U.S.-China Economic and Security Review Commission

Economics and Trade Bulletin

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Highlights of This Month's Edition

- **Bilateral trade:** The U.S. trade deficit in goods with China totaled $31.7 billion in August, down 17.6 percent year-on-year; U.S. exports rose to a five-month high.
- **Bilateral policy issues:** Members of Congress are scrutinizing risks posed by Chinese companies on U.S. exchanges and in federal retirement plans; the Trump Administration is rumored to be assessing similar risks; the U.S. Department of the Treasury published proposed regulations implementing FIRRMA.
- **Policy trends in China's economy:** China's Corporate Social Credit System, while still in the early stages of development, could pose significant compliance risks for U.S. companies and add to the Chinese government's geopolitical toolkit; Beijing removes foreign institutional investment quotas and grants first foreign payments license in latest financial opening moves.
- **In focus – China's pork supply:** U.S. pork exports to China rose this year despite tariffs in response to falling hog populations devastated by African swine fever; China's tariff exceptions announced on September 13 included pork and pig feed ingredients; China's government forecasts pork supplies will continue to be strained into the first half of 2020.

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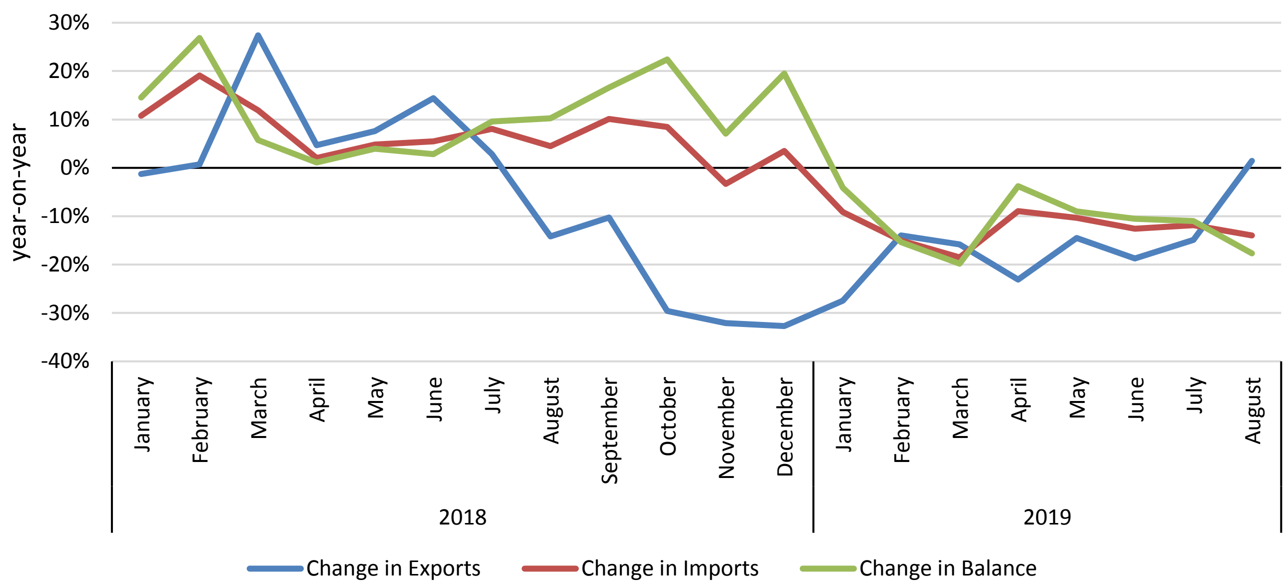
Bilateral Trade

U.S. Trade Deficit with China Continues to Narrow as Exports Hit Five-Month High

The U.S. trade deficit in goods with China totaled $31.7 billion in August 2019, down 17.6 percent year-on-year (see Figure 1).[1] U.S. exports to China rose to a five-month high of $9.4 billion, boosted by Chinese purchases of U.S. agricultural products ahead of high-level trade negotiations in mid-October, with exports of soybeans surging 1,956.1 percent year-on-year from a low base.[2] Chinese imports of U.S. pork and other meat products also contributed to the increase, with U.S. meat exports rising 92.4 percent year-on-year as China stepped up pork imports to manage the fallout from African swine fever on domestic supply.[3] U.S. imports from China contracted 14 percent year-on-year to $41.2 billion.[4] Year-to-date, the U.S. goods deficit with China reached $231.6 billion, down 11.5 percent from the same period last year.[5]

Figure 1: U.S. Imports, Exports, and the Trade Deficit with China, January 2018–August 2019



Source: U.S. Census Bureau, *Trade in Goods with China*, October 4, 2019. *https://www.census.gov/foreign-trade/balance/c5700.html*.

