U.S.-China Economic and Security Review Commission

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August 6, 2020

Highlights of This Month's Edition

- **Bilateral trade:** The U.S. goods trade deficit with China fell to $131.7 billion in the first half of 2020; U.S. energy and electronics exports expanded, while imports contracted across most sectors; U.S.-China services trade plunged in the first quarter of 2020 as the novel coronavirus (COVID-19) pandemic halted travel.
- **Bilateral policy issues:** New allegations of Chinese government-directed hacking and theft of U.S. technology came to light in July, underscoring increasing U.S.-China tech tensions; following the Chinese government's implementation of a national security law for Hong Kong, the Trump Administration revoked Hong Kong's special treatment in U.S. law and signed a bill authorizing sanctions against entities that contribute to this effort; the U.S. government enhanced its response to human rights abuses in Xinjiang by issuing an advisory on associated supply chain risks, adding to the Entity List 11 Chinese companies involved in human rights violations, and sanctioning Chinese government officials and organizations.
- **Policy trends in China:** A new data security law draft released by the China National People's Congress contains extraterritorial provisions similar to the Hong Kong national security law, extending the Chinese government's digital regime beyond China's borders; Chinese regulators step up scrutiny of corporate governance issues and financial misconduct.
- **Quarterly review of China's economy:** China's economy grew 3.2 percent in Q2 2020, according to official statistics; flooding in central and southeastern China displaced millions and drove agriculture prices higher; General Secretary Xi Jinping reiterated the need for economic self-reliance in new formulation "dual economy."

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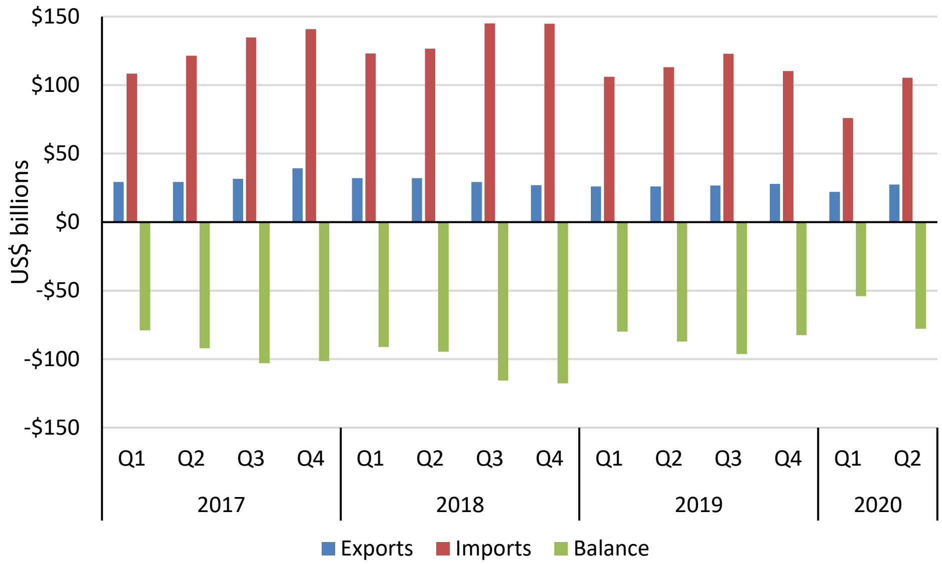
Bilateral Trade

U.S. Goods Deficit with China Down in Q2 amid Rising Exports, Falling Imports

The U.S. trade deficit in goods with China totaled $77.8 billion in Q2 2020, a 10.6 percent fall from Q2 2019. Exports totaled $27.5 billion, up 5.7 percent year-on-year, while imports fell by 6.9 percent year-on-year to $105.3 billion (see Figure 1). In the first six months of 2020, the U.S. goods trade deficit with China was $131.7 billion, a 21.1 percent fall from the same period in 2019.

Figure 1: U.S. Exports, Imports, and the Trade Deficit with China, Q1 2017–Q2 2020



Source: U.S. Census Bureau, *Trade in Goods with China*, August 5, 2020. *https://www.census.gov/foreign-trade/balance/c5700.html.*

Demand for Chinese goods imports continues to decline as the U.S. gross domestic product (GDP) contracted 9.5 percent in the second quarter compared with the first quarter, an annualized fall of 32.9 percent—the steepest decline in 70 years of Department of Commerce figures.[1] Economists expect U.S. GDP growth to return in the third quarter, but a resurgence of COVID-19 cases in the United States could dampen a rebound in demand for imports.[2]

While U.S. exports to China have shown year-on-year growth for the past three months, they remain well below the levels required to fulfill China's obligations under the Phase One trade deal. Agricultural exports, for instance, have so far fallen below 2017 levels, despite China's commitment to increase them by 50 percent from that year.[3] The *Wall Street Journal* reported that U.S. and Chinese officials are expected to meet on August 15 to assess China's compliance with the trade deal.[4]

Electronics Exports Rise in Q2 2020, Textile Imports Nearly Triple

Exports of computer and electronic products—which made up nearly one-fifth of all U.S. goods exports to China in Q2 2020—increased by 15 year-on-year to $5.4 billion (see Table 1). Meanwhile, exports of transportation equipment fell by 34.5 percent in Q2 2020 year-on-year, and exports of machinery saw a more modest decline of 5.1 percent. Oil and gas exports saw the largest on-year growth in Q2 2020, jumping by 88.4 percent.[5]

U.S. imports of many of the most popular goods from China fell modestly. Computer and electronic product imports fell by 6.4 percent but continued to dominate among Chinese imports to the United States, accounting for nearly one-third of all imports. Commodities imports fell by 14.7 percent to $7.7 billion. Textile products were a notable exception to the trend of falling imports; at $9.2 billion they were nearly three times the level in Q2 2019.[6]

Table 1: U.S. Trade with China Top Five Exports and Imports, Q2 2020

U.S. Top Five Exports to China

	Exports (in US$ millions)	Share of total (%)	Change over Q2'19 (%)
Quarter 2 (Apr-Jun' 2020)			
Computer & Electronic Products	$5,381	19.6%	15.0%
Chemicals	$4,418	16.1%	15.9%
Machinery, Except Electrical	$2,955	10.7%	-5.1%
Transportation Equipment	$2,647	9.6%	-34.5%
Oil & Gas	$2,328	8.5%	88.4%
Other	$9,759	35.5%	
Total	$27,489	**100%**	

U.S. Top Five Imports from China

	Imports (in US$ millions)	Share of total (%)	Change over Q2'19 (%)
Quarter 2 (Apr-Jun'2020)			
Computer & Electronic Products	$34,688	32.9%	-6.4%
Electrical Equipment, Appliances & Components	$10,094	9.6%	-6.9%
Textile Mill Products	$9,228	8.8%	188.6%
Machinery, Except Electrical	$7,981	7.6%	-6.4%
Miscellaneous Manufactured Commodities	$7,754	7.4%	-14.7%
Other	$35,563	33.8%	
Total	$105,308	**100%**	

Source: U.S. Census Bureau, *USA Trade Online*, August 5, 2020. *htpps://usatrade.census.gov/*.

