from China. H.R. 3273 would expand U.S. export promotion programs to boost exports to China. Finally, numerous bills have been introduced to address concerns over unsafe imports (including from China).

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

Contents

List of Tables

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. 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 (which hit $256 billion in 2007), China's refusal to adopt a floating currency, and failure to fully implement many of 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. In addition, there has been growing concerns in the United States over the health and safety of certain food products (such as seafood and pet food) and consumer products (such as toys and tires) imported from China that have been found to be unsafe or defective, and some Members have called for measures to pressure China to ensure its exports are safe as well as to strengthen U.S. federal agencies in charge of enforcing health and safety standards.

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. In 1978 (before China's reforms began), total U.S.-China trade (exports plus imports) was $1 billion; China ranked as the 32nd largest export market and the 57th largest source of U.S. imports. In 2007, bilateral trade hit $387 billion, making China the 2nd largest U.S. trading partner (after Canada). China overtook Japan to become the 3rd largest U.S. export market and also overtook Canada to become the largest source of U.S. imports. In recent years, China has been one of the fastest growing U.S. export markets and the importance of this market is expected to grow even further as living standards continue to improve and a sizable Chinese middle class emerges.

---

[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 RL33877, *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.

The U.S. trade deficit with China has surged in recent years as imports from China have grown much faster than U.S. exports to China. That deficit rose from $30 billion in 1994 to $256 billion in 2007 (see **Table 1**).[2] The U.S. trade deficit with China is significantly larger than that with any other U.S. trading partner. In 2007, it was more than twice as large as with OPEC, as well as the 27 countries that make up the European Union, and three times larger than the trade deficit with Japan (see **Table 2**).

Table 1. U.S. Merchandise Trade with China: 1980-2007

($ 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	-232.5
2007	65.2	321.5	-256.3

Source: USITC DataWeb.

[2] The United States ran trade deficits with 105 countries in 2007. These totaled $896.2 billion; the trade deficit with China was equal to 28.6% of this amount. However, the United States ran trade surpluses with 127 countries, totaling $105.2 billion, and the total U.S. trade deficit was $791.0 billion. The U.S. trade deficit with China was equal to 32.4% of the total U.S. trade deficit.

Table 2. U.S. Merchandise Trade Balances with Major Trading Partners: 2007
($ in billions)

Country or Trading Group	U.S. Trade Balance
World	-791.0
China	**-256.3**
European Union (EU27)	-107.4
Organization of Petroleum Exporting Countries (OPEC)	-127.4
Japan	-82.8
Canada	-64.7
Mexico	-74.3
Association of Southeast Asian Nations (ASEAN)	-50.6

Source: USITC DataWeb.

Major U.S. Exports to China

U.S. merchandise exports to China in 2007 were $65.2 billion, up 18.1% over the previous year.[3] China overtook Japan to become the 3rd largest export market in 2007. U.S. exports to China in 2007 accounted for 5.6% of total U.S. exports (compared to 3.9% in 2003). The top five U.S. exports to China in 2007 were aircraft and parts, semiconductors and electronic components, waste and scrap, oilseeds and grain, and resins and synthetic rubber and fibers (see **Table 3**). China is a significant market for U.S. agricultural products. It was the 4th largest destination for U.S. agricultural exports in 2007 at $8.3 billion. U.S. agricultural exports grew by 24% in 2007 over the previous year.

Over the past few years, China has been one of the fastest growing U.S. export market among major U.S. trading partners, as can be seen in **Table 4**.[4] U.S. exports to China rose by nearly 240% from 2001 to 2007, which was significantly higher than that of any other top 10 trading partner.

[3] The United States also exports a significant level of private services to China; these totaled $9.1 billion in 2005.

[4] However the growth in U.S. exports to China in 2007 (at 18.1%) was much slower than in 2006 (up 32% over 2005 levels).

Table 3. Major U.S. Exports to China: 2003-2007

($ in billions and % change)

NAIC Commodity Groupings	2003	2004	2005	2006	2007	2006-2007 % Change
Total all commodities	**28.4**	**34.7**	**41.8**	**55.2**	**65.2**	**18.1%**
Aerospace products and parts (mainly aircraft and parts)	2.7	2.1	4.5	6.3	7.4	18.0
Semiconductors and other electronic components	3.0	3.6	4.0	6.8	7.4	8.9
Waste and scrap	1.9	2.5	3.7	6.1	7.3	20.8
Oilseeds and grains (mainly soybeans)	2.9	2.8	2.3	2.6	4.1	59.8
Resin, synthetic rubber, & artificial & synthetic fibers & filament	1.2	1.6	2.1	2.5	3.3	29.1

Source: U.S. International Trade Commission Database.
Note: Commodities sorted by top five exports in 2007 using NAIC classification, four-digit level.

Table 4. U.S. Merchandise Exports to Major Trading Partners in 2001 and 2007

($ in billions and % change)

	2001	2007	Percent Change from 2006-2007 (%)	Percent Change from 2001-2007 (%)
Canada	163.7	248.4	7.9	51.7
Mexico	101.5	136.5	1.8	34.5
Japan	57.6	62.7	5.1	8.9
China	**19.2**	**65.2**	**18.1**	**239.6**
United Kingdom	40.8	50.3	10.8	23.3
Germany	30.1	49.7	20.2	65.1
South Korea	22.2	34.7	6.9	56.3
Netherlands	19.5	33.0	6.1	69.2
France	19.9	27.4	13.2	37.7
Taiwan	18.2	26.4	14.5	45.1
World	731.0	1,162.7	12.1	59.7

Note: Ranked by top 10 U.S. export markets in 2007.
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. 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 600 million cellular phone users (as of June 2007), 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 (2006-2026); during this period, China will buy 3,400 aircraft valued at $340 billion. By 2026, China's domestic market for air travel is expected to become larger than today's intra-North American market.[5] On April 11, 2006, Boeing announced it had signed a general purchase agreement with China for 80 Boeing 737s. On September 6, 2007, China announced it would buy 55 Boeing aircraft valued at $3.8 billion.

