U.S.-China Economic and Security Review Commission

Economics and Trade Bulletin

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Highlights of This Month's Edition

- **Bilateral trade:** In the first quarter of 2018, the U.S. goods trade deficit with China grew about 15.5 percent year-on-year due to increased imports; in services, the United States reached record high trade surplus with China in 2017, but export growth was the lowest in over 13 years.
- **Bilateral policy issues:** U.S. Department of Commerce bans U.S. firms from exporting to ZTE due to ZTE's repeated violations of its settlement with U.S. authorities; Chinese government strengthens long-standing policies to replace foreign technology with domestic equivalents; the EU and Japan join the United States in a challenge of China's licensing regulations, while the EU joins China in its request for consultations regarding Section 232 tariffs; Beijing increases retaliatory pressure on the U.S. agriculture sector by imposing a 178.6 percent antidumping deposit on U.S. sorghum; 82 percent of all U.S. agriculture exports to China are subject to planned or enacted retaliatory Chinese tariffs.
- **Quarterly review of China's economy:** The Chinese economy grew 6.8 percent year-on-year in the first quarter of 2018, benefitting from strong consumer demand and increased real estate investment.
- **Policy trends in China's economy:** At the Boao Forum, President Xi pays lip service to globalization and economic liberalization, but offers modest commitments.

Contents

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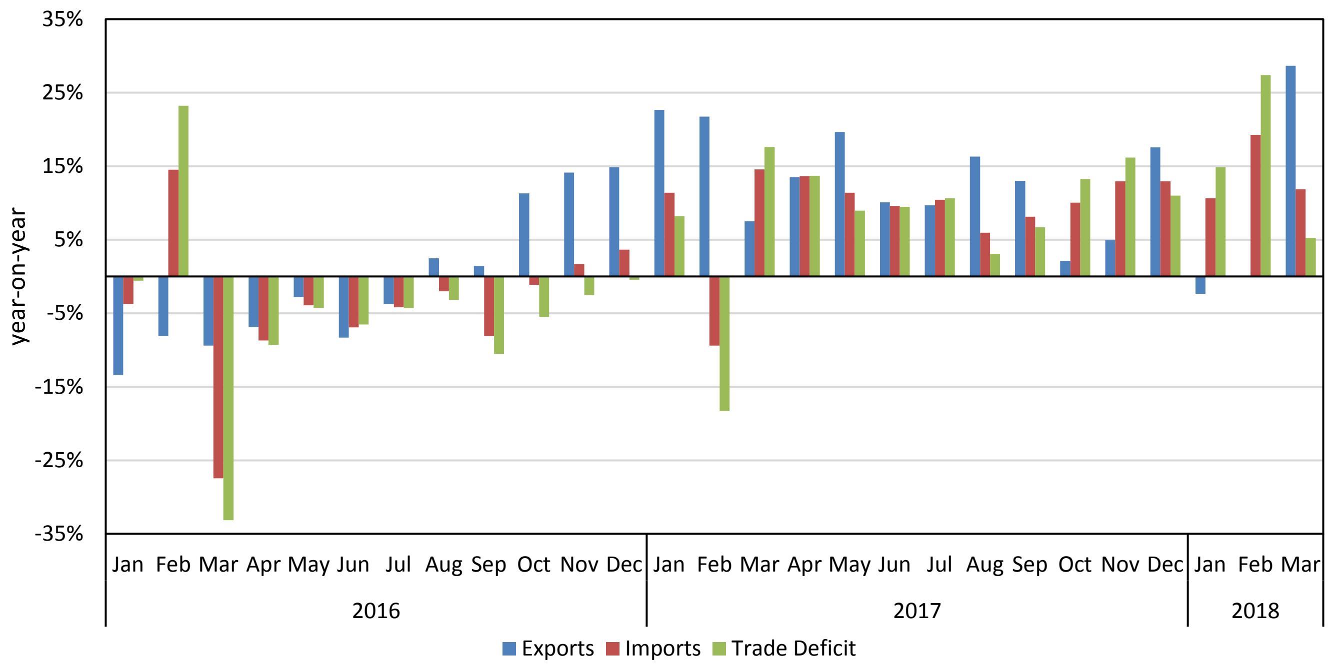
Bilateral Trade

U.S. Goods Deficit with China Expands on Stronger Imports

In the first quarter of 2018, the U.S. deficit in goods grew by about 15.5 percent over the first quarter of 2017. This increase is primarily due to a higher level of imports, which grew 13.6 percent over the same quarter in 2017; U.S. exports to China also expanded, but at a slower pace at 8.6 percent. As reported by *Reuters*, in March 2018, growth in goods exports to China was primarily driven by "a surge of deliveries" of civilian aircraft, aircraft component parts, and soybeans, which dropped the monthly goods trade deficit to $25.9 billion (see Figure 1).[1]

Figure 1: Monthly Goods Trade with China, January 2016–March 2018



Source: U.S. Census Bureau, Trade in Goods with China, March 3, 2018. *https://www.census.gov/foreign-trade/balance/c5700.html*.

Oil and Gas Exports Boom

Four of the top five U.S. imports from China grew by more than ten percent year-on-year in the first quarter of 2018, with computer and electronic products comprising over a third of these imports (see Table 1). More than half of imported product categories saw growth over ten percent year-on-year, and imports of livestock and livestock products increased by more than 60 percent.