Advanced Technology Deficit Falls Narrowly in Q2 2020

The U.S. trade deficit with China of advanced technology products (ATP) declined by 2.3 percent year-on-year to $25.9 billion in Q2 2020 (see Table 2). ATP imports totaled $33.3 billion, down from $34.5 billion in Q2 2019. Biotechnology imports from China over the first six months of 2020 totaled $208 million, a year-on-year increase of 121 percent.[7] In the same period, exports of biotechnology to China, on the other hand, fell by 57 percent to $495 million. Exports of electronics, the largest category of U.S. ATP exports to China, rose by 17 percent year-on-year in the first half of 2020 to $5.4 billion.[8]

Table 2: U.S.-China ATP Trade, Q2 2020
(US$ millions)

	Exports	Imports	Balance Q2'2020	Balance Q2'2019	Balance YOY
TOTAL	**$7,443**	**$33,330**	**-$25,887**	**-$26,495**	**-2.3%**
(01) Biotechnology	$306	$128	$178	$205	-13.2%
(02) Life Science	$1,026	$1,026	$0	$332	-100.0%
(03) Opto-Electronics	$113	$878	-$765	-$921	-16.9%
(04) Information & Communications	$788	$30,155	-$29,367	-$30,522	-3.8%
(05) Electronics	$2,843	$690	$2,153	$1,365	57.7%
(06) Flexible Manufacturing	$1,194	$211	$983	$1,051	-6.5%
(07) Advanced Materials	$68	$59	$9	-$7	-228.6%
(08) Aerospace	$1,061	$150	$911	$1,998	-54.4%
(09) Weapons	$0	$32	-$32	-$31	3.2%
(10) Nuclear Technology	$44	$1	$43	$35	22.9%

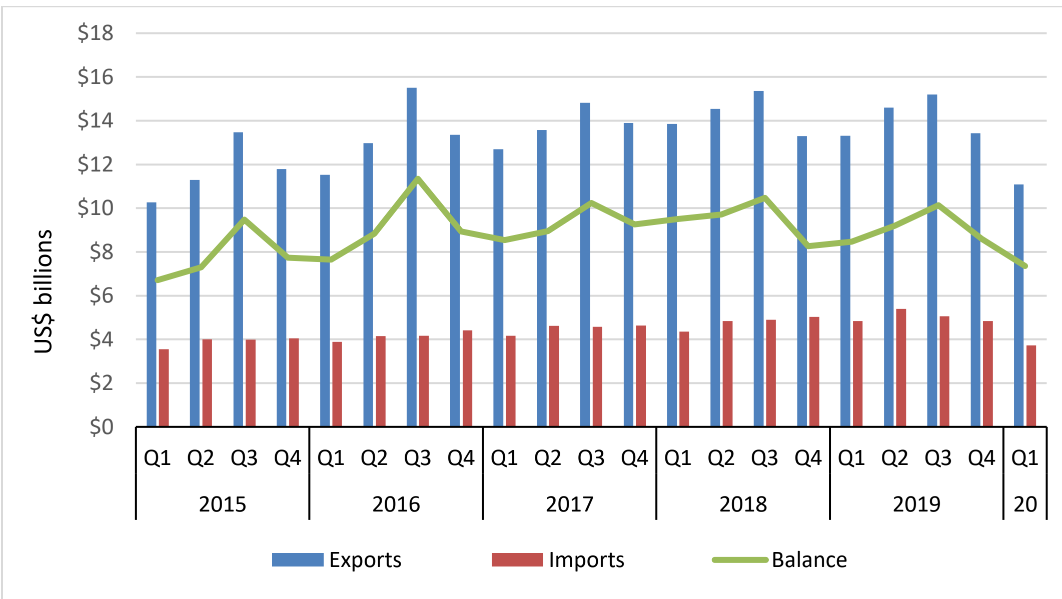
Source: U.S. Census Bureau, *U.S. Trade with China in Advanced Technology Products*, August 5, 2020. *https://www.census.gov/foreign-trade/statistics/product/atp/2019/12/ctryatp/atp5700.html.*

U.S. Services Trade Surplus with China Hits Four-Year Low in Q1 2020

The U.S. services trade surplus with China contracted 13.2 percent year-on-year to a four-year low of $7.3 billion in the first quarter of 2020 as the novel coronavirus (COVID-19) pandemic closed national borders and upended travel and transportation (see Figure 2).[9] The contraction is the steepest recorded since 2006 and threatens to narrow the full-year U.S. services trade surplus with China—typically a bright spot in bilateral trade relations—to a new low in 2020.

Narrowing U.S.-China services trade in the first quarter of 2020 was driven by extensive travel restrictions and reduced commercial air service[*] between the two countries amid the COVID-19 pandemic. According to the National Travel and Tourism Office at the U.S. Department of Commerce, 364,735 tourists from China traveled to the United States in the January-March period, with the bulk of arrivals (321,009) occurring in January, marking a 51 percent year-on-year decline.[10] The Trump Administration's decision to limit travel to and from China in late January, and U.S. carriers' subsequent moves to suspend or cancel routes from mainland China in February, contributed to depressed U.S.-China trade in travel and transport services in the first quarter of 2020.[11] Formal and informal movement restrictions and provincial lockdowns within China hampered Chinese travel more broadly, including to the United States.[†]

Figure 2: U.S.-China Trade in Services, Q1 2015–Q1 2020



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, June 19, 2020.