- 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). The number of Chinese internet users rose from 111 million at the end of 2005, to 137 million in 2006, to 210 million users at the end of 2007.[6]

- 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.[7] According to some estimates, China is now the world's second largest market for new cars. General Motors (GM) and Ford reportedly sold over one million (up 19% over 2006 levels) and 216 thousand cars (up 30%), respectively in China in 2007. According to the *International Herald Tribune*, GM expects invest $5 billion in China over the next five years to expand production facilities.[8]

---

[5] Boeing, *Press Release*, September 18, 2007.

[6] *People's Daily Online*, "210 million Internet users in China," January 21, 2008.

[7] *China Daily*, September 9, 2004.

[8] *International Herald Tribune*, "GM plans $5 billion in China investment," December 6, 2007. For additional information on China's auto industry, see CRS Report RL33317, (continued...)

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 in 2007 became, for the first time, the largest source of U.S. imports. In 2007, imports from China totaled $321.5 billion, accounting for 16.5% of total U.S. imports in 2007 (up from 6.5% in 1996). U.S. imports from China rose by 11.7% in 2007 over the previous year (compared with 18.2% in 2006). 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, to first in 2007. The top five U.S. imports from China in 2007 were computers and parts, miscellaneous manufactured articles (such as toys, games, etc.),communications equipment, apparel, and audio and video equipment (see **Table 5**).

Table 5. Top Five U.S. Imports from China: 2003-2007

($ in billions and % change)

NAIC Commodity	2003	2004	2005	2006	2007	2006-2007 % Change
Total All Commodities	**152.4**	**196.7**	**243.5**	**287.8**	**321.5**	**11.7%**
Computer equipment	18.7	29.5	35.5	40.0	45.5	11.0
Miscellaneous manufactured products (e.g., toys, games, etc.)	21.8	23.7	26.4	28.9	34.8	20.6
Communications equipment	5.9	9.0	14.1	18.0	23.2	29.0
Apparel	9.0	10.5	16.4	19.2	23.0	19.4
Audio and video equipment	10.0	12.6	15.6	18.8	19.1	1.5

Source: U.S. International Trade Commission Trade Data Web.
Note: Commodities sorted by top five imports in 2007 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, consumer electronic products, footwear, and textiles and apparel. 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. According to the U.S. Census Bureau, in 2007, U.S. imports of advanced technology products from China totaled $72.7 billion (27.4% of total U.S. imports from China), compared with $29.3 billion

---

[8] (...continued)
China's Impact on the U.S. Automotive Industry, by Stephen Cooney.

in 2003 (19.2% of total U.S. imports from China).[9] In addition, imports of advanced technology products accounted for 26.9% of total U.S. imports of such products in 2007, compared with 14.1% in 2003, indicating that U.S. dependency on China for advanced technology products is rapidly increasing.

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.[10] 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 2002-2007. 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 seven years, Japan's ranking fell to 4th, the value of its shipments dropped by over half, and its share of shipments declined to 7.0% (2007). China was by far the largest foreign supplier of computer equipment in 2007 with a 51.5% share of total U.S. imports. While U.S. imports of computer equipment from China rose by 436% over the past seven years, the total value of U.S. imports from the world of these commodities rose by only 26%. Many analysts contend that a large share of the increase in Chinese computer production has come from foreign computer companies that have moved manufacturing facilities China.

Table 6. Major Foreign Suppliers of U.S. Computer Equipment Imports: 2000-2007

($ in billions and % change)

	2000	2002	2004	2006	2007	2000-2007 % change
Total	68.5	62.3	73.9	83.8	86.3	26.0
China	**8.3**	**12.0**	**29.5**	**40.0**	**44.5**	**436.1**
Malaysia	4.9	7.1	8.7	11.1	10.9	122.4
Mexico	6.9	7.9	7.4	6.6	6.6	-4.3
Japan	13.4	8.1	6.3	6.3	5.0	-62.7
Singapore	8.7	7.1	6.6	5.6	4.3	-50.6

Source: U.S. International Trade Commission Trade Data Web.
Note: Ranked according to top six suppliers in 2007.

China is becoming a major supplier of U.S. agricultural products. It was the 3rd largest source of U.S. agricultural imports in 2007 (compared with 5th largest in

[9] U.S. Census Bureau, Foreign Trade Division.

[10] 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 57% in 2007.

2006), at $3.3 billion.[11] U.S. agricultural imports from China rose by 23% in 2007 and by 133% from 2003-2007. Major agricultural imports from China include fish, vegetables and fruit, tea and spices, feeding stuff for animals, and sugar products.

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), concerns over unsafe Chinese food and consumer products, 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 Chinese 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).