Bilateral Policy Issues

Rumored White House Action and Proposed Legislation Weigh Restrictions on U.S. Investments in Chinese Securities

On September 27, Bloomberg reported that the Trump Administration was considering steps to limit U.S. financial flows to China, a move that would open a new front in the ongoing U.S.-China trade dispute. According to the report, which cited unnamed officials familiar with internal White House deliberations, possible measures under consideration included forcing Chinese companies to delist from U.S. stock exchanges, restricting federal government retirement fund investments in Chinese equities, and capping the value of Chinese stocks included in stock indexes managed by U.S. firms.* [6] The report prompted a minor selloff of U.S.-listed Chinese stocks as investors feared that investments in Chinese equities on U.S. exchanges, valued at over $1 trillion in September 2019, could be exposed to new political risks.[7] U.S. Department of the Treasury Spokesperson Monica Crowley and Director of the Office of Trade and Manufacturing Policy Peter Navarro subsequently issued qualified denials that calmed markets, but significant questions remain about whether and how the White House will move to restrict bilateral capital flows.[8]

Some U.S. senators have also criticized the inclusion of Chinese firms in U.S. federal retirement plans. In an editorial on September 30, Senators Marco Rubio and Jeanne Shaheen criticized the investment board of the Thrift Savings Plan (TSP), part of the U.S. government retirement fund, for benchmarking the "I" (or International) fund to an MSCI index that includes Chinese state-owned enterprises and companies allegedly linked with China's military and surveillance technologies.† The investment board decided on this change in 2017, and the fund will be benchmarked to the index by mid-2020.[9] According to the senators, the decision to follow this index will lead to an estimated investments of nearly $50 billion from U.S. government employees' retirement savings into Chinese securities.[10] In a letter to the investment board, Senators Rubio and Shaheen argued this decision would expose U.S. federal government employees to undisclosed material risks from listed Chinese companies concerning national security, human rights, and financial transparency.‡ [11] Apart from index funds, U.S. investors can also hold Chinese companies' stock through U.S. and Hong Kong stock exchanges and invest in Chinese government and corporate bonds.

Why Do Indices Matter?

Initially created as benchmarks to measure the performance of specific markets, stock and bond indices are now used by fund managers and retail investors to allocate funds across a variety of investments, including those held in retirement accounts. Stock and bond indices assess the performance of a group of companies by a given location or company size. For example, the S&P 500 index tracks the performance of 500 of the largest U.S. companies' stocks, which are "weighted" by—or held in proportion to—their market capitalization.[12] Because these 500 stocks combined are equivalent to about 80 percent of total U.S. market capitalization, the S&P 500 is viewed as a good indicator of U.S. stocks overall.[13] Indices can thus be seen to represent specific markets. This allows fund managers to use indices to form the basis for selecting and allocating funds in low-cost "passively-managed" investments, where the investment product will "passively" follow the index rather than rely on a fund manager's "active" skill in choosing stocks or bonds.[14] To track the index, the investment product buys and holds the same stocks or bonds at the same weight as the index.[15]

In 2019, the weighting of some Chinese stocks has increased in global indices. Index creator MSCI announced in February 2019 it would increase the weight of China A Shares in MSCI indices between May and November 2019.[16]

* Under U.S. law, the president possesses the legal authority to block U.S. investors from providing equity financing to Chinese companies by declaring a state of emergency under the 1976 National Emergencies Act. Once declared, the president would then receive powers under the 1977 International Emergency Economic Powers Act (IEEPA), which grants the president the power to regulate foreign economic transactions after an executive declaration of national emergency. This includes the power to "prohibit any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of … or transactions involving any property in which any foreign country or a national thereof has any interest." International Economic Emergency Powers Act § 1701 Pub. L. No. 95-223, 1977. *https://www.treasury.gov/resource-center/sanctions/Documents/ieepa.pdf*.

† The Thrift Savings Plan, which resembles a 401k retirement plan, uses the MSCI All Country World ex-U.S. Investable Market Index as one of its benchmarks. Marco Rubio and Jeanne Shaheen, "Federal Retirement Savings Should Not Fund China's Communist Party," *CNBC*, September 30, 2019. *https://www.cnbc.com/2019/09/30/federal-retirement-savings-should-not-fund-chinas-communist-party.html*.

‡ In the letter, the senators illustrated their concerns using the examples of AviChina Industry & Technology Ltd., which develops military technology for the People's Liberation Army; Hangzhou Hikvision Digital Technology, whose surveillance cameras are used in the detention of Uyghur minorities in Xinjiang and was recently added to the Bureau of Industry and Security's Entity List; and Kangmei Pharmaceutical Co., which admitted to falsely overstating the value of its cash holdings. Marco Rubio and Jeanne Shaheen, "Letter to Chairman Michael Kennedy," August 26, 2019. *https://www.rubio.senate.gov/public/_cache/files/87600faa-153e-43db-aae1-9b42e03df612/DBC911B002D667ECFF793F7B9A94AE75.20190826-final-rubio-shaheen-letter-to-frtib-on-tsp-china.pdf*; Ana Swanson and Paul Mozur, "U.S. Blacklists 28 Chinese Entities over Abuses in Xinjiang," *New York Times*, October 7, 2019. *https://www.nytimes.com/2019/10/07/us/politics/us-to-blacklist-28-chinese-entities-over-abuses-in-xinjiang.html*.