U.S. services exports to China declined 16.7 percent year-on-year to $11.1 billion, the sharpest fall on record, as top U.S. services exports, particularly travel and transport, registered contractions across the board (see Figure 3).[12] Chinese tourism to the United States, a top U.S. services export that includes travel for educational purposes, shrank 24.1 percent year-on-year in the first quarter of 2020.[13] U.S. imports of Chinese services plummeted 23 percent year-on-year to $3.7 billion in the first quarter of 2020, driven by a record 61.2 percent year-on-year plunge in U.S. travel imports from China.[14]

[*] Travel and transport are key components of U.S.-China services trade. In 2019, trade in travel and transport services accounted for 57.3 percent ($43.9 billion) of the total value of services traded between the two countries ($76.7 billion). 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, June 19, 2020.

[†] For further discussion of these movement restrictions, see Kaj Malden and Suzanna Stephens, "Cascading Economic Impacts of the COVID-19 Outbreak in China," *U.S.-China Economic and Security Review Commission*, April 21, 2020. *https://www.uscc.gov/sites/default/files/2020-04/Cascading_Economic_Impacts_of_the_Novel_Coronavirus_April_21_2020.pdf*.

Figure 3: U.S. Major Services Sector Exports to China, Q1 2018–Q1 2020
(year-on-year)

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, June 19, 2020.

Growth in U.S. services exports to China may stage a recovery later in the year as the Chinese government expands market access for U.S. financial services firms as part of the Phase One trade agreement signed by the two countries in January,[*] paving the way for increased U.S. exports of financial services.[†] Several U.S. companies have taken tentative steps into the Chinese banking market in 2020, although still as joint ventures with local partners.[15] For example, in February Mastercard received approval from the People's Bank of China (PBOC) to establish a bankcard clearing business with NetsUnion Clearing Corporation, a clearinghouse platform backed by the PBOC.[16]

Other U.S. financial services firms are moving to establish full control over their businesses in China. On July 23, JPMorgan Chase Futures acquired the remaining 51 percent stake in its China futures joint venture from its Chinese partner Shenzhen Wallace Rand Equity Investment Fund Management Company.[17] The move makes JPMorgan Chase Futures the first wholly foreign-owned futures company in China.[18] Despite this apparent liberalization, there are indications the Chinese government may move to empower domestic financial institutions to outcompete new U.S. and other foreign entrants. For example, Chinese financial media reported in June that the China Securities Regulatory Commission (CSRC) would grant securities licenses to state-owned banks in a pilot scheme, with Industrial and Commercial Bank of China and China Construction Bank among the banks under consideration to launch investment banking business lines just as Wall Street firms finally gain long-overdue access to the market.[19]

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[*] For more on the Phase One agreement, see Virgil Bisio et al., "The U.S.-China 'Phase One' Deal: A Backgrounder," *U.S.-China Economic and Security Review Commission*, February 4, 2020. *https://www.uscc.gov/sites/default/files/2020-02/U.S.-China%20Trade%20Deal%20Issue%20Brief.pdf*.

[†] The export of financial services can be defined as the process of providing financial services by banks and other financial institutions, which are registered in one country, to clients from another country. The Bureau of Economic Analysis at the U.S. Department of Commerce defines these services as those for which an explicit commission or fee is charged, such as securities brokerage and underwriting, financial management, financial advisory, and custody services; credit card and other credit-related services; and securities lending, electronic funds transfer, and other services. See "Explanatory Notes" in U.S. Census Bureau, *Monthly U.S. International Trade in Goods and Services, May 2020*, July 2, 2020. *https://www.census.gov/foreign-trade/Press-Release/current_press_release/ft900.pdf*.

Bilateral Policy Issues

Hacking and Espionage Cases Highlight Growing U.S.-China Technology Conflict

A pair of U.S. court proceedings over the past month have underscored the increasingly contentious role technology plays in U.S.-China relations. In addition to disputes over espionage and theft of U.S. technology, growing privacy concerns associated with Chinese technology have prompted calls from U.S. politicians for a greater degree of U.S.-China technological decoupling.

On July 7, the U.S. Department of Justice (DOJ) indicted two Chinese nationals, Li Xiaoyu and Dong Jiazhi, for hacking into computer systems since 2009 and stealing hundreds of millions of dollars from hundreds of victims around the world, including technology and pharmaceutical firms. The indictment alleged the individuals hacked not only for personal profit, but also with the cooperation of China's Ministry of State Security.[20] According to U.S. government officials, earlier this year Li and Dong shifted their focus to firms conducting COVID-19 research.[21] DOJ alleged the individuals most recently attempted to hack several U.S. biotech firms conducting research on COVID-19 vaccines and treatments.[22] The indictment did not specify whether these efforts were successful.[23]

The case marks the first time DOJ has charged Chinese hackers with working for personal profit as well as for the benefit of the government, which DOJ officials referred to as a "blended threat."[24] Li and Dong, who reside in China, are unlikely to stand trial in the United States. However, DOJ officials have referred to the public indictment as an important way of publicizing China's criminal conduct and deterring further activities.[25] July's indictment follows a series of recent indictments against Chinese hackers, including members of the Chinese People's Liberation Army.[*]

On July 24, Singaporean national Jun Wei (Dickson) Yeo pled guilty to spying on the United States on behalf of China, targeting U.S. citizens likely to have access to nonpublic information, such as government employees with security clearances and military members.[26] Yeo confessed to setting up a LinkedIn account for a fake consulting company in order to target these individuals.[27] Yeo also confessed to meeting with Chinese intelligence service operatives who instructed him to gather nonpublic information about "the U.S. Department of Commerce, artificial intelligence, and the 'trade war' between China and the United States."[28] In a statement, Alan E. Kohler, Jr., assistant director of the U.S. Federal Bureau of Investigation's (FBI) Counterintelligence Division, called the case "yet another reminder that China is relentless in its pursuit of U.S. technology and policy information in order to advance its own interests."[29]

These two cases reflect growing concern among U.S. government officials and members of the business community over China's attempts to illicitly gain access to U.S. technological data. On July 7, FBI Director Christopher Wray gave a speech discussing China's attempts to hack U.S. personal data and intellectual property, saying U.S. citizens are "victims of what amounts to Chinese theft on a scale so massive that it represents one of the largest transfers of wealth in human history."[30] Director Wray also addressed privacy concerns associated with Chinese technology and singled out Chinese telecommunications giant Huawei in his remarks, commenting that "[i]f Chinese companies like Huawei are given unfettered access to [U.S.] telecommunications infrastructure, they could collect any … information that traverses their devices or networks."[31]