Health and Safety Concerns Over Certain Imports from China[12]

Reports throughout 2007 of tainted or unsafe food and consumer products (including seafood, pet food, toys, and tires) from China raised concerns in the United States over the health, safety, and quality of imports from China. Some analysts contend that China maintains a poor regulatory framework for enforcing its health and safety regulations and standards, and that this is proving to be a growing problem for U.S. consumers. Many U.S. policymakers have raised concern over how to press China to improve enforcement of its health and safety standards of its exports as well as the ability of U.S. regulatory agencies to ensure the health and safety of imports from China (and other countries).

In 2007 and early 2008, there were numerous recalls, warnings, and import restrictions involving Chinese products. To illustrate:

The Food and Drug Administration (FDA) in March 2007 issued warnings and announced voluntary recalls on over 150 brands of pet foods (and products such as rice protein concentrate and wheat gluten used to manufacture pet food and animal feed) from China believed to have caused the sickness and deaths of numerous pets in the United States.[13] In May 2007, the FDA issued warnings on certain toothpaste products (some of which were found to be counterfeit) found to originate in China that contained poisonous chemicals. In June 2007, the FDA announced import

---

[11] China ranked as the 4th largest export market for U.S. agricultural products at $8.3 billion.

[12] For additional information on this issue, see CRS Report RS22713, *Health and Safety Concerns Over U.S. Imports of Chinese Products: An Overview*, by Wayne M. Morrison

[13] For a legal overview of FDA recalls, see CRS Report RL34167, *The FDA's Authority to Recall Products*, by Vanessa K. Burrows.

controls on all farm-raised catfish, basa, shrimp, dace (related to carp), and eel from China after antimicrobial agents, which are not approved in the United States for use in farm-raised aquatic animals, were found. The FDA ordered that such shipments will be detained until they are proven to be free of contaminants.[14] On January 25, 2008, the FDA posted on its website a notice by Baxter Healthcare Corporation that it had temporarily halted the manufacture of its multiple-dose vials of heparin (a blood thinner) for injection because of recent reports of serious adverse events (including four deaths and 350 complications) associated with the use of this drug. Some analysts have speculated that an unlicensed drug company in China, which produces ingredients for the drug, may be the source of the problem.[15]

The National Highway Traffic Safety Administration (NHTSA) in June 2007 was informed by Foreign Tire Sales, Inc., an importer of foreign tires, that it suspected that up to 450,000 tires (later reduced to 255,000 tires) made in China may have a major safety defect (i.e., missing or insufficient gum strip inside the tire). The company was ordered by the NHTSA to issue a recall. The Chinese government and the manufacturer have maintained that the tires in question meet or exceed U.S. standards.

The Consumer Product Safety Commission (CPSC) has issued alerts and announced voluntary recalls by U.S. companies on numerous products made in China. From January-December 2007, over four-fifths of CPSC recall notices have involved Chinese products. Over this period, roughly 17.6 million toy were recalled because of excessive lead levels. Recalls were also issued on 9.5 million Chinese-made toys (because of the danger of loose magnets), 4.2 million “Aqua Dots” toys (because beads contain a chemical that can turn toxic if ingested) and 1 million toy ovens (due to potential finger entrapment and burn hazzards).[16] China is the dominant supplier of toys to the United States, accounting for 89% of total U.S. imports (2007).

China’s Poor Regulatory System and Implications. China is believed to have a rather weak health and safety regime for manufactured goods and agricultural products. Problems include:

- weak consumer protection laws and poorly enforced regulations,
- lack of inspections and ineffective penalties for code violators,

---

[14] In addition, FDA has refused shipments of a variety of Chinese food and drug products. See CRS Report RL34080, *Food and Agricultural Imports from China*, by Geoffrey S. Becker.

[15] New York Times, *China Didn’t Check Drug Supplier, Files Show*, February 16, 2008.

[16] For a list of company recalls of Chinese products, see the CPSC website at [http://www.cpsc.gov/cpscpub/prerel/prerel.html]. In addition, several U.S. retailers have announced that they have halted sales of certain Chinese products, due to health and safety concerns, which do not appear on the CPSC website.

- underfunded and understaffed regulatory agencies and poor interagency cooperation,
- the proliferation of fake goods,
- the existence of numerous unlicensed producers,
- falsified export documents,
- extensive pollution,[17]
- intense competition that often induces firms to cut corners,
- the relative absence of consumer protection advocacy groups,
- failure by Chinese companies to effectively monitor the quality of their suppliers' products,
- restrictions on the media,[18] and
- extensive government corruption and lack of accountability, especially at the local government level.

Although China has criticized the United States for its recent actions against unsafe Chinese products,[19] it has pledged to improve and strengthen food and drug safety supervision and standards, beef up inspections, require safety certificates before some products can be sold, and to crack down on government corruption.

The United States and China reached a number of agreements in 2007 to address health and safety concerns:

- On September 11, 2007, the CPSC and its Chinese counterpart, the General Administration of Quality Supervision, Inspection and Quarantine (AQSIQ), signed a Joint Statement on enhancing consumer product safety. China pledged to implement a comprehensive plan to intensify efforts (such as increased

[17] For example, many fish farmers in China are believed to feed various drugs to the fish to help keep them alive in polluted waters. See *Washington Post*, "Farmed in China's Foul Waters, Imported Fish Treated with Drugs; Traditional Medicine, Banned Chemicals Both Used," July 6, 2007, p. A1.

[18] China's media often reports on health and safety problems, but rarely criticizes the central government for such problems.

