CHAPTER 1
THE U.S.-CHINA TRADE AND ECONOMIC RELATIONSHIP

INTRODUCTION

Over the past year, the U.S.-China economic relationship has continued to expand at a rapid pace. New U.S. foreign direct investment (FDI) in China totaled nearly $4 billion. The trade relationship grew markedly, with U.S. imports from China outpacing U.S. exports to China by more than five to one. The result was a bilateral goods trade deficit that reached $162 billion in 2004—a 31 percent increase over the previous year—and is on pace to well exceed $200 billion in 2005.

Moreover, the past year saw Chinese firms bid to take control of three major U.S. companies—the personal computer division of International Business Machines (IBM), the energy firm Unocal, and the appliance firm Maytag. Although only the IBM bid was concluded successfully for the proposed Chinese buyer, these U.S. corporate acquisition efforts by Chinese firms signal what may be the beginning of a steady stream of Chinese purchases of U.S. corporate assets, fueled in part by the Chinese government's efforts to invest some of its $769 billion in foreign reserves, accumulated in great part through trade surpluses with the United States.

Chinese companies with varying degrees of state ownership and control continue to seek capital infusions from a variety of sources, including U.S. investors. Inadequate transparency and disclosure by Chinese firms prevent the U.S. government and investors from fully understanding the possible nexus between Chinese firms listing on U.S. and international capital markets and support for Chinese and other weapons proliferation activity.

As this chapter will highlight, China's economic policies and resulting industrial growth are increasingly affecting the competitiveness of U.S. firms across a wide spectrum of important industry sectors, with implications for long-term U.S. economic health. Moreover, Chinese firms are raising billions of dollars in the U.S. and international capital markets, often without adhering to Western norms of corporate governance and disclosure of operations and overseas involvements. Assessing the effectiveness of the WTO, U.S. trade laws, and U.S. government policies to deal with these challenges has been a key focus of the Commission's work over the past year.

Highlights of the economic relationship:

- In 2004, total U.S. goods trade with China was $231 billion, making China the United States' third largest trading partner, behind Canada and Mexico. China was the United States' second highest source of imports, behind Canada, and its fifth largest export destination, behind Canada, Mexico, Japan, and the United Kingdom.

- The U.S. goods trade deficit with China hit a record $162 billion in 2004 and was the United States' largest bilateral trade deficit—more than twice that of the U.S. goods deficit with Japan, which ranked second. Imports from China reached $197 billion and U.S. exports to China totaled $35 billion. These figures represent an increase over 2003 in imports from China (28 percent), exports to China (22 percent) and the overall U.S. goods trade deficit with China (31 percent). Since 2001, the year that China joined the World Trade Organization (WTO), U.S. exports to China have increased 81 percent, and U.S. imports from China have increased 92 percent, leading to an increase in the U.S. bilateral goods deficit of 95 percent. From 1990 to the end of 2005, the United States will have accumulated over $1 trillion in trade deficits with China.
- The United States remained China's top export market in 2004 and its fifth largest import supplier, behind Japan, the EU15,[1] Taiwan, and South Korea, according to Chinese government statistics. The United States accounted for 33 percent of China's total exports, whereas China accounted for 4.2 percent of total U.S. exports.
- According to China's Ministry of Commerce, nearly 60 percent of China's exports are now produced by foreign-funded corporations.
- The U.S. goods trade deficit with China represents nearly a quarter of the overall U.S. goods deficit and grew at a faster rate in 2004 (31 percent) than the overall U.S. goods trade deficit (22 percent). In fact, the increase in the U.S. goods trade deficit with China of $38 billion in 2004 accounts for nearly one-third of the $119 billion total expansion of the U.S. goods trade deficit during that year.
- The U.S. goods trade deficit with China is spread across nearly all major product categories. Of particular significance is the growing U.S. deficit with China in goods designated by the Department of Commerce as advanced technology products (ATP). U.S. ATP imports from China grew more than 55 percent in 2004, leading to a U.S. ATP deficit with China of more than $36 billion. Since China joined the WTO, the U.S. ATP deficit with China has increased six-fold, from $6 billion to $36 billion.
- The U.S. enjoyed a modest trade surplus in services with China in 2003 of around $2 billion, which did little to offset the enormous U.S. goods trade deficit. This level of surplus in U.S.-China services trade has remained relatively flat since China joined the WTO. The principal components of the U.S. surplus with China in 2003 were educational services and royalties and licensing agreements.
- For the first six months of 2005, the U.S. goods trade deficit with China has reached $90.1 billion, an increase of 32 percent over the comparable period in 2004. At this rate, the full-year 2005 deficit will reach $213 billion.
- As reported by the Chinese Ministry of Commerce, U.S.-utilized investment into China was around $4 billion in 2004, representing approximately 6.5 percent of China's total utilized FDI. Since China joined the WTO, total FDI into China has increased

nearly 30 percent—from $47 billion to $61 billion—with the U.S. share decreasing from 10 percent to 6.5 percent.

- China's foreign exchange holdings reached $769 billion in September 2005, up from $416 billion at the start of 2004, and including $248 billion in U.S. Treasury securities.