Table 1: U.S. Trade with China: Top Five Exports and Imports

U.S. Top-Five Exports to China	Exports (US$ millions)	Share of total (%)	Change over Q1'17 (%)
Quarter 1 (Jan-Mar'18)			
Transportation Equipment	6,053.87	18.9%	18.5%
Computer and Electronic Products	4,123.89	12.9%	6.1%
Chemicals	3,922.10	12.2%	5.5%
Agricultural Products	3,739.78	11.7%	-16.9%
Oil and Gas	2,643.58	8.3%	88.4%
Other	11,540.22	36.0%	
Total	**32,023.44**	**100.0%**	

U.S. Top-Five Imports from China	Imports (US$ millions)	Share of total (%)	Change over Q1'17 (%)
Quarter 1 (Jan-Mar'18)			
Computer and Electronic Products	42,379.62	34.4%	15.5%
Electrical Equipment, Appliances, and Component	10,989.43	8.9%	18.8%
Machinery, Except Electrical	9,724.96	7.9%	17.8%
Miscellaneous Manufactured Commodities	8,989.98	7.3%	11.4%
Apparel and Accessories	6,343.37	5.2%	1.1%
Other	44,685.02	36.3%	49.4%
Total	**123,112.38**	**100.0%**	

Source: U.S. Census Bureau, USA Trade Online, May 3, 2018. *https://usatrade.census.gov/.*

The first quarter of 2018 saw an 88 percent year-on-year increase in oil and gas exports to China. The U.S. oil and gas export growth received a boost from a recent deal: in February 2018, Cheniere Energy signed a long-term supplier contract to export an annual 1.2 million tons of LNG to the China National Petroleum Corp.[2] Some of that supply will ship this year. [3] Oil and gas now account for about 8 percent of China's total imports from the United States, up from less than 1 percent in the first quarter of 2017.[4]

Advanced Technology Products Deficit Increases

The U.S. trade deficit in advanced technological products (ATP) stood at about $33.4 billion in the first quarter of 2018, up 19.4 percent over the first quarter of 2017; ATP imports grew by 17.5 percent.

Information and communication technologies (ICT) remained the greatest contributor to the deficit, with $36.1 billion in imports from China compared to $944 million exports from the United States.

Table 2: ATP Trade through March 2018

(US$ millions)

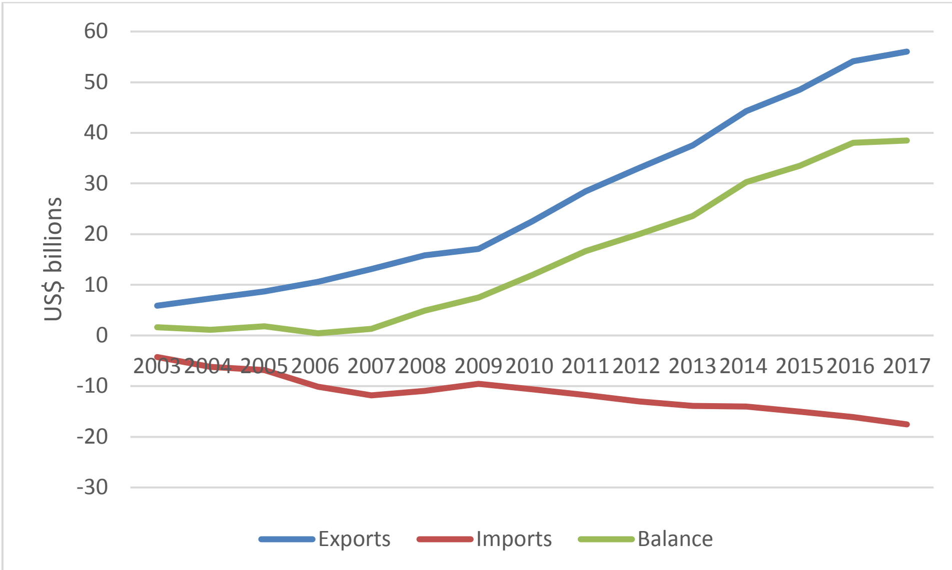
Quarter 1	Monthly			Cumulative year-to-date			
	Exports	Imports	Balance March 2018	Exports	Imports	Balance 2018	Balance 2017
TOTAL	**1,891**	**13,785**	**-11,894**	**6,197**	**39,599**	**-33,402**	**-26,913**
(01) Biotechnology	74	19	55	219	58	161	211
(02) Life Science	397	221	176	866	645	221	188
(03) Opto-Electronics	60	280	-220	129	897	-769	-611
(04) Information & Communications	367	12,605	-12,238	944	36,066	-35,122	-29,681
(05) Electronics	564	485	79	1,598	1,254	344	476
(06) Flexible Manufacturing	339	125	214	792	372	421	463
(07) Advanced Materials	27	40	-13	67	102	-35	2
(08) Aerospace	50	1	49	1,558	177	1,381	1,884
(09) Weapons	0	8	-8	0	25	-25	-24
(10) Nuclear Technology	13	1	12	23	2	21	180

Source: U.S. Census Bureau (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, March 2018). *http://www.census.gov/foreign-trade/statistics/product/atp/2017/12/ctryatp/atp5700.html.*

U.S. Services Trade with China

In 2017, the U.S. services surplus with China reached a record high of $38.5 billion, up from $38 billion in 2016 (Figure 2).[5] Exports to China hit $56 billion, a 3.5 percent increase year-on-year (the lowest growth rate in over 13 years).[6] Services imports reached $17.6 billion, an 8.7 percent increase from 2016.[7]