[19] In June 2007, China impounded U.S. shipments of apricots and orange pulp, claiming that they contained excessive bacteria. In July 2007, China had suspended some frozen chicken and pork products imported from the U.S., citing various health concerns. In August 2007, China rejected a shipment of U.S. pacemakers, due to quality concerns. Some analysts contend these have been retaliatory moves over U.S. recalls and detentions of Chinese products.

inspections, efforts to educate Chinese manufacturers, bilateral technical personal exchanges and training, regular meetings to exchange information with U.S. officials, and the development of a product tracking system) to prevent exports of unsafe products to the United States, especially in regard to lead paint in toys.

- On September 12, 2007, the NHTSA signed a Memorandum of Cooperation with its Chinese counterpart on enhanced cooperation and communication on vehicles and automotive equipment safety.

- On December 11, 2007, the U.S. Health and Human Services (HHS) announced that it had signed two Memoranda of Agreements (MOA) with its Chinese counterparts; the first covering specific food and feed items that have been of concern to the United States, and the second covering drugs and medical devices. Both MOAs would require Chinese firms that export such products to the United States to register with the Chinese government and to obtain certification before they can export. Such firms would also be subject to annual inspections to ensure they meet U.S. standards. The MOAs also establish mechanisms for greater information sharing, increase access of production facilities by U.S. officials, and create working groups in order to boost cooperation.

Many Members of Congress (and some industry groups) have called for tighter scrutiny (such as increased inspections and certification requirements) of imported products, greater funding for U.S. regulatory agencies to inspect imports, and higher penalties against violators of U.S. health and safety laws.[20] WTO rules allow countries to impose restrictions on imports for health and safety reasons as long as they are based on science, but forbid measures deemed to be discriminatory or protectionist in nature. Both the United States and China have accused each other of using health and safety concerns as an excuse to impose protectionist measures.

[20] The primary bill addressing product safety that Congress is considering is H.R. 4040 (Rush), which passed the House on December 19, 2007, and passed the Senate (as a substitute amendment with several differences with the House version) on March 7, 2008. Although not identical, both bills would boost the CPSC's funding and expand its authority, ban the sale of children's products that contain more than trace levels of lead, and require third-party inspections and mandatory tracking labels for children's products. For an overview of legislative proposals to reform the CPSC, see CRS Report RL34399, *Consumer Product Safety Commission Reform: S. 2045/S. 2663 and H.R. 4040*, by Margaret Mikyung Lee; and CRS Report RS22821, *Consumer Product Safety Commission: Current Issues*, by Bruce Mulock. For a listing of bills on food safety, see CRS Report RL34152, *Food Safety: Selected Issues and Bills in the 110th Congress,* by Geoffrey S. Becker.

China's Currency Policy[21]

Between 1994 and July 2005, China pegged its currency, the renminbi (RMB) or 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 (and dollar assets).

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 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 $1.5 trillion at the end of 2007) 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 greater 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 $406 billion at the end of 2007.

---

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

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 was "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.

Section 3004 of the 1988 Omnibus Trade and Competitiveness Act (P.L. 100-418) requires the Secretary of Treasury to issue a report every six months on international economic policy (including exchange rate policy) and to determine if any country is manipulating its currency in order to prevent an effective balance of payments adjustment or to gain an unfair competitive advantage in international trade. Since China reformed its currency in July 2005, Treasury has continued to press China to reform its currency, but has not cited it for currency manipulation.

According to the Bank of China, from July 21, 2005, to February 29, 2008, the dollar-yuan exchange rate went from 8.11 to 7.12, an appreciation of 13.9%.[22] Many members contend that China's currency reforms and the appreciation of its currency have not moved fast enough. As a result, numerous bills have been introduced in Congress to respond to China's currency policy (see section on legislation).

---

[22] Source: Calculated from Bank of China data using the official middle rate.

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 (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 sixth annual China WTO compliance report (issued in December 2007) identified several areas of concern, including failure by the Chinese government to maintain an effective IPR enforcement regime (discussed below), industrial policies that attempt to promote Chinese firms (while discriminating against foreign firms), restrictions on trading and distribution rights (especially in regards to IPR products, such as movies, books, and music), discriminatory and unpredictable health and safety rules on imports (especially agricultural products), burdensome regulations and restrictions on services (including excessive capital requirements), and failure to provide adequate transparency of trade laws and regulations.[23]

The USTR's 2007 China WTO 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.[24]

- 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

[23] USTR, *2007 Report to Congress on China's WTO Compliance*, December 11, 2007.

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

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 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.[25]" 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.[26] 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.[27]

U.S. WTO Cases Against China. To date, the United States has initiated five WTO dispute resolution cases against China, two of which have been resolved. Cases outstanding include:

---

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

[26] 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.

[27] 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% or more of the cost of a car made in China. This policy increases tariffs on some auto parts from about 10% to about 25% (which is the tariff China currently applies to imports of completed autos). Source: USTR *2007 Report to Congress on China's WTO Compliance,* p. 61.

- On March 3, 2008, the USTR requested WTO dispute resolution consultations with China regarding its discriminatory treatment of U.S. suppliers of financial information services in China.

- On April 10, 2007, the USTR filed two IPR-related cases against China: the first case charges that China has failed to comply with the TRIPS agreement (namely in terms of its enforcement of IPR laws) and the second case charges that China has failed to provide sufficient market access to IPR-related products, namely in terms of trading rights and distribution services (see below).