U.S. government officials have also criticized U.S. technology firms for their ties to China. In a speech on July 16, Attorney General Bill Barr said that "America's big tech companies have allowed themselves to become pawns of Chinese influence," highlighting Apple's censorship of material in China as well as its recent decision to transfer some of its iCloud data to servers located in China.[32] On July 30, Secretary of State Mike Pompeo criticized technology firms for understating the extent of Chinese companies' theft of U.S. technology.[33] The day before Secretary Pompeo's remarks, the CEOs of Amazon, Apple, Facebook, and Google testified at a hearing before the House Judiciary subcommittee on antitrust. At the hearing, only Facebook CEO Mark Zuckerberg said China was stealing information from U.S. companies.[34] On August 5, Secretary Pompeo announced an expansion of the Clean

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[*] For more on indictments against Chinese individuals for alleged hacking, see U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, March 9, 2020, 2–3. *https://www.uscc.gov/sites/default/files/2020-03/March%202020%20Trade%20Bulletin.pdf.*

Network program, a U.S. government initiative to safeguard U.S. data from intrusion by malign actors, such as the Chinese Communist Party (CCP).[35] The expanded Clean Network program includes five new lines of effort to protect U.S. telecommunications and technology infrastructure—including telecommunications networks, mobile app stores, cloud storage, and underseas cables—from intrusion by the Chinese government.[36] The expanded initiative also states that U.S. and foreign companies "should remove their apps from Huawei's app store to ensure they are not partnering with a human rights abuser."[37]

Amid U.S. government officials' increasingly vocal discussion of the risks posed by China's technological practices, some companies found themselves under scrutiny for their dealings in China. On August 3, U.S. video conferencing company Zoom announced it would stop selling products directly to China as of August 23.[38] Zoom had previously received criticism for banning the accounts of three users organizing Tiananmen Square memorials, a decision it later reversed.[39] The company also came under pressure earlier this year for not using end-to-end encryption of its service and for routing non-Chinese calls through China, which it said was done mistakenly.[40]

Foreign governments have increasingly reevaluated their relationship with Chinese technology as well. On July 14, the British government announced it would ban the purchase of Huawei equipment for the country's 5G networks starting in December, and would require existing Huawei equipment to be removed by 2027.[41] Popular video app TikTok has also received increased scrutiny from several governments, including the United States. (For more on government actions against TikTok, see "China's Digital Governance, Reaching beyond China's Borders.")

Some Chinese companies are also taking steps to disengage from U.S. markets. In June, the Semiconductor Manufacturing Industrial Corporation (SMIC), China's largest chipmaker, voluntarily delisted from the New York Stock Exchange and filed for an initial product offering (IPO) on the STAR Market, a Chinese exchange created last year in an attempt to encourage Chinese technology companies to list domestically rather than in the United States.[*] [42] SMIC raised an estimated $7.6 billion (renminbi [RMB] 53.2 billion) in its first day of trading, the largest IPO in China since the Agricultural Bank of China listed in 2010.[43]

United States and China Trade Sanctions over Hong Kong

Following China's implementation of the Hong Kong national security law in late June, on July 14 the Trump Administration issued an executive order that revoked special treatment for Hong Kong under U.S. law. The same day, President Donald Trump signed into law the Hong Kong Autonomy Act, which provides the authority to impose sanctions against foreign entities who "materially contribute" to the Chinese and Hong Kong governments' "failure" to preserve Hong Kong's autonomy and thus honor its commitments under the Sino-British Joint Declaration and the Basic Law, Hong Kong's mini-constitution.[44]

On June 30, the National People's Congress Standing Committee adopted a sweeping national security law for Hong Kong.[45] The law grants widespread authority to arrest any Hong Kong resident or foreign national who is perceived by Beijing to be engaging in acts of separatism, subversion, terrorism, or collusion with foreign or overseas forces.[46] Claiming extraterritorial jurisdiction, U.S. citizens and foreigners outside of Hong Kong who criticize the CCP, the Chinese government, or the Hong Kong government could be detained if entering the territory. Although Chinese and Hong Kong authorities insist the law will only target a small number of people in the territory committing the specific crimes outlined, the law's vague provisions create a climate of fear and intimidation that severely constrains freedom of expression.[47] This law has reportedly already been used to detain activists, with the first arrest being that of an activist who unfurled a flag during demonstrations on June 30.[48] Hong Kong police also reportedly sought six people for allegedly breaking the law, including activist and pandemocrat Nathan Law and former British consulate employee Simon Cheng Man-kit.[49]

President Trump's July 14 executive order recognized Hong Kong's changed status, stating that the Hong Kong Special Administrative Region is "no longer sufficiently autonomous to justify differential treatment" from China.[50] The executive order suspended special treatment for Hong Kong in U.S. law, as prescribed by the Hong Kong

* For more on the STAR Market, see U.S. Economic and Security Review Commission, *Economics and Trade Bulletin*, August 5, 2019, 11. *https://www.uscc.gov/sites/default/files/Research/August%202019%20Trade%20Bulletin.pdf*.

Policy Act.[51] Suspending the act included removing exceptions for Hong Kong in the areas of trade, U.S. export control laws governing dual-use items, preference for Hong Kong passport holders, and the U.S. extradition treaty with Hong Kong, among other areas.[52] In addition to executive action, Congress passed the Hong Kong Autonomy Act authorizing sanctions on foreign individuals, entities, and financial institutions that "materially contribute" to China's "failure" to preserve Hong Kong's autonomy.[53] The legislation directed the secretary of state to submit a report identifying such entities within 90 days of its passage. In the text of this legislation, Congress stated that "the Government of China, at times with the support of a subservient Government of Hong Kong, has acted in contravention of its obligations under the Joint Declaration and the Basic Law."[54]

On July 13, Hua Chunying, a spokesperson from China's Ministry of Foreign Affairs, said that in retaliation for U.S. sanctions, China had to react to "stop any words and deeds that interfere in China's internal affairs and harm China's interests."[55] Beijing imposed sanctions on Senator Marco Rubio of Florida, Senator Ted Cruz of Texas, Representative Chris Smith of New Jersey, Ambassador at Large for International Religious Freedom Sam Brownback, and the Congressional-Executive Commission on China.[56] Senator Rubio, Senator Cruz, and Representative Smith have all sponsored legislation on human rights concerns in China.[57] Senator Rubio is also the current chairman of the Congressional-Executive Commission on China, which follows and reports on human rights and rule of law concerns in China.