Figure 2: U.S.-China Trade in Services, 2003–2017



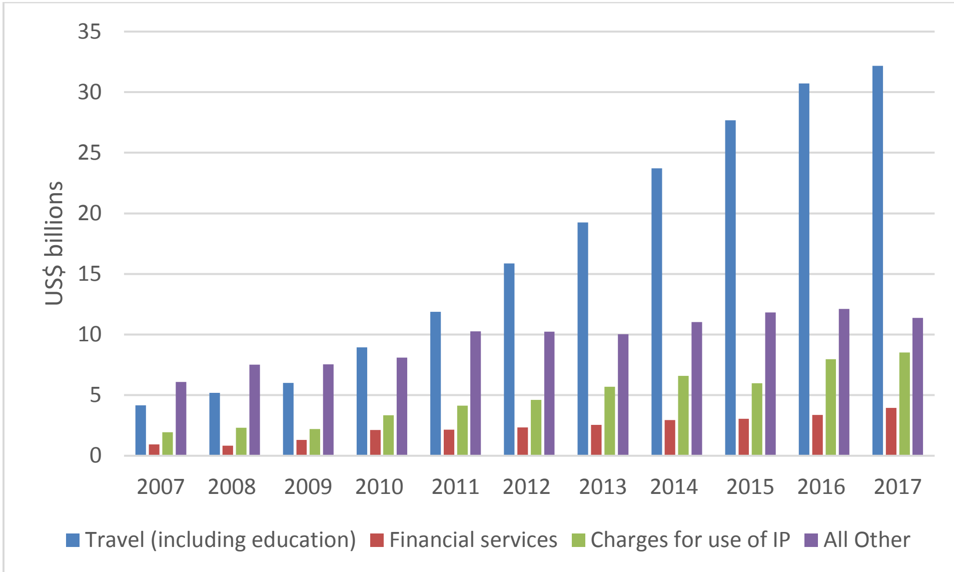
Source: U.S. Department of Commerce – Bureau of Economic Analysis, *U.S. Trade in Goods and Services by Selected Countries and Areas, 1999-Present*, U.S. Department of Commerce, Foreign Trade Division, March 21, 2018.

Exports of tourism, which includes Chinese students coming to the United States to study, dominate U.S. services trade with China: in 2017, they reached $32.2 billion, or 57 percent of all U.S. services exports to China (see Figure 3).[*] [8] For the third year in a row, however, exports of tourism are slackening; in 2017 they grew only 4.8 percent year-on-year, down from 23.2 percent year-on-year in 2014.[9] U.S. exports of financial services and intellectual property (IP) charges saw fairly significant year-on-year increases in 2017, growing 17.5 percent and 7.2 percent, respectively.[10]

In 2017, as in previous years, U.S. services imports from China were led by transport, which increased 5.3 percent from $4.4 billion in 2016 to $4.6 billion in 2017; travel (including for education), which increased 3.7 percent from $4.5 billion to $4.7 billion; and other business services, which increased 7.9 percent from $4.5 billion to $4.9 billion (see Figure 4).[11] Together, these three categories made up 81 percent of U.S. services imports from China.[12] Imports of insurance services leaped 726 percent from $50 million in 2016 to $413 million in 2017, going from a 0.3 percent share of U.S. services imports from China in 2016 to 2.4 percent in 2017.[13]

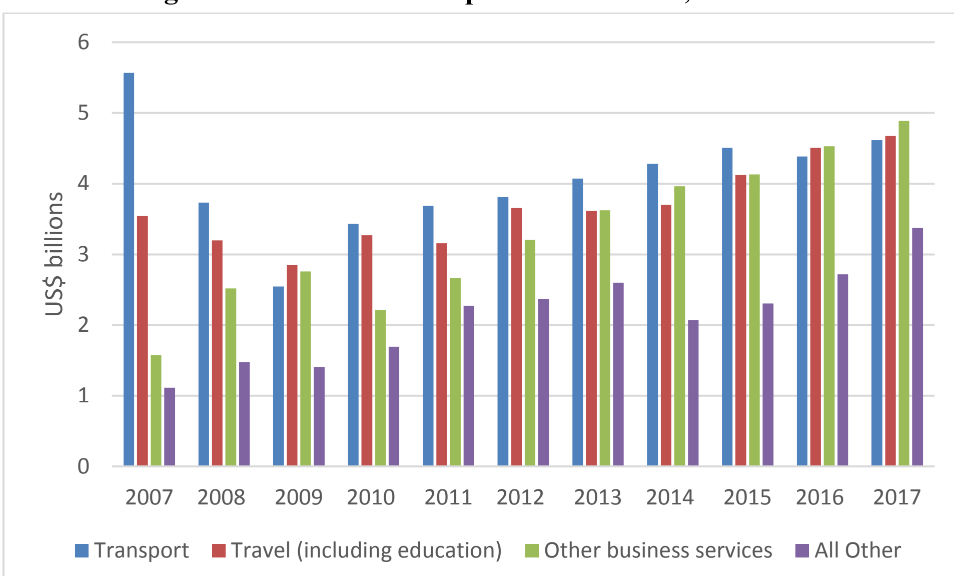
[*] The U.S. government classifies tuition payments as tourism and travel exports. For more on Chinese tourism in the United States, see Matt Snyder, "Chinese Tourism and Hospitality Investment in the United States," *U.S.-China Economic and Security Review Commission*, July 25, 2016. *http://www.uscc.gov/Research/chinese-tourism-and-hospitalityinvestment-united-states*.

Figure 3: U.S. Services Exports to China, 2007–2017



Source: U.S. Department of Commerce – Bureau of Economic Analysis, *U.S. Trade in Goods and Services by Selected Countries and Areas, 1999-Present*, U.S. Department of Commerce, Foreign Trade Division, March 21, 2018.

Figure 4: U.S. Services Imports from China, 2007–2017



Source: U.S. Department of Commerce – Bureau of Economic Analysis, *U.S. Trade in Goods and Services by Selected Countries and Areas, 1999-Present*, U.S. Department of Commerce, Foreign Trade Division, March 21, 2018.