These changes will increase the weighting of Chinese A Shares in the widely used MSCI Emerging Markets Index* from 0.72 percent in February 2019 to 3.3 percent in November 2019, associated with a potential inflow of about $80 billion into Chinese A Shares.[17] Overall, the total weighting of Chinese companies in the MSCI Emerging Market Index is about 30 percent, including Chinese A Shares issued in mainland China as well as Chinese securities issued in Hong Kong, the United States, and elsewhere.[18] In making this decision, MSCI cited "overwhelming support for the weight increase from international institutional investors" and pointed to Chinese authorities' progress and plans to pursue financial market opening.[19] Between 2013 and 2016, MSCI had rejected the inclusion of A Shares due to concerns about limitations on foreign investors, approval processes, and capital controls.[20]

Separately from policy discussions on federal retirement investments, some Congress members have also proposed legislation on U.S. accounting oversight of Chinese companies listed on U.S. exchanges. As of September 2019, 172 tickers representing 166 Chinese companies were listed on U.S. major exchanges, including the New York Stock Exchange, the NASDAQ, and the American Stock Exchange.[21] Accounting for over $1 trillion in combined market capitalization as of September 2019, these companies represent sectors as diverse as technology, finance, basic industries, and consumer goods and services.[22] Unlike other foreign securities issuers,† however, these companies do not allow the audit inspections required of all U.S. securities issuers under the Sarbanes-Oxley Act of 2002.[23] Under Sarbanes-Oxley, all issuers of U.S. securities must allow the Public Company Accounting Oversight Board (PCAOB) access to their audit work papers; however, the PCAOB has been blocked from reviewing the audits of U.S.-listed Chinese companies by Chinese financial regulators on national security grounds.[24] A joint statement by the PCAOB and the U.S. Securities and Exchange Commission in December 2018 stated that despite yearslong negotiations, U.S. financial regulators had "not yet made satisfactory progress" in gaining access: Chinese regulators continue to obstruct PCAOB audit inspections.[25]

On June 5, legislation requiring U.S.-listed Chinese companies to allow the PCAOB access to their accountants' audit work papers as currently stipulated in U.S. regulations was introduced by Representatives Michael Conaway, Tim Ryan, and Mike Gallagher in the House, and Senators Marco Rubio, Robert Menendez, Tom Cotton, and Kirsten Gillibrand in the Senate.[26] If the legislation is adopted, companies unable to comply with this regulation for three consecutive years would be required to delist.[27]

Reports of potential delisting Chinese companies have elicited a variety of responses from U.S. commentators and politicians. Some have advocated against delisting Chinese companies and blocking capital flows. The *Wall Street Journal* editorial board, for example, decried the prospect of forcing Chinese companies off of U.S. stock exchanges as the "worst China trade idea," arguing it would only hurt U.S. businesses and capital markets.[28]

Other commentators suggested Chinese entities should be delisted if they are unwilling to permit PCAOB inspections, citing a double standard allowing Chinese and Belgian companies to enjoy lower oversight than all other companies on U.S. exchanges. Professor and accounting expert Paul Gillis has noted that adopting legislation similar to the 2018 H.R. 7234 bill (introduced by Representative Michael Conaway), which also proposed delisting after three years, would resolve this double standard, which currently "makes a mockery of U.S. regulation."[29] In a Bloomberg editorial, professor and economic expert Christopher Balding called this double standard "indefensible" and said measures to enforce current regulations would be "long overdue and welcome."[30]

Treasury Publishes Draft CFIUS Regulations

On September 17, Treasury issued proposed regulations for implementing the 2018 Foreign Investment Risk Review Modernization Act (FIRRMA), which significantly expands the jurisdiction of the Committee on Foreign

* As of April 10, 2019, about $1.9 trillion in assets were benchmarked to the MSCI Emerging Market index. Steve Johnson, "IMF Warns on Risk of Rapid Exit from Emerging Market Assets," *Financial Times*, April 10, 2019. *https://www.ft.com/content/12303ac0-5ad7-11e9-939a-341f5ada9d40*.

† Companies from China, Hong Kong, and Belgium are the only foreign companies issuing U.S. securities whose audit papers are not possible for the PCAOB to inspect. Public Company Accounting Oversight Board, "Public Companies That Are Audit Clients of PCAOB-Registered Firms from Non-U.S. Jurisdictions Where the PCAOB Is Denied Access to Conduct Inspections," September 20, 2019. *https://pcaobus.org/International/Inspections/Pages/IssuerClientsWithoutAccess.aspx*.