- On March 30, 2006, the USTR initiated a WTO case against China for its use of discriminatory regulations applied to imported auto parts (which often applies the high tariff rate on finished autos to certain 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 13, 2008, a WTO panel ruled that China's discriminatory tariff policy was inconsistent with its WTO obligations.

The two WTO cases that have been resolved include:

- 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.[28] China's WTO accession agreement required it to immediately eliminate such subsidies. On November 29, 2007, China formally agreed to eliminate the subsidies in question by January 1, 2008.

- On March 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.

---

[28] 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.

Violations of U.S. Intellectual Property Rights

History of U.S. Efforts to Improve China's IPR Regime. 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 TRIPS agreement. The U.S. Trade Representative's (USTR) office 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.

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 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. [29]

- 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 July 2005 U.S.-China Joint Commission on Commerce and Trade (JCCT)[30] 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 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.

---

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

[30] The JCCT was established in 1983 to serve as a forum for high-level dialogue on bilateral trade issues. In 1994, it was enhanced by the establishment of specific working groups, which have grown to include trade and investment issues, business development and industrial cooperation, commercial law, textiles, IPR, trade remedies, statistics, travel and tourism, high-tech and strategic trade, and agricultural trade.

- On April 28, 2006, the USTR listed China as a Priority Foreign 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.[31] 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.

- On December 12, 2007, the Motion Pictures Association of America, Inc. issued a press release stating that "China may have instituted a block on the import of American films into their country."[32] Although Chinese officials said no such ban was in effect, several U.S. industry officials claimed that such restrictions were in place and speculated they were in retaliation over the U.S. WTO cases against China involving IPR issues.[33]

The Scope of the IPR Piracy Problem in China. U.S. firms contend that IPR piracy in China has worsened in recent years, despite Chinese government promises to strengthen IPR enforcement by increasing criminal prosecutions of IPR offenders (and toughening penalties), improve coordination among IPR enforcement officials, and make a long term concentrated effort to stamp out major piracy centers.[34] Many business groups contend that poor IPR protection is one of the most significant obstacles for doing business in China. According to a representative of the Motion Picture Association of America, "China is the most difficult market to crack for the U.S. motion picture industry." Nine out of ten movie DVDs are fake, and 2005 losses from piracy in China were estimated at $244 million.[35] Major causes of the high piracy levels in China are attributed to be the Chinese government's tight restrictions on the number of foreign movies allowed to be imported (20 per year),

---

[31] 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.

[32] Press release available at [http://www.mpaa.org/PressReleases.asp].

[33] New York Times, "China Said to Block U.S. Films," December 11, 2007.

[34] Often the Chinese government will announce a major campaign to crack down on piracy, conducting widespread raids, shutting down illegal factories, and destroying pirated products. However, once the campaign period is over, enforcement becomes lax, and the illegal activity resurfaces. As a result, the long term result of the government's anti-piracy campaign is negligible.

[35] Statement by Dan Glickman, Chairman and Chief Executive Officer, Motion Picture Association of America before the House Ways & Means Committee, Subcommittee on Trade, hearing on Trade With China, February 15, 2007.

extensive periods of government review and censure requirements before a foreign movie can be legitimately shown, tight limits on distribution of films by foreign companies, and government pressure on movie houses to show only Chinese-made movies. American music producers have faced similar problems in terms of high piracy rates in China (estimated at 85%), trade and investment barriers on legitimate products, and large-scale exports of pirated music CDs by illegal Chinese firms. Piracy of music and recordings is estimated to have cost U.S. firms $206 million in 2006, according to the IIPA.[36] Pirated music, music videos, and movies are also widely distributed over the Internet in China.[37]

The Chinese government estimates that counterfeits constitute between 15% and 20% of all products made in China and are equivalent to about 8% of China's annual gross domestic product. A study by the Motion Picture Association of America estimated that China's domestic film industry lost about $1.5 billion in revenue to piracy in 2005 (and that the combined losses of both foreign and Chinese film makers totaled $2.7 billion).[38] It also found that about half of pirated films in China are Chinese movies. The Chinese government estimates that 500 million pirated books are produced each year.[39] Press reports indicate a number of health and safety problems resulting from counterfeit products in China. For example, in 2004, 13 infants in China reportedly died, and hundreds were sickened, from drinking fake baby formula.[40] Many observers contend that, without a solid IPR enforcement regime, innovation and growth of IPR-related industries in China will likely be greatly retarded.

Opinions differ as to why the Chinese government has been unable make a significant reduction in the level of piracy in China. Some explanations put forward by various analysts include the following:

- China's transformation from a Soviet-style command economy (in which the government owned and controlled nearly every aspect of the economic life) to one that is becoming more market-based is a very recent occurrence. IPR is a relatively alien or unfamiliar concept for most people in China to grasp (as is the concept of private property rights) and thus it is difficult for the government to convince the public that piracy is wrong.[41]

---

[36] The International Federation of the Phono-graphic Industry (IFPI) estimates that more than 350 million illegal discs were sold in China in 2005.

[37] IPR piracy has become so prevalent in China that it has produced a number of humorous quips, such as "if you did not see a fake DVD, you were not in China," and (in Shanghai) "we can copy everything except your mother."

[38] *Reuters*, "China Piracy Costs Film Industry $2.7 Billion in 2005," June 19, 2006.

[39] *Xinhua News Agency*, March 19, 2007.

[40] *New York Times*, "China: Prison for Two in Baby Formula Scandal," August 6, 2004, p. A4.