Bilateral Policy Issues

United States Takes Action against ZTE's Violations; Chinese Government Strengthens Domestic-Only Technology Push

In response to Chinese telecommunications firm ZTE's "unacceptable pattern of false and misleading statements and related actions" during the investigation into its practices and its probation, the U.S. Department of Commerce's Bureau of Industry and Security (BIS) decided to "activate the suspended denial order in fall and to suspend the export privileges of ZTE for a period of seven years."[14] This order went into effect immediately and prevents U.S. firms such as Qualcomm, Dolby, and Acadia Communications from exporting components to ZTE directly or through third countries until March 13, 2025.[15] ZTE is presenting additional evidence but cannot formally appeal the ban.[16] This order will directly affect 10–15 percent of ZTE's bill of materials, according to Joel Ying, an analyst with the Japanese financial services firm Nomura.[17]

The BIS denial order against ZTE caps off a lengthy investigation into ZTE activities. In March 2017, BIS cited ZTE for violating the "U.S. trade embargo against Iran to obtain contracts to supply, build, operate, and maintain telecommunications networks in Iran using U.S.-origin equipment, and also illegally shipping telecommunications equipment to North Korea in violation of the Export Administration Regulations."[18] As part of its settlement with the U.S. government, ZTE pled guilty and agreed to pay $892 million in overall forfeiture and fines,* take disciplinary action against 39 of its employees involved in orchestrating its export evasion, and undergo a seven-year probation requiring six audit reports to ensure ZTE's compliance.[19] Despite ZTE's claims that it had carried out the required disciplinary actions against the relevant staff, BIS found that "ZTE paid their bonuses and paid them in full and the employees went without reprimand."[20] In March 2018, ZTE admitted it has made false statements to BIS in direct violation of its settlement, stating that it "had not executed in full certain employee disciplinary measures that it had previously described."[21]

Due to ZTE's violations of U.S. export laws during the investigation, its false statements to BIS and other law enforcement agencies, and its coverup scheme to destroy, remove, or sanitize evidence, BIS concluded:

> *If the $892 million monetary penalty paid pursuant to the March 23, 2017 Order, criminal plea agreement, and settlement agreement with the Department of the Treasury did not induce ZTE to ensure it was engaging with the U.S. Government truthfully, an additional monetary penalty of up to roughly a third that amount ($300 million) is unlikely to lead to the company's reform.*[22]

In response, ZTE claims that "the U.S. ban may cause ZTE to enter a state of shock and directly harm the company's employees, operators around the world, customers, end-users and shareholders."[23] On April 17, 2018, ZTE halted trading of its shares on the Hong Kong Stock Exchange and Shenzhen Stock Exchange.[24] On April 18, 2018, China's Ministry of Commerce highlighted the importance of ZTE for U.S. firms and jobs and stated that it "will be prepared to take necessary measures at any time to safeguard the legitimate interests of Chinese enterprises."[25]

ZTE, which in 2017 accounted for 10 percent of the global telecommunications market, is also facing pressure in other countries.[26] The United Kingdom's National Cyber Security Center assessed in April 2018 that "the national security risks arising from the use of ZTE equipment or services within the context of the existing UK

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* ZTE agreed to pay BIS $361,000,000 and the U.S. Department of the Treasury's Office of Foreign Assets Control $100,871,266 for a total of $892,360,064 in overall forfeiture and fines. If ZTE violates the settlement agreement, it will be required to pay an additional $300 million. U.S. Department of Justice, Office of Public Affairs, *ZTE Corporation Agrees to Plead Guilty and Pay over $430.4 Million for Violating U.S. Sanctions by Sending U.S.-Origin Items to Iran*, March 7, 2017. *https://www.justice.gov/opa/pr/zte-corporation-agrees-plead-guilty-and-pay-over-4304-million-violating-us-sanctions-sending*; U.S. District Court for the Northern District of Texas, Dallas Division, *United States v. ZTE Corporation: Plea Agreement*, No. 3-17CR-0120K, March 7, 2017. *https://www.justice.gov/opa/press-release/file/946276/download*.

telecommunications infrastructure cannot be mitigated"—in effect barring ZTE from the UK telecommunications market.[27]

For many in China, the BIS action against ZTE is a confirmation of long-standing fears over China's dependence on foreign technology, with the government redoubling its efforts to develop its own semiconductor and other core technology capabilities.[28] At the National Cybersecurity and Informationization Work Conference on April 20–21, 2018, Chinese President and General Secretary of the Chinese Communist Party (CCP) Xi Jinping stressed that "core technology is a great matter of state" and the role of the state to "unwaveringly support cybersecurity and informatization enterprises to grow large and strong, strengthen normative guidance, and stimulate their healthy and orderly development."[29] On April 25, 2018, Jack Ma, cofounder and executive chairman of the Chinese e-commerce firm Alibaba, said, "the market of chips is controlled by America ... and suddenly they stop selling ... Japan, China, any country should have their own technology."[30] In a speech on April 26, 2018, President Xi stressed that "now China must rely on itself to develop core and crucial technology, which are national treasures."[31]

In support of its Made in China 2025 objective of meeting 70 percent of its domestic market with local core components and materials, the Chinese government announced it is creating a second state-backed fund worth approximately $19 billion (RMB 120 billion) to finance the development of its domestic semiconductor[*] industry.[32] This fund would complement the initial $17.9 billion (RMB 120 billion) National Integrated Circuit Industry Investment Fund that was established in June 2014.[33]

Separately, the *Wall Street Journal* reported on April 25, 2018, that the U.S. Department of Justice (DOJ) has been investigating whether Huawei has illegally shipped U.S.-origin products to Iran since 2016.[34] In line with their practice, DOJ, the Department of Commerce, and Treasury did not comment.[35] If found guilty, Huawei could face administrative penalties and regulatory sanctions similar to those imposed on ZTE.[36] Huawei accounted for 27 percent of the global telecommunications equipment market in 2017.[37] On April 26, 2018, Huawei halted its planned bond sale due to the rumors of DOJ's investigation.[38]

U.S. Trade Actions Lead to a Flurry of Activity at the World Trade Organization

In April, a volley of statements and case initiations took place at the World Trade Organization (WTO) as U.S. trade actions prompted responses from China and other actors. The consultations discussed below have started the clock for possible WTO trade disputes: after one party requests consultations to formally initiate a dispute, the two parties have 60 days to settle the complaint before entering into litigation at the WTO.[†39] Thus far, three WTO cases have entered into consultations: (1) DS542, concerning China's licensing regulations; (2) DS543, concerning U.S. tariffs resulting from the Section 301 investigation; and (3) DS544, concerning U.S. tariffs on steel and aluminum.