Investment in the United States (CFIUS).* The proposed regulations provide further detail on many of the provisions in FIRRMA. Public comments on the proposed regulations are open until October 17, with final regulations slated to take effect by February 13, 2020.[31]

The first part of the proposed regulations primarily addresses CFIUS's jurisdiction over noncontrolling investments (such as minority equity investments) by foreign persons that result in certain types of rights to, access to, or involvement in certain businesses. Specifically, CFIUS has jurisdiction over a noncontrolling investment in a business that (1) produces, designs, tests, manufactures, fabricates, or develops critical technology;† (2) owns, operates, manufactures, supplies, or services critical infrastructure; or (3) maintains or collects sensitive personal data of U.S. citizens that may be exploited in a manner that threatens to harm national security. These are known as "TID [technology, infrastructure, and data] businesses." The proposed regulations include an annex listing 28 categories of "critical infrastructure" that are subject to CFIUS's "noncontrolling" jurisdiction, including certain airports or maritime ports, as well as any financial market utility that the Financial Stability Oversight Council has designated as "systemically important." The proposed regulations also provide categories of data considered "sensitive personal data," including genetic data or certain data collected by businesses that could be used to analyze financial hardship.[32]

Under the proposed regulations, the majority of CFIUS disclosures remain voluntary, although the party filing a voluntary notice may receive a "safe harbor" letter, meaning CFIUS will not subsequently investigate a transaction except under limited circumstances. Parties may also file an abbreviated "declaration" with a shorter review timeline.[33] However, the regulations set forth mandatory disclosure requirements in certain instances where a foreign country has a "substantial interest," as required by FIRRMA.[34] Additionally, the proposed rulemaking does not affect CFIUS's pilot program that establishes mandatory declarations for transactions involving certain types of critical technologies.[35]

The proposed regulations also create exemptions for certain "excepted investors" who have ties to "excepted foreign states" and who have demonstrated compliance with certain laws, orders, and regulations. (These exemptions do not apply to transactions where the investors would gain control of a U.S. entity.) The list of "excepted foreign states" has not yet been published; Treasury will post a list of eligible countries on its website.[36]

The second set of proposed regulations applies specifically to real estate transactions. As FIRRMA established, CFIUS has jurisdiction over certain real estate transactions, including those that are part of air or maritime ports as well as those that are within "close proximity" of certain military installations. The proposed regulations provide more detail on these provisions, including a list of relevant military installations and defining "close proximity" as a range of one mile.[37] The proposed regulations also give CFIUS jurisdiction over certain transactions within an "extended range"—defined as 100 miles—of a subset of the military installations specified in the proposed regulations.[38]

Disclosure of all real estate transactions to CFIUS is voluntary, although a party who files a notice or short-form "declaration" may receive a "safe harbor" letter.[39] Similar to the first set of proposed regulations, the proposed real estate regulations set forth exemptions for "excepted real estate investors" with connections to "excepted real estate states" who meet certain requirements.[40] Additionally, certain types of real estate transactions, including single housing units and most transactions in an "urbanized area" or "urban cluster," are exempt from CFIUS oversight.[41]

Policy Trends in China's Economy

China's Economic Planner Completes Initial Corporate Social Credit Evaluation

On September 1, China's economic planning agency, the National Development and Reform Commission (NDRC), completed an initial evaluation of 33 million companies in preparation for the launch of China's National "Internet+

* For more on FIRRMA's changes to the authority of CFIUS, see U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, September 5, 2018, 2–4. *https://www.uscc.gov/sites/default/files/Research/September%202018%20Trade%20Bulletin.pdf*.

† As required in FIRRMA, the definition of "critical technology" in the proposed regulations includes not only traditional export-controlled articles (i.e., defense articles covered in the U.S. Munitions List or Commerce Control List), but also certain nuclear facilities and equipment, select agents and toxins, and "emerging and foundational technologies" as defined in the Export Control Reform Act of 2018.

Monitoring" System, the meta-database powering China's Corporate Social Credit System.[42] Notionally established in 2015 with the assignment of unique identifying numbers to every company in China, the Corporate Social Credit System is intended to be a nationwide master database tracking all aspects of corporate behavior and administering automated regulatory responses to keep companies in line with the CCP's governance objectives.

The various data inputs into the score are mostly standard matters of bureaucratic compliance, ranging from details on tax filings to whether companies paid into government employee benefits funds (see "Meta-database" in Table 1). To this end, the *Wall Street Journal*'s Nathaniel Taplin speculates the Corporate Social Credit System serves primarily to improve information flows within government and create selective transparency—an inherently difficult process in a heavily censored society where lack of press freedom discourages whistleblowing and corporate malfeasance often goes unreported.[43] However, observers and industry associations point to the potential for government abuse of the system, whether augmenting protectionist regulatory enforcement by local bureaucracies or central government retaliation against foreign companies operating in China during geopolitical disputes.