U.S. Government Responds to Forced Labor, Other Abuses in Xinjiang

In July, the U.S. government took additional actions against Chinese entities engaged in systemic human rights violations against Muslim minorities in Xinjiang Uyghur Autonomous Region. In particular, the U.S. government is targeting the Xinjiang Production and Construction Corps (XPCC), the Xinjiang Public Security Bureau, six current and former government officials, and 11 Chinese companies, including two subsidiaries of biotechnology company BGI. To date, the U.S. government has acted against 20 Chinese government entities and 27 Chinese commercial entities in connection to human rights violations in Xinjiang. Pressure has been rising on U.S. and other foreign companies to devest from Xinjiang and audit their supply chains for potential use of forced labor originating in Xinjiang. More than 180 civil society organizations and labor unions issued a call on July 23 to "cut all ties with suppliers implicated in forced labor and end all sourcing from the Uyghur Region" within a year.[58] China is a major cotton and apparel producer, representing a third of U.S. apparel imports and 22 percent of the global cotton market (with 85 percent of China's cotton coming from Xinjiang), which increases the risk that U.S. companies in these industries may be sourcing products made with forced labor.[59]

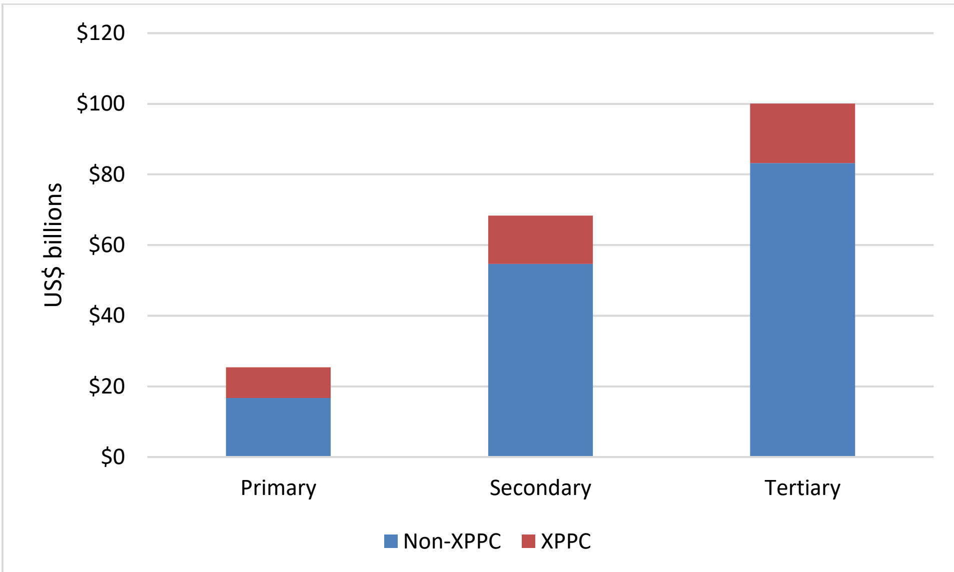
On July 1, the Departments of State, the Treasury, Commerce, and Homeland Security released a joint advisory on supply chain exposure to entities engaged in forced labor. The advisory identified three potential avenues of exposure to human rights abuses in Xinjiang: (1) supporting the Chinese government's technological surveillance in Xinjiang, including through financial support, research partnerships, and the sale of surveillance-related goods and services to entities associated with surveillance in Xinjiang; (2) relying on goods from Xinjiang or from factories implicated in using forced labor from Xinjiang; and (3) aiding in the construction of internment camps or adjacent manufacturing facilities that use forced labor, including through the sale of construction materials to Chinese entities operating in Xinjiang.[60]

On July 9, pursuant to the Global Magnitsky Act,[*] Treasury sanctioned Chen Quanguo, the First Political Commissar of the XPCC and Communist Party secretary of Xinjiang, marking the first time the United States has sanctioned a Politburo member.[61] On July 31, the Department of Commerce sanctioned the XPCC and two current or former head officials pursuant to an executive order building on the Global Magnitsky Act, with U.S. entities given until September 30 to wind down and divest from XPCC subsidiaries.[62]

[*] The Global Magnitsky Act allows the president to impose sanctions on a foreign person based on credible evidence that the person in question either: (1) is responsible for extrajudicial killings, torture, or other gross violations of internationally recognized human rights against people exposing illegal actions by government officials or exercising or promoting human rights; (2) acted as an agent in such killings; (3) is a government official responsible for acts of significant corruption; or (4) has materially assisted acts of significant corruption. Sanctions can include blocking entry to the United States and/or blocking of property and financial transactions under the International Emergency Economic Powers Act (IEEPA). U.S. Department of the Treasury, *FAQ: Global Magnitsky Sanctions*, December 21, 2017. *https://www.treasury.gov/resource-center/sanctions/Programs/Documents/12212017_glomag_faqs.pdf*.

The XPCC is a paramilitary organization that has administrative control over several of Xinjiang's medium-sized cities and operates labor camps and detention facilities in the region. The XPCC plays a critical role in the region's economy. In 2019, Xinjiang's GDP was $193.9 billion (RMB 1.4 trillion) of which $39.2 billion (RMB 274.2 billion), or 20.2 percent, was generated through the XPCC's activities.[63] The XPCC employs 3.2 million workers, accounting for 12.9 percent of Xinjiang's population.[64] The XPCC accounts for 34.2 percent of primary industry production within Xinjiang (see Figure 4).[65] Research by Amy Lehr, director of the Human Rights Initiative at the Center for Strategic and International Studies (CSIS), indicates the XPCC is the single-largest producer of cotton in the region, producing over a third of Xinjiang's cotton in 2017.[66] According to Yajun Bao, a research fellow at the State Council's Development Research Center who was assigned to the XPCC for a year, the XPCC is tasked with "[ensuring] a permanent population of Han Chinese" in the region.[67]

Figure 4: Xinjiang GDP by Industry Type, 2019



Source: Various.[68]

To date, U.S. government action to address Xinjiang-related forced labor has focused on entities located in the region. In September 2019, U.S. Customs and Border Control issued a withhold release order* for all garments produced by a Xinjiang-based factory allegedly using forced labor from an adjacent internment camp. Withhold release orders for two Xinjiang-based hair product companies were issued in May and June of 2020. On July 20, 2020, the Commerce Department added Urumqi-headquartered Changji Esquel, a subsidiary of the world's largest shirt maker, and ten other Chinese companies to the Entity List, which restricts the export of specified items to listed entities.[69] Prior to these U.S. government actions, according to the Observatory of Economic Complexity, exports from Xinjiang to the United States increased by 250 percent ($26.6 million) from April 2019 to April 2020, which Ms. Lehr argues demonstrates the Chinese government's success in promoting Xinjiang as a manufacturing hub.[70] Top exports from Xinjiang in 2019 included apparel, footwear, chemicals, and machinery.[71]