Statements and case initiations included:

- *Following Section 232 investigations:* On April 5, China requested WTO consultations concerning the United States' decision to implement 25 percent and 10 percent tariffs on steel and aluminum, respectively.[‡40] The complaint stated that tariffs proposed by Section 232 "constitute[d] safeguard measures in substance" and therefore were not consistent with the United States' obligations under the WTO.[41] The EU filed a separate consultations request regarding steel and aluminum tariffs with the WTO Committee

[*] For more information on China's efforts to develop its semiconductor industry, see U.S.-China Economic and Security Review Commission, Chapter 1, Section 3, "China's 13th Five-Year Plan," in *2016 Annual Report to Congress*, November 2016, 151–161. *https://www.uscc.gov/sites/default/files/Annual_Report/Chapters/Chapter%201%2C%20Section%203%20-%2013th%20Five-Year%20Plan.pdf*.

[†] Following the 60-day consultation period, a panel of experts will be appointed within 45 days and the parties will transition to a formal dispute settlement phase of the process. See World Trade Organization, "Understanding the WTO: Settling Disputes." *https://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm*.

[‡] For more information on the Section 232 investigation, see the U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, March 2018, 2. *https://uscc.gov/trade-bulletin/march-2018-trade-bulletin*.

on Safeguards on April 16; on April 23, the EU requested to join China in its consultations, now case DS544.[42] Hong Kong, India, Russia, and Thailand have also requested to join consultations.[43]

- *Following Section 301 investigations:* After reviewing the Section 301 investigation report,[*] President Donald Trump directed the Office of the U.S. Trade Representative (USTR) to initiate a case at the WTO against China's licensing practices. [44] By April 7, the EU and Japan had requested to join the United States' challenge, now case DS542.[45] In response to tariffs announced after the Section 301 investigation, on April 4 China requested consultations with the United States over the proposed Section 301 tariffs on $50 billion of Chinese exports to the United States, now case DS543.[46]
- *China's subcentral subsidies:* On April 23, the United States circulated a statement at the WTO saying that China's subcentral subsidy notification was incomplete, covering only 20 of 32 Chinese provinces.[47] The statement also identified industry gaps: (1) provincial-level Strategic Emerging Industries[†] implementation programs do not appear on the subcentral subsidy notification, nor do (2) government subsidies and grants listed in the annual reports of Chinese steel companies. [48]

Ongoing negotiations will determine whether countries will be able to settle these concerns ahead of litigation. On May 1, President Trump made the decision to delay steel and aluminum tariffs on the EU, Canada, and Mexico.[49]

China Imposes Duties on U.S. Sorghum, Pork, Fruit, and Other Agricultural Products

In a move seen by analysts as further retaliation by China against U.S. trade measures,[‡] China's government announced on April 18 that exporters of U.S. sorghum will have to pay a 178.6 percent deposit in advance of forthcoming Chinese antidumping duties.[50] The Chinese government announced that its domestic farmers have been "substantially damaged" by U.S. sorghum imports, which it claims are being sold at below-market prices in China.[51] Beijing will issue a final ruling on the antidumping duties at a later date.[52]

The antidumping deposit is just one of many Chinese penalties pending against U.S. sorghum. On February 4, China's government announced it had launched a countervailing duty probe against U.S. sorghum (apparently in retaliation for U.S. duties on washing machines and solar panels enacted in January 2018), but has yet to announce its final ruling.[§] Sorghum may also be hit with an additional 25 percent duty as part of China's retaliation for the United States' proposed trade enforcement action against Chinese IP and tech transfer policies, as documented in the USTR's Section 301 report. If China imposes these additional tariffs on U.S. sorghum, the total duty and deposit collected by Chinese authorities will climb to 203.6 percent plus a yet-to-be-determined countervailing duty.[53]

According to U.S. traders, China's deposit requirement is high enough[**] to effectively price U.S. sorghum out of China's market.[54] As Beijing announced the deposit, 20 ships carrying $215 million worth of U.S. sorghum were at sea, many of which changed course away from China after the antidumping deposit was imposed.[55]

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[*] For more information on the Section 301 investigation, see the U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, April 2018, 2. *https://uscc.gov/trade-bulletin/april-2018-trade-bulletin*.

[†] "Strategic Emerging Industries" refer to seven industries targeted for development by the State Council in a 2010 policy document, *Decision on Accelerating the Development of Strategic Emerging Industries*. These are environmental technologies, next-generation information technology, biotechnology, new energy vehicles, high-end equipment manufacturing, new energy, and new materials. See U.S.-China Business Council, "China's Strategic Emerging Industries: Policy, Implementation, Challenges, and Recommendations," March 2013. *https://www.uschina.org/sites/default/files/sei-report.pdf*.

[‡] For more on China's tariffs and agricultural policy, see U.S.-China Economic and Security Review Commission, *Hearing on China's Agricultural Policies: Trade, Investment, Safety, and Innovation*, April 26, 2018. *https://www.uscc.gov/Hearings/china%E2%80%99s-agricultural-policies-trade-investment-safety-and-innovation*.

[§] For more on China's countervailing duty probe against U.S. sorghum, see U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, March 9, 2018. *https://www.uscc.gov/sites/default/files/Research/March%202018.pdf*.

[**] China appears to have cherry-picked production costs from the United States to ensure a high antidumping deposit. As part of the process of imposing antidumping duties, countries examine production costs from exporting countries to determine if foreign companies are

Sorghum is the United States' fourth-largest agricultural export to China (see Table 3), and U.S. farmers are heavily reliant on China's sorghum market. In 2017, China accounted for more than 81 percent of all U.S. sorghum exports (see Table 4).[56] The vast majority of sorghum grown in the United States is exported,[*] and China's role as the world's largest sorghum importer[†] will make it difficult for U.S. farmers to find new buyers for their crop without a discount. According to U.S. Grains Council President Thomas Sleight, if U.S. sorghum farmers succeed in finding other markets for their crop they will likely receive much lower prices.[57] While some farmers may be able to transition away from sorghum to planting other crops in the near future, according to Mr. Sleight many U.S. farmers (particularly those in Texas) are still growing sorghum and will be adversely affected by China's actions.[58]

Table 3: Top Five U.S. Agriculture Exports to China, 2017

Product	U.S. Exports to China (US$ millions)	Share of Total U.S. Agriculture Exports to China
Soybeans	$12,356	63%
Cotton	$976	5%
Hides & Skins	$946	5%
Sorghum	$836	4%
Pork & Pork Products	$663	3%

Source: U.S. Department of Agriculture Foreign Agricultural Service, *Global Agricultural Trade System Online*, April 12, 2018. *https://apps.fas.usda.gov/gats/ExpressQuery1.aspx*.