The NDRC's initial evaluation categorized companies' "creditworthiness" as excellent, good, fair, or poor.[44] While the results are still preliminary and were sent back to local authorities for review, Chinese regulators have already extended some of the corporate ratings comprising the database nationwide.[45] They have also concluded reviews of several industries, including travel services and coal mining.[46] The NDRC is set to launch the system for all companies by the end of 2020, although many analysts question whether it will be fully functional.[47]

How Does Corporate Social Credit Work?

Analysis by Trivium China, a research and advisory firm, segments the Corporate Social Credit System into three distinct components: a meta-database aggregating companies' information from corporate registries and databases, a system of positive and negative inducements Chinese regulators may use to reward or punish companies, and a series of blacklists maintained by government agencies to effectively deny companies the ability to conduct business (see Table 1).[48]

In system design, all of the constituent databases would feed into the NDRC's National "Internet+ Monitoring" System, with new inputs updating an algorithmically generated credit score. The credit score would inform application of sticks and carrots that might be applied to a company, with noncompliance escalating to a company becoming blacklisted.[*] Getting off a blacklist requires a laborious "rectification" process, including correcting violations and completing creditworthiness training. The amount of time an entity may remain on a blacklist varies from three months to indefinite, depending on the severity of the violation.

In its present form, the incipient Corporate Social Credit System is still a patchwork of the constituent databases managed by individual government agencies and local bureaucracies, and requires extensive human input to update records.[49] There is not yet an overarching, centrally administered blacklist, although to increase the punitive effect of being blacklisted, government agencies have agreed to share blacklists.[50] This practice creates a "ripple effect" where violating one agency's regulations could render a company unable to apply for a license from another agency.[51]

[*] In practice, the blacklists detailed in Table 1 are currently operative but the respective agencies maintaining them update them independently of the Corporate CSC. The EU Chamber of Commerce in China forecasts that interagency data sharing for blacklists is a priority and could be largely complete within 2019. European Union Chamber of Commerce in China and Sinolytics, "The Digital Hand: How China's Corporate Social Credit System Conditions Market Actors," *European Union Chamber of Commerce in China*, August 28, 2019, 15. *https://www.europeanchamber.com.cn/en/publications-archive/709/The_Digital_Hand_How_China_s_Corporate_Social_Credit_System_Conditions_Market_Actors.*

Table 1: China's Corporate Social Credit System

Meta-Database	Sticks and Carrots	Blacklists
The meta-database powering China's social credit system aggregates data from numerous sources, including: • Court rulings; • Administrative punishments; • Environmental compliance; • Government licensing; • Product quality inspection; • Work safety records; • Tax records; and • Employee benefits contributions. At least 46 central government agencies are contributing to constructing a national data-sharing platform, and provinces are developing their own elaborate credit scoring systems.	Companies with poor credit ratings could experience: • Fines; • Frequent inspections and audits; • Licensing and approval restrictions; • Exclusion from preferential policies; and • Exclusion from public procurement contracts. Companies with excellent ratings may enjoy: • Fast-tracked procedures; • Preferential policy support; • Reduced inspections; and • Advisory and consulting services (e.g., for tax filings).	Government agencies and local bureaucracies maintain numerous blacklists. Prominent examples include: • Court Defaulter's Blacklist▲ (Supreme People's Court); • Seriously Untrustworthy Entities Involved in the Financial Sector▲ (NDRC); • Serious Tax Violators▲ (State Administration of Taxation); • Companies and Related Personnel with Serious Unpaid Wages to Migrant Workers▲ (Ministry of Human Resources and Social Security); and • Customs Defaulting Companies (General Administration of Customs).

Note: Blacklists marked ▲ include both individuals and companies.[52]
Source: Kendra Schaefer et al., "Understanding China's Social Credit System," *Trivium China*, September 23, 2019, 10, 12–16, 19. *http://socialcredit.triviumchina.com/wp-content/uploads/2019/09/Understanding-Chinas-Social-Credit-System-Trivium-China-20190923.pdf*.

Implications for the United States and U.S. Companies Operating in China

As the cascading blacklists demonstrate, lack of automation or unification under a national system do not prevent the Corporate Social Credit System from having substantial and immediate consequences for U.S. companies and the United States, including as a tool of economic coercion. It has already been used to extend censorship globally pressuring companies to modify behavior in other markets: the Chinese Civil Aviation Administration's April 2018 threat to penalize United Airlines and 35 other carriers for listing Taiwan as separate from China on their websites prompted changes in those companies' websites worldwide.[53] As Australian Strategic Policy Institute visiting fellow Samantha Hoffman notes, this created a precedent where the Corporate Social Credit System ' ability to interfere in other nations' sovereignty is taken as a routine market access requirement.[54]

A study by the EU Chamber of Commerce in China (EUCCC) concludes that Chinese regulators intend for the Corporate Social Credit System to become the centerpiece of a broader overhaul in foreign market access.[55] In place of hard controls currently governing market access, such as negative lists prohibiting or restricting investment in certain sectors, the Corporate Social Credit System will provide a framework of sticks and carrots to manipulate foreign firms' behavior within and beyond China's borders.[56] This emerging system will both expand routine compliance burdens and regulatory risk for companies in China and create a broader vehicle for the Chinese government to exact pressure on companies to achieve geopolitical ends.