Products made using forced labor from Xinjiang can be finished outside of the region, obscuring their origin. For example, Xinjiang accounts for 85 percent of China's cotton production, with half of cotton, yarn, and textiles produced in Xinjiang finished elsewhere in China, according to Ms. Lehr and Mariefaye Bechrakis, also of CSIS, meaning that avoiding sourcing from Xinjiang is insufficient to prevent involvement in supply chains that use forced labor.[72] In addition, the Chinese government's forced labor transfer programs move ethnic minorities from Xinjiang into factories in other parts of the country. A March 2020 report by the Australian Strategic Policy Institute (ASPI) identified 82 foreign and Chinese companies directly or indirectly benefiting from this labor transfer program.[73] On

* Withhold release orders allow for the seizure or denial of entry of all goods produced by the company upon their arrival in the United States.

July 19, the *New York Times* reported that at least 17 Chinese companies making personal protective equipment (PPE) participated in this labor transfer program.[74] Reflecting on the use of the forced labor transfer program throughout China, the authors of the ASPI report conclude "it is now difficult to guarantee that products manufactured in China are free from forced labor."[75]

Policy Trends in China's Economy

China's Digital Governance, Reaching beyond China's Borders

On July 3, 2020, the China National People's Congress Standing Committee circulated a draft data security law for comment, to be finalized this year.[76] According to cyber experts from think tank New America, this law, along with an anticipated draft of the personal information protection law, will form the "highest level set of rules" added to the Chinese government's data regime since the 2017 Cybersecurity Law.[77] Observers have expressed concern about the expansive scope of the law. More specifically, while the law states it applies to data activities within mainland China, perceived offenses beyond the Mainland will also be investigated, contributing to the uncertainty faced by technology companies and other multinational corporations based in Hong Kong.[78]

Building on the foundation established by China's 2017 Cybersecurity Law, the draft data security law grants government officials broad authority to access data and regulate data collection regardless of the data controller's location.[79] The law requires government departments to identify and catalog valuable data according to its importance to "economic and social development" as well as its impact on national security.[*] [80] It imposes cross-border "export controls" on transfers of "controlled categories" of data.[†] [81] Finally, it establishes a means to retaliate against what it calls "discriminatory" investment or trade measures taken by foreign countries that relate to data or technology.[82]

Notably, like the recent Hong Kong national security law, the draft data security law text contains an extraterritorial provision applying to entities outside China if their activities affect China's national security.[83] Article 2 of the law states that where entities outside mainland China "engage in data activities that harm the national security, the public interest, or the lawful interests of [Chinese] citizens or organizations," liability will be "investigated according to the law."[84] The draft text leaves the concept of "national security" undefined; however, in their analysis, Lester Ross, Kenneth Zhou, and Tingting Liu of law firm Wilmer Hale emphasized the term's expansive scope in the 2015 National Security Law.[85] They warned the law's breadth and reach pose risks for foreign companies and media outlets.[86]

Growing international mistrust of the Chinese government's digital regime has complicated access for Chinese tech companies abroad. India, in particular, represents one of the most important markets for mobile technologies with its young and increasingly connected population.[87] In 2019, five of the top ten most downloaded mobile applications in India were Chinese, including the top downloaded application, TikTok.[88] Following deadly skirmishes on the Sino-Indian border in June, however, India banned 59 Chinese mobile applications on June 29 and an additional 47 mobile applications on July 27, citing national security concerns.[89] India's Ministry of Electronics and Information Technology alleged the applications were sending user data to servers outside India.[90] The ministry stated the compilation and analysis of this data "by elements hostile to national security and defense of India" impinged on India's sovereignty.[91] Regulators in the United States, Australia, Japan, and the EU are also investigating or considering restrictions on the application over privacy concerns.[92]

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[*] According to Chapter 3, Article 19 of the draft law, these categories will be defined by government actors at the regional, departmental, and industrial levels. The law specifies: "Each region and department, according to relevant national provisions, shall determine a regional, departmental, and industrial important data protection catalog, and undertake special protections for that which is listed in the catalog." Emma Rafaelof et al., "Translation: China's 'Data Security Law [Draft],'" *New America*, July 2, 2020. *https://www.newamerica.org/cybersecurity-initiative/digichina/blog/translation-chinas-data-security-law-draft/*.

[†] Experts at Wilmer Hale state the law refers to "controlled [data] categories" as defined in Article 2 of the Export Control Law. These categories include "dual-use items, military products, nuclear, and other goods, technologies, services, and items" related to national security or the fulfilment of international obligations. Lester Ross, Kenneth Zhou, and Tingting Liu, "China Publishes Draft Data Security Law," *Wilmer Hale*, July 10, 2020. *https://www.wilmerhale.com/en/insights/client-alerts/20200710-china-publishes-draft-data-security-law*.

Corporate Governance, Accounting Fraud Come Under Regulatory Spotlight

Chinese regulators homed in on financial institutions' corporate governance practices in July, signaling to financial institutions Beijing's staunch commitment to financial de-risking despite economic pressures exerted by the COVID-19 pandemic. In an op-ed published in state-run *Economic Daily* on July 3, Guo Shuqing, chairman of the China Banking and Insurance Regulatory Commission (CBIRC), highlighted illegal conduct by shareholders and inadequate supervision by boards of directors, among other things, as deficiencies in financial institutions' corporate governance.[93] The following day, the CBIRC published for the first time a list of 38 shareholders of banking and insurance institutions found to have flouted regulatory ownership rules and used unqualified sources of funding.[94] The move reflects an effort by regulators to prevent investors from using their shareholdings in banks to provide financing to other companies they own. This is a key source of risk in China's financial system as bank loans become concentrated in only a handful of firms with close ties to shareholders.[95] Separately, in July the CBIRC became more aggressive in fining banks for shoddy governance and financial misconduct. For example, *Caixin* reported that China Minsheng Bank would be fined $14.3 million (RMB 100 million) for having two board members unapproved by the CBIRC, while China Guangfa Bank would be fined $12.8 million (RMB 90 million) for the illegal use of funds in property investment.[96] The last time the CBIRC levied fines at such levels was in January 2018 when it imposed a penalty of $66.2 million (RMB 461.8 million) on the Chengdu branch of Shanghai Pudong Development Bank for providing loans to local shell companies to hide nonperforming assets.[97]