[41] Some Chinese officials have noted that some individuals who were arrested for IPR piracy violations expressed shock at their arrest because in their minds they were not harming

(continued...)

- Chinese leaders want to make China a major producer of capital-intensive and high-technology products and thus they are tolerant of IPR piracy if its helps Chinese firms become more technologically advanced.[42]

- While the central government may be fully committed to protection of IPR, local government officials are often less enthusiastic to do so because production of pirated products generates jobs and tax revenue, and some officials may be obtaining bribes or other benefits which prompts them to tolerate piracy.

- As a developing country, China (like many other developing countries) lacks the resources and a sophisticated legal system to go after and punish IPR violators, and that establishing an effective enforcement regime will take time.[43]

- As a practical matter, IPR enforcement in China will always be problematic until Chinese-owned companies begin to put pressure on the government to protect their own brands and other IPR-related products.

- Chinese trade barriers and regulatory restrictions on IPR-related products and their distribution are so onerous that they prevent legitimate products from entering the market, or raise costs so high that they are unaffordable to the average individual, thus creating a huge demand for low-cost pirated products.

The U.S. Files Two WTO Cases Against China on IPR. U.S. trade officials were reportedly on the verge of filing a WTO dispute resolution case against China in the fall of 2006 over its inadequate IPR enforcement, but were convinced by the Chinese government to give them more time to implement new IPR enforcement policies. In addition, U.S. officials indicated that they were are in the process of building a WTO case on IPR that would also include Chinese trade barriers to IPR-related products (which is seen as a major factor in the high piracy rates in China).[44] Despite various efforts on the part of the Chinese government to improve IPR enforcement, the USTR decided to file two WTO cases against China on April 10, 2007.[45]

---

[41] (...continued)
anybody.

[42] On the other hand, IPR piracy may prevent foreign firms from investing in high-tech production in China.

[43] Some critics of this argument note that China seems to be very efficient at going after political dissenters and others deemed to be "threats" to social stability.

[44] *Inside U.S. Trade,* February 21, 2007.

[45] For example, the Chinese government claimed it seized 73 million pirated products in (continued...)

The U.S. WTO cases on China's IPR regime represent the most comprehensive and complex cases the United States has filed against any WTO to date. Most WTO cases involve specific restrictions on specific products; however these two cases challenge a broad range of China's IPR policies, and could potentially lead the WTO to authorize the United States to impose a significant level of sanctions against China.[46] Specifically, the U.S. WTO complaints against China's IPR regime involve the following issues:[47]

- The thresholds for criminal prosecutions of IPR violations are too high, meaning the government will only pursue cases it considers to be serious or excessively large, creating a safe harbor for smaller producers or violators. In addition, the thresholds for prosecuting IPR violations are based on the value of the pirated products rather than the value such legitimate products would fetch in the marketplace. Such thresholds make it very difficult to pursue cases against many commercial producers of illegal IPR-related products.

- China often allows seized imported pirated goods to re-enter the market rather than disposing of them.

- China's copyright laws fail to protect imported works (such as movies) that are under review by Chinese censorship authorities (and must be approved before the works can be distributed in China). As a result, pirated copies of the works can be widely distributed without violating copyright law and thus do not face prosecution.

- Chinese IPR laws do not appear to allow producers of pirated products to be prosecuted unless they also illegally distribute such products.

- China has not abided by its 2001 WTO accession agreement to liberalize its rules on trading rights and distribution services. As a result, U.S. IPR-related products face significant trade barriers in China, and such barriers are a major factor for causing the high rate of piracy in China.

The USTR's 2007 Special 301 Report (issued on April 30, 2007) stated that its top IPR protection and enforcement priorities were China (along with Russia). The

---

[45] (...continued)
2006, made improvements to its legal system and increased prosecutions, and that it developed a national comprehensive strategy to deal with piracy.

[46] If the cases go to a WTO dispute resolution panel, and that panel ruled in favor of the United States, the panel would seek to estimate that level of trade losses suffered by the United States due to China's failure to enforce its IPR laws or to provide market access to IPR-related products. This figure could potentially be over a billion dollars (based on U.S. industry estimates of trade losses from IPR piracy in China).

[47] See USTR April 9, 2007 Press Release and related documents at [http://www.ustr.gov/index.html].

report stated that Chinese counterfeit products, such as pharmaceuticals, electronics, batteries, auto parts, industrial equipment, and toys "pose a direct threat to the health and safety of consumers in the United States, China and elsewhere." The report also included a special province-by-province assessment of IPR protection, the first time such a assessment has been made of any country.

Applying U.S. Countervailing Laws to China[48]

Many critics of Chinese trade policies contend that the Chinese government provides a significant level of subsidies to many of its industries, such as preferential bank loans and grants, debt forgiveness, and tax breaks and rebates.[49] In addition, some analysts charge that China's currency policy constitutes a form of government export subsidy.[50] Such critics contend that U.S. countervailing laws, which seek to address the negative impact foreign government subsides on exported products may have on U.S. producers in the United States, should be applied to nonmarket economies such as China.[51]

Until very recently, the Commerce Department contended that U.S. countervailing laws could not be applied to a non-market economy because of the assumption that most production and prices in such an economy are determined by the government, and thus it would be impractical to determine the level of government subsidy that might be conveyed to various exported products. However, in November 2006, the Commerce Department decided to pursue a countervailing case against certain imported Chinese coated free sheet paper products. On March 30, 2007, the Commerce Department issued a preliminary ruling to impose countervailing duties (ranging from 11% to 20%) against the products in question. Commerce contends that, while China was still a non-market economy for the purposes of U.S. trade laws, economic reforms in China have made several sectors of the economy relatively market based, and therefore it is possible to identify the level of government subsidies given to the Chinese paper firms in question.[52]

Many Members of Congress have called on the Administration to expand its use of countervailing measures against other Chinese products (as well to apply the law to the products of other nonmarket economies), and some have argued that

---

[48] For additional information on this issue, see CRS Report RL33550, *Trade Remedy Legislation: Applying Countervailing Action to Nonmarket Economy Countries*, by Vivian C. Jones.