In day-to-day operations, the EUCCC estimates large multinationals with significant operations in China will be subject to 30 credit ratings encompassing upward of 300 criteria.[57] Lawyers predict that simply maintaining awareness of the regulations to which a company is subject will require a substantial increase in compliance.[58]

Implementation of the Corporate Social Credit System will also change the demands of corporate responsibility in China, requiring companies to monitor their business partners' and executives' ratings. Companies' credit scores include "guilt by association," whereby a business relationship with a poorly rated company could harm a company's credit score, and individual executives within a poorly rated company could have their personal credit scores impacted or vice versa.[59]

China Removes Foreign Institutional Investment Quotas, Grants First Foreign Payments License

On September 10, China's foreign exchange regulator announced it would remove quotas on two major inbound investment programs—the Qualified Foreign Institutional Investor (QFII) program and the Renminbi Qualified Foreign Institutional Investor (RQFII) program—as a weakening renminbi (RMB) and rising capital outflows push Beijing to seek to attract more foreign capital.[*] [60] "Henceforth, foreign institutional investors with the relevant qualifications can simply register to remit funds to carry out investment in securities in compliance with regulations," China's State Administration of Foreign Exchange said in a statement.[61] The QFII and RFQII programs were introduced in 2002 and 2011, respectively, as part of an effort to open up China's capital market to international investors. The QFII program provides licensed foreign institutional investors access to onshore stocks and bonds while the RQFII program allows foreign investment in the Chinese stock and bond markets via offshore RMB accounts.[62] Post-liberalization, China hopes these two programs will attract more foreign capital inflows.

Analysts view the move as largely symbolic and unlikely to boost capital inflows, as demand for QFII and RQFII quotas has never been particularly high.[63] At the end of August 2019, just $111 billion of the total $300 billion quota for QFII investments and $98 billion of the total $270 billion quota for RQFII investments had been used.[64] Moreover, foreign investors are increasingly turning to China's Stock Connect and Bond Connect programs, which lack the cumbersome administrative requirements the QFII and RQFII programs are subject to.[†] [65] Nonetheless, according to Paul Sandhu, head of Asia-Pacific multi-asset quant solutions at BNP Paribas Asset Management, the decision to remove QFII and RQFII limits, coupled with the People's Bank of China's recent moves to cut reserve requirement ratios for commercial banks, makes it "clear that [Beijing] is strategically making a positive push towards adding liquidity to the financial markets and renewing [the] flow of investment into China," which can "[reduce] some of the risk in the market caused by the U.S.-China trade negotiations."[66]

Additionally, on September 30 PayPal became the first foreign company to receive an online payments license in China, after purchasing a majority stake in Chinese payments provider GoPay.[67] The deal comes more than a year after Beijing pledged "equal treatment" for domestic and foreign companies in the payments market.[68] Despite being a leader in digital payments in the United States, PayPal is a latecomer to China's rapidly growing mobile payments market.[69] China's mobile payments market is dominated by two domestic players—Tencent's WeChat Pay and Alibaba's AliPay account for over 90 percent of the market.[70] Industry analysts expect the main opportunities for PayPal and other foreign companies will be in cross-border payments.[71] According to ING Greater China economist Iris Pang, "The market for outbound payments isn't as crowded as the domestic payment platforms, and with increasing demand for foreign goods, Chinese consumers might find it easier to use foreign payment platforms on foreign e-commerce sites."[72]