China's restrictions on U.S. sorghum are part of a larger series of tariffs placed on U.S. goods as retaliation for recent U.S. trade actions. As seen in Table 4, China has announced retaliatory tariffs against U.S. fruit, nuts, wine, pork, sorghum, soybeans, and several other products.[59] Taken together, these agricultural tariffs would affect almost 82 percent of all U.S. agricultural exports to China, roughly $16 billion out of $19.6 billion.[60] Soybeans alone accounted for over 63 percent of all U.S. agricultural exports to China and 9.3 percent of all U.S. goods exports to China in 2017.[61] China's tariffs on U.S. nuts, fruit, wine, and pork (which are linked to U.S. tariffs on steel and aluminum) entered into effect on April 2.[62] These tariffs have already affected U.S. businesses, particularly U.S. pork firms. China is the United States' fourth-largest export market for pork, and the imposition of tariffs immediately caused the price of U.S. pork to dive to a 16-month low in early April.[63] Overall, according to the U.S. farm lobbyist group Farmers for Free Trade, the tariffs on nuts, fruit, wine, and pork could result in as much as $500 million of duties on U.S. exporters in 2018.[64]

Table 4: Retaliatory Chinese Tariffs on Select U.S. Agriculture Products

Product	U.S. Exports to China, 2017 (US$ millions)	Exports to China as a Share of Total U.S. Exports of Select Product, 2017	Tariff, 2018	Status as of May 5, 2018
Fresh Fruit	$226	4.76%	15%	Enacted
Nuts	$243	2.86%	15%	Enacted

dumping their goods at below-market prices. In his testimony before the U.S.-China Economic and Security Review Commission, president of the U.S. Grains Council Thomas Sleight said China selected U.S. sorghum production costs from abnormally high-cost areas in California to justify a higher antidumping duty. U.S.-China Economic and Security Review Commission, *Hearing on China's Agricultural Policies: Trade, Investment, Safety, and Innovation*, oral testimony of Thomas Sleight, April 26, 2018.

[*] In 2016, 83 percent of all sorghum produced in the United States was exported. UN Comtrade, "International Trade Statistics Database." *https://comtrade.un.org/data/*; U.S. Department of Agriculture Economic Research Service, *Cash Receipts by Commodity State Ranking*. *https://data.ers.usda.gov/reports.aspx?ID=17844#P44ccd825c3af4f0fb15b6ac742c80baa_2_251iT0R0x128*.

[†] In 2016, China accounted for 74 percent of imports of sorghum worldwide. UN Comtrade, "International Trade Statistics Database." *https://comtrade.un.org/data/*.

Wine	$83	4.49%	15%	Enacted
Pork	$663	10.22%	25%	Enacted
Sorghum	$836	81.40%	25%; 178.6% deposit	Tariff proposed, deposit enacted
Soybeans	$12,356	57.25%	25%	Proposed
Tobacco	$162	16.11%	25%	Proposed
Orange Juice	$1	0.26%	25%	Proposed
Beef	$31	0.43%	25%	Proposed
Wheat	$351	5.73%	25%	Proposed
Corn	$142	1.56%	25%	Proposed
Cotton	$976	16.70%	25%	Proposed

Source: Various.[65]

Quarterly Review of China's Economy

China's Gross Domestic Product Increases 6.8 Percent in First Quarter of 2018

In the first quarter of 2018, China's officially reported gross domestic product (GDP) grew at 6.8 percent year-on-year, exceeding the GDP growth target of "around 6.5 percent" set by the Chinese government (see Figure 5).[66] This marks the third consecutive quarter China's official GDP growth has been recorded at 6.8 percent.[67] In 2017, China's full-year GDP growth was recorded at 6.9 percent, up from 6.7 percent in 2016.[68]

Figure 5: China's Official GDP Growth, 2013–Q1 2018

Note: In 2016, the GDP growth target was set at a range of 6.5–7.0 percent.
Source: China's National Bureau of Statistics via CEIC database; Li Keqiang, *Report on the Work of the Government* (First Session of the 13th National People's Congress, Beijing, China, March 5, 2018), 20. *http://online.wsj.com/public/resources/documents/NPC2018_GovtWorkReport_English.pdf.*

Although there remain concerns about the accuracy of Chinese official government data,* unofficial proxies for Chinese economic growth also report a robust strong first quarter. Investment in the Chinese property market, for example, increased 10.4 percent year-on-year—the fastest growth in three years.[69] Housing investment was boosted in part by Chinese government efforts to build public housing facilities, as well as continued increases in land prices, particularly in the largest Chinese cities.[70]

Consumption also remained strong, with retail sales growing 10.1 percent year-on-year in March, up from 9.7 percent year-on-year in each of the first two months of the year.[71] This was consistent with 2017 levels, when retail sales increased 10.2 percent year-on-year.[72] Consumption is becoming a more significant contributor to China's economy, accounting for almost 80 percent of China's economic growth in the first quarter of 2018 compared to 58.8 percent in 2017.[73]