[49] See USTR *2007 National Trade Estimates of Foreign Trade Barriers*, April 2, 2007.

[50] They charge that government intervention in currency markets to keep the value of the yuan low vis-a-vis the dollar, keeps the price of Chinese exports low.

[51] The relief comes in the form of additional duties that are imposed on the imported products in question after a determination is made that a foreign government subsidized export to the United States has harmed a U.S. producer. The additional duties are intended to offset the impact of the subsidy.

[52] Countervailing investigations have also been initiated of Chinese off-the-road tires (June 18, 2007) and Chinese steel pipe (June 14, 2007).

Commerce should consider China's undervalued currency as a factor in determining the level of countervailing duties.[53]

Textile and Apparel Products[54]

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.[55] According to the U.S. Commerce Department, China is the largest foreign supplier of textiles and apparel to the United States at $37.5 billion, or 34.9%(2007), and were nearly double 2004 levels ($19.2 billion).[56]

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.

The U.S.-China Strategic Economic Dialogue (SED)

On September 29, 2006, President Bush and Chinese 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.[57] The first meeting (chaired by Secretary of Treasury Paulson and Chinese Vice Premier Wu Yi) was held on December 14-15, 2006. The two sides have focused on four main topics: macroeconomic policy (including China's currency policy), innovation and IPR protection, energy and the environment, and services trade and investment. The United States has sought to use

---

[53] Legislation has been introduced in the 110th Congress that would clarify U.S. law to indicate that countervailing laws can apply to nonmarket economies. Other proposed legislation make "currency manipulation" or "currency misalignment" actionable under U.S. countervailing laws (see section on legislation).

[54] For additional information, see CRS Report RL34106, *U.S. Clothing and Textile Trade with China and the World: Trends Since the End of Quotas*, by Michael F. Martin.

[55] 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.

[56] 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/].

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

the talks to induce China to: quicken the pace of its currency reforms, expand market access for financial and non-financial services (beyond its WTO accession commitments), take steps to boost domestic consumption (including developing a social safety net), improve the business climate in China (such as transparency), and to address U.S. high priority trade issues (such as Chinese restrictions on U.S. beef, IPR protection, and health and safety issues regarding Chinese food products).

The second round of SED talks were held on May 22-23, 2007, in Washington, DC. The Chinese delegation was led by Chinese Vice Premier Wu Yi and included representatives from 15 ministries. According to the Treasury Department, China agreed to:

- Resume licensing for qualified joint ventures with foreign securities firms in China and expand the scope of their operations (such as in securities brokerages, propriety trading, and asset management), increase the level of permitted foreign investment (by qualified entities) in China's securities markets (e.g., stocks, bonds, etc.), and expand the scope of overseas equity investments that Chinese nationals are allowed to make through domestic entities.

- Allow foreign banks in China to issue RMB bank cards.

- Double the number of daily U.S. passenger flights to China by 2012 and provide full liberalization for cargo providers by 2011.

- Expand cooperation with the United States on sharing data on seizures of pirated goods in order to track violators.

- Increase cooperation and lower barriers for bilateral trade in environmental goods and services.

The December 2007 SED talks focused on a number of issues, many of which led to formal agreements, including:[58]

- a Memorandum of Understanding (MOU) on illegal logging and associated trade. The MOU establishes a Bilateral Forum between the two countries to identify joint work promoting both sustainable forest management and trade in legally-sourced forest products, as well as encourage public-private partnerships;

- MOAs on food and feed and on drugs and medical products;

- an MOA on strengthening cooperation on sound environmental management practices related to trade;

[58] Note, some of these agreements occurred during the December 11, 2007 JCCT meeting, which was held right before the SED meeting (December 12-13).

- an MOU to expand collaboration and cooperation for the exchange of information on regulatory standards for alcohol and tobacco products, and to improve the safety of imports and exports between the two countries;
- an MOU on biofuels, including cooperation on scientific, technical, and policy aspects of biofuels development, production, and use;
- an MOU on bilateral tourism promotion;
- an agreement on "Guidelines for U.S.-China High-Technology and Strategic Trade Development" to expand information sharing on market opportunities, and to identify and remove trade barriers;
- an MOU to expand U.S. exports to major urban areas in China;
- a memorandum of cooperation (MOC) to launch the Environmental Industries Forum, a forum of public and private sector groups, to promote the deployment of environmental technologies in China and increased trade in environmental goods and services; and
- renewal of a 2002 protocol promoting cooperation and collaboration on agricultural science and technology, and renewal and expansion of a 2002 MOU on cooperation in fighting HIV/AIDS.

The two sides also agreed to expand cooperation in the following areas:

- the use of strategic oil reserves;
- the use of low-sulfur fuels;
- clean water (the United States will provide technical assistance to China); and
- improved transparency on trade issues.