China's financial authorities are also scrutinizing companies' corporate governance practices and are set to more consistently penalize companies charged with financial fraud. The prospect of stepped up enforcement against financial misconduct in China's capital markets comes as the United States tightens scrutiny of U.S.-listed Chinese companies following revelations of accounting fraud at Luckin Coffee and as bilateral economic frictions extend into financial markets. In a Financial Stability and Development Committee[*] meeting on July 11, Vice Premier Liu He stated there would be "zero tolerance" for illegal and criminal acts in announcing the establishment of a new working group focused on combating accounting fraud in China's capital markets.[98] The group, to be led by the CSRC, will focus on speeding up investigations into major crimes and stepped-up punishment, enabling the timely litigation of class-action lawsuits in major cases of accounting fraud, and improving delisting systems to exclude unfit companies from China's capital markets.[99] While it is not clear when the group will begin its work, regulators have already begun removing loss-making companies from China's stock markets, with the CSRC delisting 26 companies in 2020 so far, compared with only 110 companies delisted between 2001 and 2018.[100]

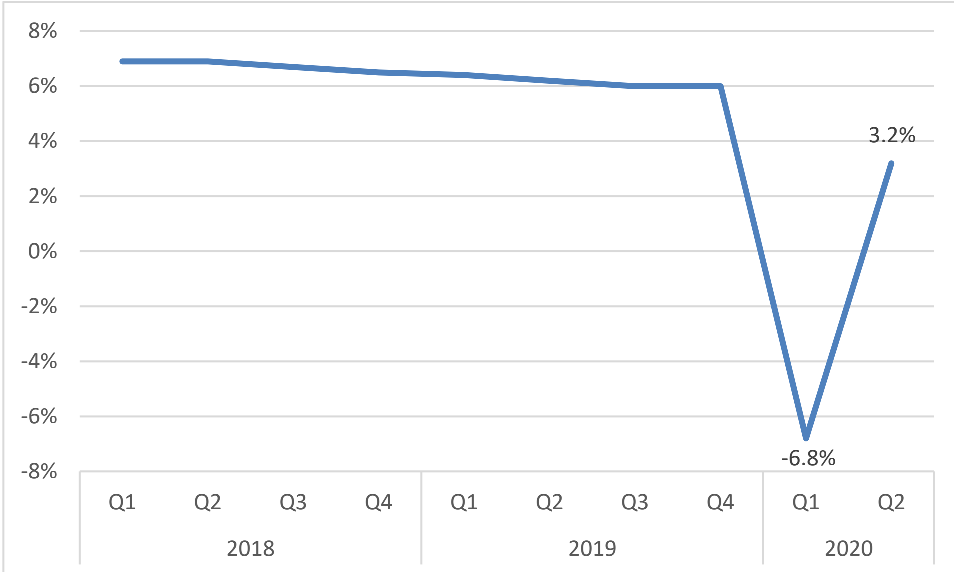
Quarterly Review of China's Economy

Beijing Reports Rebound from Q1 Contraction, but Consumption Remains Weak

China's economy grew by 3.2 percent in Q2 2020 compared to the same period in 2019, according to official data released by China's National Bureau of Statics (see Figure 5).[101] While far below the prior year's growth levels of around 6 percent, China's second quarter growth reverses a 6.8 percent contraction in Q1 2020 and positions China as the first major economy to show signs of recovery from COVID-19-related disruptions.[102] Though beating many economists' forecasts, China's second quarter growth was uneven, with industrial output rising but consumption falling below expectations.[103] Some observers questioned the recovery's sustainability, and the veracity of the data itself, as China's economy remains reliant on exports and investment.[104]

[*] Established at the July 2017 National Financial Work Conference, the Financial Stability and Development Committee is a cabinet-level body tasked with coordinating financial regulation and oversight among China's financial regulators, including the CSRC, CBIRC, and the PBOC. For more, see Andrew Polk, "Lost in the Shuffle: China's New, Overlooked Financial Regulatory Commission," *Jamestown Foundation China Brief*, March 26, 2018. *https://jamestown.org/program/lost-in-the-shuffle-chinas-new-overlooked-financial-regulatory-commission/*.

Figure 5: China's Official GDP Growth, 2018–Q2 2020



Source: China's National Bureau of Statistics via CEIC database.

China's Q2 2020 growth was led foremost by recovery in industrial output, likely driven by largely fiscal stimulus.[105] At China's "two meetings" in May,[*] officials announced a series of stimulus measures to strengthen investment in digital infrastructure, as well as programs to cut taxes and fees for business, increase lending, and introduce loan forbearance for businesses.[†] Fixed-asset investment (see Figure 6), which includes infrastructure construction, remained weak in the second quarter, but is set to increase with further state-led investment in the second half of 2020.[106] A surge in production of heavy machinery like excavation equipment, as well as record steel production, drove industrial product output growth of 4.4 percent, up from an 8.4 decrease the first quarter.[107] Infrastructure investment will likely continue to rebound in the third quarter from state-led stimulus China's agricultural sector also grew at 3.9 percent, though severe flooding could lead to contraction for agricultural producers in the third quarter.[108] Exports rebounded more modestly, growing only 0.1 percent.

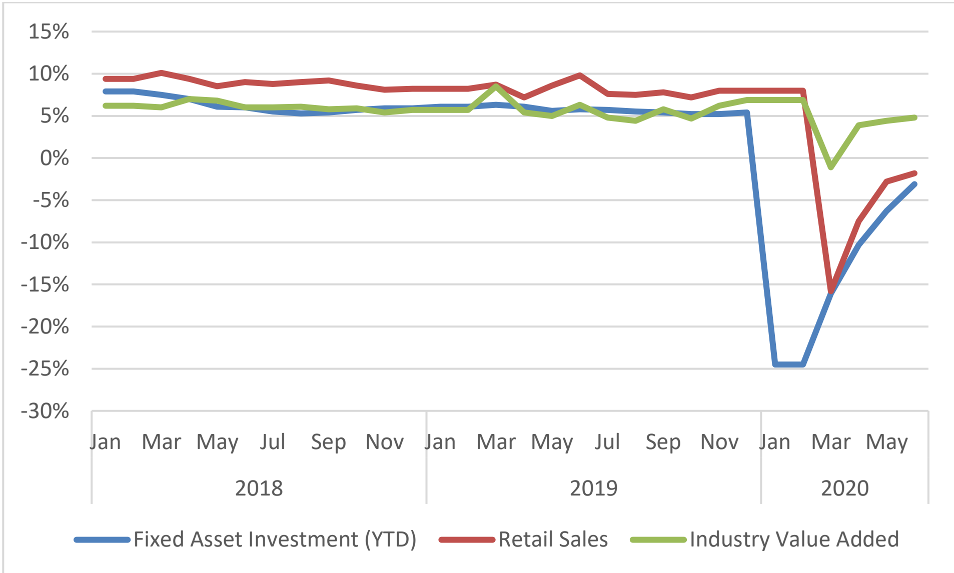
Despite the rebound in GDP growth, consumption indicators for the second quarter fell short of many economists' expectations. Retail sales remained weak, contracting by 3.9 percent year-on-year in Q2 2020 compared to a 7.6 decline in Q1 2020.[109] Imports contracted 9.7 percent, though showed signs of rebounding toward the end of the quarter.[110]