Domestic Manufacturing, Industrial Output Slows

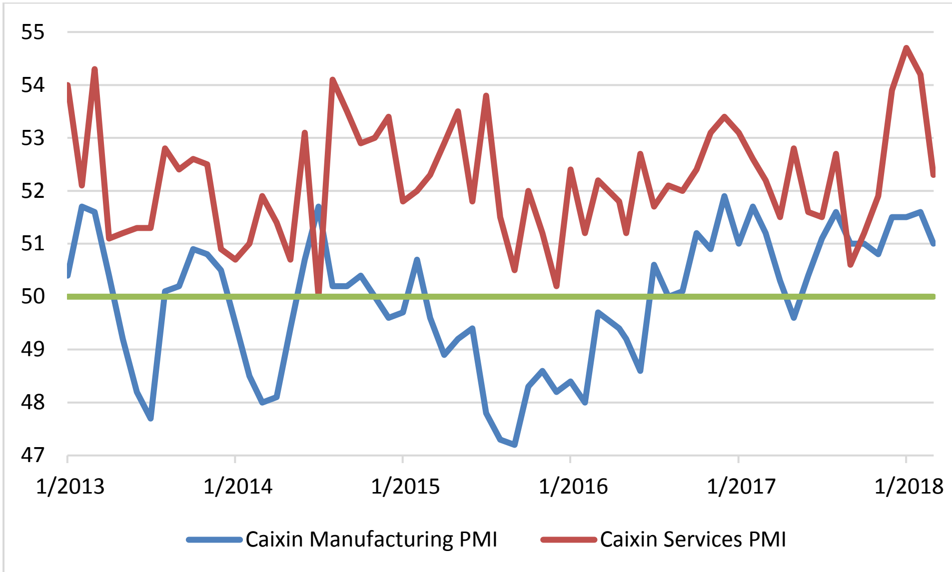
The Chinese government's efforts to rebalance China's economy away from heavy industry, low-tech manufacturing, and other old drivers of growth are becoming more urgent as these sectors begin to weigh on China's overall economic performance. According to Robert Subbaraman, an economist at the financial services firm Nomura, economic data from March 2018 "point to nascent signs of a growth slowdown underway, led by these old economy sectors."[74]

In March 2018, Chinese business activity expanded at its slowest pace in four months.[75] Unofficial estimates by the Chinese financial media firm Caixin found China's services Purchasing Managers' Index (PMI),† a measure of economic expansion and industrial utilization, fell to 52.3 in March 2018, down from 54.7 and 54.2 in the first two months of the year (see Figure 6).[76] According to Caixin, in March 2018 China's manufacturing PMI fell to 51 (a four-month low), down from 51.5 and 51.6 in January and February, respectively.[77] Increasing costs, particularly in the services sector, were largely to blame for the slowdown, forcing Chinese companies to increase prices and reducing their competitiveness.[78] China's industrial output growth slowed to a seven-month low in March 2018, increasing only 6 percent year-on-year after growing 7.2 percent in the first two months of the year.[79]

* Analysis from Bloomberg Economics in January 2018 found that China's official GDP growth rate between 2011 and 2015 was overstated in part due to provinces seeking to hide the depth of the economic slowdown. For example, Inner Mongolia Province overstated its 2016 industrial growth by 40 percent. James Mayger, "China's 2015 GDP Was Exaggerated by Fake Data, Analysis Shows," *Bloomberg*, January 31, 2018. *https://www.bloomberg.com/news/articles/2018-02-01/china-s-2015-gdp-puffed-up-by-fake-economic-data-analysis-shows*; Nathaniel Taplin, "Real News on Fake Data in China," *Wall Street Journal*, January 10, 2018. *https://www.wsj.com/articles/real-news-on-fake-data-in-china-1515573859*.

† The PMI measures the production level, new orders, inventories, supplier deliveries, and employment level to gauge the economic activity level in the services and manufacturing sector. The global financial information services provider Markit Economics compiles the Caixin-Markit China services and manufacturing PMI from monthly questionnaires to more than 400 purchasing executives (including small and medium-sized enterprises). By comparison, China's official manufacturing PMI tracks larger state-owned companies, generally leading to a stronger reading than private PMIs.

Figure 6: Caixin Services and Manufacturing PMIs, 2013–Q1 2018



Note: A reading above 50 indicates expansion; a reading below 50 shows contraction.
Source: Caixin and IHS Markit, "Caixin China General Manufacturing PMI," *Markit Economics*, January 2, 2018. *https://www.markiteconomics.com/Survey/PressRelease.mvc/5d67c1b2d63a4013aa2120ea2962a71e*; Caixin and IHS Markit, "Caixin China General Services PMI," *Markit Economics*, January 4, 2018. *https://www.markiteconomics.com/Survey/PressRelease.mvc/021247a9d84a4d4f805074a04f7cd584*.

Fixed-asset investment (FAI),* another traditional driver of the Chinese economy, grew 7.5 percent year-on-year, down from 7.9 percent in the first two months of 2018. That represents a slight acceleration from last year, when Chinese FAI grew 5.9 percent year-on-year, but is still down from 2016 levels, when FAI growth reached 8.1 percent year-on-year.[80] Government spending has been a key contributor to FAI growth, with public infrastructure investment increasing 17.8 percent year-on-year in 2017 and 13 percent year-on-year in the first quarter of 2018.[81] In the first quarter of 2018, however, private investment exceeded investment by state groups for the first time since 2015, rising 8.9 percent year-on-year, the fastest pace in more than two years. Investment from public entities, meanwhile, reached its lowest level on record, increasing just 7.7 percent year-on-year.[82]

China's goods trade surplus declined 21.8 percent year-on-year by value to around $52 billion in the first quarter of 2018. The decline was a result of slowing export growth (which rose 7.4 percent by value year-on-year in the first quarter) coupled with strong import growth (which increased by 11.7 percent by value year-on-year).[83] In March 2018, China posted an overall trade deficit, with imports growing 14.4 percent year-on-year by value while exports fell 2.7 percent year-on-year. This marked the first time China has posted a monthly trade deficit since February 2017.[84] Economists believe the March trade numbers may have been distorted by seasonal factors—including the Lunar New Year taking place later in the year than normal—contributing to the spike in import activity.[85]

* FAI is a measure of capital spending, or any type of investment by government and the private sector in physical assets such as buildings, machinery, or equipment.