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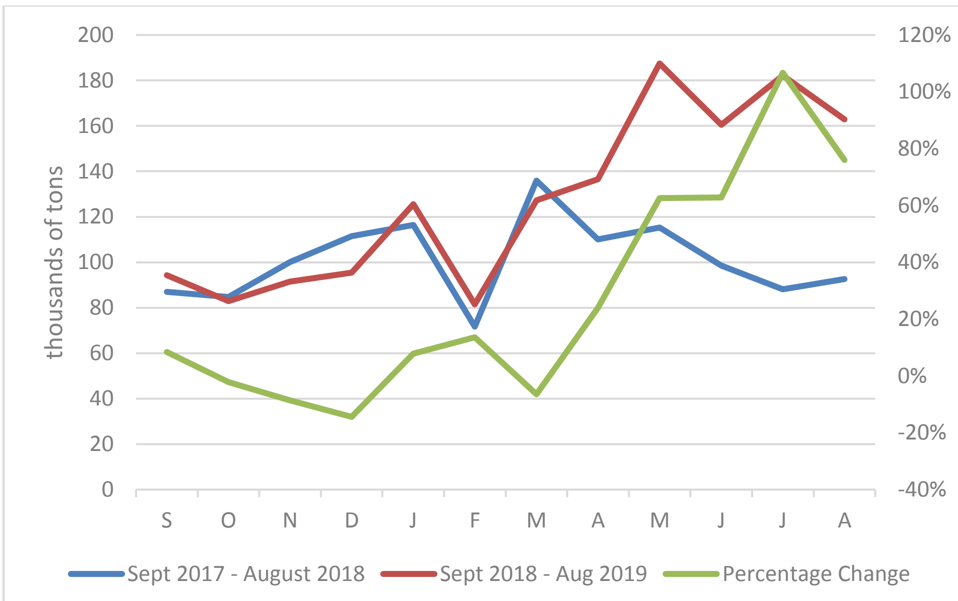
[*] For more on Beijing's recent efforts to increase foreign access to China's financial sector, see U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, June 6, 2019, 6–8. *https://www.uscc.gov/sites/default/files/trade_bulletins/June%202019%20Trade%20Bulletin.pdf*.

[†] For example, under the QFII and RQFII schemes, foreign investors are required to file their investment profits with the local tax bureau before they can transfer funds offshore, even though they are exempt from paying taxes on interest gained from investing in onshore stocks and bonds under these channels. Xie Yu, "China's Scrapping of QFII and RQFII Caps on Foreign Investment Will Have a Very Limited Effect, Say Analysts, *South China Morning Post*, September 21, 2019. *https://www.scmp.com/business/banking-finance/article/3029625/chinas-scrapping-qfii-and-rqfii-caps-foreign-investment*; Rebecca Feng, "China Reforms QFII, RQFII but Leaves Critical Problems Untouched," *Global Capital Asia*, September 17, 2019. *https://www.globalcapital.com/article/b1h674kg3wfdh6/china-reforms-qfii-rqfii-but-leaves-critical-problems-untouched*.

In Focus: African Swine Fever Outbreak Wreaks Havoc on China's Pork Supply

One year after the initial outbreak, African swine fever has devastated China's domestic pig population, shrinking it by one-third, according to conservative estimates.[73] Chinese authorities have responded with incentives for farmers to build up healthy herds and cull infected livestock.[74] The Chinese government has also opened up purchases of U.S. pork, which started to rise in March 2019 to meet high demand despite being subjected to retaliatory tariffs of 50 percent.[75] China's monthly global pork imports have increased 25 percent year-on-year in April and 100 percent year-on-year in July (see Figure 2).[76] On September 13, China lifted tariffs on U.S. pork and pig feed inputs, which likely will further encourage imports.[77] As a show of government support and an effort to stabilize prices before the National Day holiday on October 1, 30,000 tons of pork were released from China's government-managed pork reserves.[78] Despite these measures, forecasts from China's government put pork supplies under continued strain into the first half of 2020.[79]

Figure 2: China's Global Pork Imports, September 2017–August 2019



Source: China's General Administration of Customs via CEIC.

Impact of Swine Fever on China's Pig Population

In addition to being the world's largest pork consumer, China is the world's largest pork producer.[80] Pork is a staple food of middle-class Chinese diets, and in 2018 monthly pork consumption stood at approximately 4.7 million tons per month (over 150,000 tons per day.)[81] The *South China Morning Post* reported that in 2018, China was home to 433.25 million pigs—about half the global pig population.[*] [82] China's Ministry of Agriculture and Rural Affairs reported in August 2019 that China had lost 38.7 percent of its pig livestock due to African swine fever.[83] Estimates from nongovernment researchers place the number as high as 60 percent.[84]

As a consequence of the shortage, pork prices in August climbed 46.7 percent higher year-on-year, and China's consumer price index rose 1.08 percentage points as a result.[85] According to China's Ministry of Agriculture and Rural Affairs, by the third week of September pork prices rose 81 percent higher than the previous year.[86]

Concerns remain that the disease continues to spread among China's hog population. Some farmers have continued to sell diseased livestock to reduce their losses and avoid paying fees at officially sanctioned slaughtering houses.[87]

[*] In 2018, there were approximately 150 million pigs in the EU and 73 million pigs in the United States.