In addition, China agreed to allow foreign companies doing business in China to issue RMB-denominated stocks and bonds, and to complete a study with recommendations on adjusting the extent of foreign equity participation in the securities sector. The United States agreed to allow mutual funds administered by Chinese banks to invest in the U.S. stock market. China also agreed to re-list six of the 11 U.S. plants that had been de-listed for export to China because of Chinese claims that a feed additive (ractopamine) was unsafe.

Some Members expressed disappointment that the latest SED round did not contain commitments by China to further reform its currency policy, expand market access for U.S. financial firms, or to open China's markets to U.S. beef exports.

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

Several bills have been introduced in the 110th Congress to address various concerns over China's economic policies, especially its currency policy.

Currency Legislation. A significant share of trade legislation aimed at China involves efforts to change China's currency policy. The bills reflect various approaches. Some would impose tariffs against Chinese products (equal to the estimated undervaluation of China's currency) if China does not appreciate its currency to market levels. Another approach would apply U.S. countervailing laws to China's currency policy in the belief that such a policy constitutes a government subsidy. Some bills would change U.S. law regarding the Treasury Department's bi-annual determination of countries that manipulate their currencies. For example, some would replace the term currency "manipulation" with currency "misalignment" and would change factors Treasury would have to consider when determining which countries to cite, thus increasingly the likelihood that Treasury would have to designate China.[59] A final approach would make China's undervalued currency a factor in U.S. antidumping cases. Major currency legislation includes:

- 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. 782 (Tim Ryan) and S. 796 (Bunning) would make exchange rate "misalignment" actionable under U.S. countervailing duty laws, require the Treasury 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.

---

[59] Current U.S. law implies that there has to be *intent* to prevent an effective balance of payments or to seek an unfair competitive advantage before a country can be designated as a currency manipulator. Some of the proposed currency bills attempt to factor out this "technicality" so that a designation would occur as long as if Treasury found that a currency was fundamentally misaligned.

- H.R. 708 (English), H.R. 1229 (Davis) and S. 974 (Collins) would apply U.S. countervailing laws to non-market economies. S. 364 (Rockefeller) would apply U.S. countervailing laws to non-market economies and make exchange rate manipulation actionable under those laws.

- H.R. 2942 (Tim Ryan) would apply countervailing laws to nonmarket economies, make an undervalued currency a factor in determining antidumping and countervailing duties, require Treasury to identify fundamentally misaligned currencies and to list those meeting the criteria for priority action. If consultations fail to resolve the currency issues, the USTR would be required to take action in the WTO.

- S. 1607 (Baucus) would require the Treasury Department to identify currencies that are fundamentally misaligned and to designate such currencies for priority action under certain circumstances in its semi-annual reports to Congress on exchange.[60] If after consultations the country maintaining the designated currency policy fails to adopt appropriate policies, the U.S. would make currency undervaluation a factor in determining antidumping duties, ban federal procurement of products or services from the designated country, bar financing by the U.S. Overseas Private Investment Corporation (OPIC),[61] and would oppose multilateral financing for that country. If the designated country failed to take appropriate measures, the USTR would be required to file a case in the WTO. A modified version of the bill passed the Senate Finance Committee on July 31, 2007.

- S. 1677 (Dodd) would require the Treasury Department to identify countries that manipulate their currencies regardless of their intent and to submit an action plan for ending the manipulation; and gives Treasury the authority to file a case in the WTO. The bill was approved by the Senate Banking Committee on August 1, 2007.

Other Legislation. Other proposed bills that would affect commercial relations with China include:

- H.Res. 552 (Marshall) calls on China to remove barriers to U.S. financial services firms doing business in China.

- H.Res. 730 (Ros-Lehtinen) expresses the sense of the House regarding the planned acquisition of a minority interest in 3Com Corporation (a U.S. producer of data-networking equipment) by affiliates of Huawei Technologies (a Chinese company).

---

[60] A designation would occur based on such factors as protracted large-scale currency intervention, excessive reserve accumulation, restrictions on capital flows, or any other policy the Treasury Department determines that would warrant such a designation.

[61] OPIC has been banned from operating in China since 1989 under U.S. sanctions.

- H.Res. 925 (Poe) would condemn China for its socially unacceptable business practices, including the manufacturing and exportation of unsafe products, casual disregard for the environment, and exploitative employment practices.

- 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. 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. 1958 (Kaptur) and 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.

- H.R. 3220 and H.R. 3221 (both by Pelosi) would (among other things) promote U.S. exports of clean and efficient energy technologies to China (and India) and help build the capacity of government officials to become more familiar with available clean and efficient technologies.

- H.R. 3272 (Kirk) would provide for increased funding and support for diplomatic engagement with China and would provide funding for rule of law programs in China.

- H.R. 3273 (Larsen) seeks to expand U.S. export promotion programs in order to boost exports to China by small and medium-sized firms.

- H.R. 3274 (Israel) would authorize the Secretary of Energy to make grants to encourage cooperation between the United States and China on joint research, development, or commercialization of carbon capture and sequestration technology, improved energy efficiency, or renewable energy sources.

- H.R. 3275 (Davis) would, for the purpose of boosting U.S. global economic competitiveness, provide resources to U.S. schools in order to provide Chinese language and cultural studies classes.

- S. 1919 (Baucus) would (among other things), limit the discretion of the president in regards to Section 421 (China-specific safeguards) investigations on import surges from China and would amend U.S. trade law to apply U.S. countervailing laws to nonmarket economies.