Policy Trends in China's Economy

President Xi Promises Openness but Offers Modest Commitments at Boao Forum

In remarks delivered at the April Boao Forum for Asia, an annual Chinese conference modelled on the World Economic Forum, President Xi sought to portray China as a champion of globalization and promised to continue to open up the country's economy. Calling economic globalization "an irreversible trend of our times," President Xi said that "China's door of opening up will not be closed and will only open up even wider."[86] He highlighted four broad areas where China would pursue further opening:

- *"Significantly broaden" market access:* President Xi promised that in the services sector, China will ensure earlier commitments to raise foreign equity caps in banking, securities, and insurance are implemented. Additionally, China will accelerate opening up the insurance industry and ease restrictions on foreign financial institutions' ability to expand their business scope, among other measures to further improve market access. In manufacturing, China will ease foreign equity restrictions in the automotive, ships, and aircraft sectors "as soon as possible."[87]

- *Create a more attractive investment environment:* President Xi said China will work to create a more attractive investment environment by "enhancing alignment with international economic and trading rules, increasing transparency, strengthening property rights protection, upholding the rule of law, encouraging competition, and opposing monopoly."[88] China will release a new foreign investment negative list in the first half of 2018.

- *Strengthen intellectual property rights (IPR) protection:* According to President Xi, "Stronger IPR protection is the requirement of foreign enterprises, and even more so of Chinese enterprises."[89] China will restructure the State Intellectual Property Office to "strengthen the ranks of its officers, step up enforcement, significantly raise the cost for offenders, and fully unlock the deterrent effect of relevant laws," he said.[90]

- *Expand imports:* President Xi insisted that China "does not seek trade surplus" and has a "genuine desire to increase imports."[91] Increased imports would be achieved through "significantly lowering" tariffs for automobiles and "some other products," importing more products that "are competitive and needed by [Chinese] people," and "seeking faster progress" toward joining the WTO's Government Procurement Agreement (GPA).[*] [92] To that end, he said, "We hope developed countries will stop imposing restrictions on normal and reasonable trade of high-tech products and relax export controls on such trade with China."[93]

President Xi's rhetoric belied the many ways China's domestic investment environment remains highly restricted.[94] President Xi has progressively centralized power since becoming general secretary of the CCP in 2012, and at the annual meeting of China's National People's Congress in March 2018, the country's legislature approved changes further entrenching the CCP's power as well as President Xi's dominance within the CCP.[†]

Moreover, most of the commitments President Xi highlighted had been announced previously, and he offered few details about when or how the measures would be implemented, although some were subsequently fleshed out by

[*] The GPA sets out rules ensuring open and fair conditions of competition in the government procurement markets. Despite committing in 2001 to join the GPA "as soon as possible," China currently holds observer status on the agreement and has been negotiating accession for some time. Members to the agreement rejected China's latest offer in 2014 because of its insufficient coverage of state-owned enterprises. European Union Chamber of Commerce in China, "Stance on President Xi's Speech at Bo'ao," April 10, 2018. *http://www.europeanchamber.com.cn/en/press-releases/2615/stance_on_president_xi_s_speech_at_bo_ao*; Bryce Baschuk, "China Pushing Bid to Join WTO Procurement Pact, Xi Says," *Bloomberg BNA*, April 10, 2018. *https://www.bna.com/china-pushing-bid-n57982090983/*.

[†] For more on the key outcomes from the March 2018 National People's Congress, see U.S.-China Economic and Security Review Commission, *Economic and Trade Bulletin*, April 6, 2018, 7–8. *https://www.uscc.gov/sites/default/files/trade_bulletins/Apr%202018%20TB_4.9.18_FINAL.pdf*.

government agencies.[95] China proposed greater financial sector liberalization and easing the 50 percent foreign ownership cap on automotive joint ventures in November 2017, following President Trump's visit to China.[96] U.S. officials have described such commitments as coming too late to be meaningful for foreign companies.[97]

On automobiles, President Xi promised to lower tariffs on imported cars before the end of the year, but failed to specify by how much they would fall. China's high tariffs on imported automobiles—25 percent compared to 2.5 percent in the United States—have led foreign companies to shift a large part of their supply chains to China, where they produce most of the cars they sell domestically.[98] On April 17, China's National Development and Reform Commission announced that China would lift foreign ownership limits on electric vehicle joint ventures by the end of this year and lift foreign ownership caps on all automotive joint ventures by 2022.[99] Industry analysts believe the new measures could be meaningful for electric vehicle manufacturers like Tesla that do not already have operations in China.[100] However, major U.S. automakers are unlikely to benefit as they have already invested tens of billions of dollars in profitable, long-term joint venture contracts with local partners;[*] ending these partnerships would be costly and difficult.[101]

On financial services, People's Bank of China (PBOC) Governor Yi Gang said on April 11 that China will allow majority foreign control of brokerages and insurers by the end of June 2018 and full ownership in three years.[†] [102] This speeds up the timetable announced for opening up China's financial sector last November, when Beijing said foreign stakes in life insurance joint ventures would be raised to 51 percent in three years and removed completely in five years.[‡] Additionally, PBOC Governor Yi said China will make it easier for foreign banks to open branches and for foreign brokerage firms to receive licenses for businesses such as stock underwriting, although he did not offer specifics.[103]

[*] For instance, General Motor's partnership with state-owned Shanghai Automotive Industry Corp. does not expire until 2027, and Ford's partnership with Chang'an expires even later, in 2051.

[†] Foreign ownership is currently capped at 49 percent for securities, futures, and fund management firms and 50 percent for life insurance companies. Kevin Yao, "China Pledges to Allow More Foreign Investment in Financial Sector by Year-End," *Reuters*, April 10, 2018. *https://www.reuters.com/article/us-china-boao-pboc/china-pledges-to-allow-more-foreign-investment-in-financial-sector-by-year-end-idUSKBN1HI074*.

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