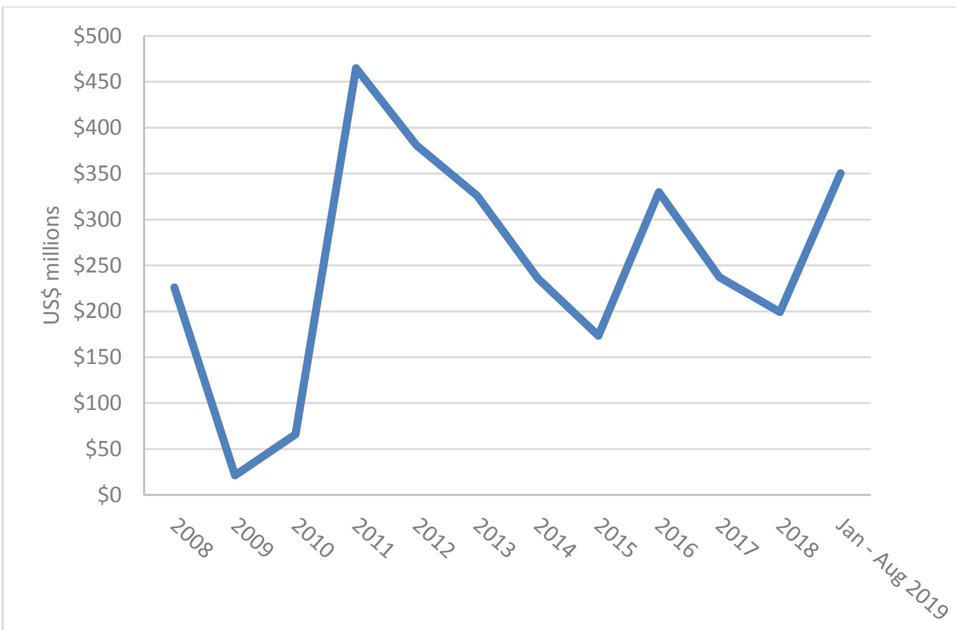
On March 1, China's Ministry of Public Security announced the arrest of over 960 individuals involved crimes related to African swine fever, including selling unreported diseased pigs; unregulated slaughtering; and illegal trafficking of diseased pigs, including transportation and falsifying quarantine certificates for diseased animals.[88] According to remarks from China's Vice Premier Hu Chunhua on August 22, unannounced investigations found large numbers of dead pigs in regions where African swine fever had not been reported.[89] In the same speech, Vice Premier Hu disclosed government estimates that China will have a 10-million-ton pork supply deficit this year, and that pork supply will continue to be strained into the first half of 2020.[90]

Meeting China's Pork Demand

In 2018, China's top five pork suppliers were, in order, Germany, Spain, Canada, Brazil, and the United States.[91] Although the United States remains in the top five, U.S. exports dropped in 2018 due to tariff increases, with purchases from Brazil expanding over 200 percent compared to 2017 to fill the gap.[92] However, China's purchases from the United States picked up in 2019 amid continued supply strain, despite being subject to cumulative 62 percent tariffs.[*] [93] By the end of August, sales of fresh or frozen pork[†] had already exceeded total annual purchases in 2016 (see Figure 3).

On September 13, China announced a one-year window during which retaliatory tariffs would be lifted on 16 U.S. products, including pork.[94] Other exemptions include soy, fish meal, and whey permeate, all of which are commonly used by Chinese famers as pig or piglet feed.[95]

Figure 3: U.S. Pork Exports to China, 2008–2019



Note: Graph depicts products categorized under "Meat of Swine" (0203) under the Harmonized System Codes (HS Codes), and includes carcasses, half carcasses, and cuts of meat with bone. Live animals, edible offal, and processed meats are not included.
Source: United States Department of Agriculture, Foreign Agricultural Service. *https://apps.fas.usda.gov/gats/default.aspx.*

To further stabilize prices before the October 1 holiday, China's Merchandise Reserve Management Center auctioned 30,000 tons of pork from its central reserves in three batches between September 19 and September 28.[96] Originally established in 1996, China's pork reserves contain both frozen cuts of pork—which are rotated every four months—and live pigs cared for in government-run bases.[97] Though official numbers are not publically

[*] Prior to the start of U.S.-China trade tensions, U.S. pork entering China was subject to 12 percent import duties. In the course of the trade war, China imposed two rounds of tariffs worth 25 percent each.

[†] The U.S. primarily exports unprocessed (fresh, chilled, or frozen) pork, as well as edible pork offal (including pigs' feet, hearts, and tongues) rather than processed or cured meat. United States Department of Agriculture, Foreign Agricultural Service, *https://apps.fas.usda.gov/gats/default.aspx*.

disclosed, conservative estimates from Nomura economists place pork reserves at 350,000 to 400,000 tons.[98] Other industry analysts estimate reserves could be between 3 million and 5 million tons.[99]

While the release itself was dwarfed by expected demand, the move served as a signal of government priorities to cool prices.[100] China's highest levels of government have offered more explicit support as well. In a circular released on August 22, the State Council outlined plans to stabilize pork prices, including issuing subsidies to farmers who need to slaughter diseased livestock and calling for local government policies to scale up pig raising.[101] In his speech given the same day, Vice Premier Hu explicitly stated stabilizing pork supply is a "political task" for China's government officials. [102]

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