[*] Each year China's government convenes an annual plenary session called the "two meetings" (*lianghui* or 两会) consisting of a lower legislative body called the National People's Congress (NPC), and a higher advisory called the Chinese People's Political Consultative Conference. The Premier also reads the government work report at the session, which lays out economic goals and broad policy directions for the next year and summarizes performance for the previous year. Normally the "two meetings" are held in March, but in 2020 they were postponed until late May due to COVID-19.

[†] For more background on the 2020 legislative session, see U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, June 8, 2020, 9-11. *https://www.uscc.gov/sites/default/files/2020-06/June_2020_Trade_Bulletin.pdf.*

Figure 6: Key Chinese Economic Indicators, 2018–Q2 2020

(year-on-year)



Source: China's National Bureau of Statistics via CEIC database.

Analysts agreed the recovery was uneven, but disagreed whether signs of swifter recovery toward the end of the quarter and at a sector level would translate to a broader trend.[111] Some analysts noted that weak data from April dragged down quarterly figures and higher growth in June, forecasting a robust recovery in the second half of 2020. Chinese consumers' purchasing power remains relatively robust in spite of weak retail sales, reflecting poor consumer sentiment rather than underlying economic distress in households incomes and savings.[112] Furthermore, in reopening before other economies, China's manufacturing sector was able to serve global demand as factories in other countries remained shuttered due to the pandemic.

Other analysts suggested the apparent recovery in the second quarter would slow after a temporary resurgence of economic activity from businesses reopening passed. State-led investment is unlikely to spur broader recovery without increased consumer confidence and spending on nonessential goods.[113] Investment by private firms, which are primarily concentrated in manufacturing rather than infrastructure investment and heavy industry, remains weak, as businesses are reluctant to invest without signs of recovery in consumption.[114] Banks have been instructed to grant private manufacturers loans as long as they do not cut their workforce, but this risks creating further excessive inventories in consumer goods, if production continues to exceed demand.[115] Programs to extend credit provide debt relief to private businesses may also be obscuring an accurate picture of recovery, as banks are granting loan forbearance to firms that are effectively bankrupt.

Severe Flooding Threatens Recovery, Compounds Agriculture Sector Challenges

As policymakers sought to revitalize the economy and forestall a second contraction from a collapse in global demand, successive waves of flooding along the Yangtze River[*] and its tributaries led to at least 158 dead or missing, displaced millions more, and destroyed $20.5 billion in property.[116] Flood damage combined with

[*] The Yangtze River runs from Qinghai Province in China's West to the Yangtze River Delta, the urban area situated around Shanghai on China's eastern seaboard. Flooding has been most severe in the provinces Jiangxi, Anhui, Hubei, Hunan, Sichuan, and Jiangsu, and the municipality Chongqing, directly on the Yangtze, though in total floods have impacted 27 of China's 31 provincial-level municipalities. Rosa de Acosta and Max Rust, "China's Mighty Yangtze Is Heaving from Rain and the Three Gorges Will Be Tested," *Wall Street Journal*, July 25, 2020. *https://www.wsj.com/articles/chinas-mighty-yangtze-is-heaving-from-rain-and-the-three-gorges-will-be-tested-11595675012*.

anticipated crop loss to pests* and resurgence of African Swine Fever† has impacted agriculture prices, driving up futures of staple grains and pork.[117] Outside of the agriculture sector, severe flooding inhibited transportation in some provinces, delaying production and shipments, including of medical equipment bound for export to help combat COVID-19.

Risks from severe flooding are compounded by extensive damming along China's waterways. The vast majority of some 98,000 dams and dikes on China's rivers date from the Mao-era.[118] Many of these smaller dams are not structurally sound, creating unsecure reservoirs that could overflow or break through the dams, exacerbating downstream flooding.[119] Officials from China's Ministry of Water Resources indicated continued heavy rains in August could result in further flooding.[120]

Floods have damaged 3.53 million hectares of farmland, submerging nearly 20 percent of China's arable land.[121] After anticipating a bumper crop in early June, threats to staple grain harvests quickly drove up futures, particularly for maize, widely used in animal feed.[122] Coupled with a return of African Swine Fever which devasted China's hog population and drove global pork prices up by 40 percent in the first half of 2019, rising agriculture commodity prices could threaten to spur consumer inflation even as the economy copes with deflationary pressure from decreased export demand.[123] China's Ministry of Agriculture is reportedly contemplating releasing stores of maize reserves to address rising prices and potential shortages, though China's government regards this information as highly sensitive and is unlikely to publicize details.[124] China has also accelerated purchases of U.S. agricultural goods, working to fulfill China's purchase commitments under its Phase One trade deal with the United States.[125] However, projected purchases still remain below China's commitments for 2020.[126]

Policymakers responded to potential economic damage wrought by the flooding with a $165 million disaster relief package for affected provinces, directed chiefly at flood control mechanisms, with some supporting households. Beijing directed another $47 to farmers, to resume production and repair agricultural facilities.[127] Outside of direct relief measures, China's banking and insurance regulator attempted to bolster local economies by urging banks to continue to provide credit and repayment forbearance to impacted businesses, and nudging insurers to process claims.[128] Analysts from Trivium China, a consultancy, noted the response mirrored Beijing's approach to addressing economic fallout from COVID-19.[129]

Xi Deepens Calls for Self-reliance in "Dual Circulation" Economy Model

In multiple fora during July, General Secretary Xi issued calls for China to pivot to a new model of a "dual circulation" economy, a vague framework stressing both domestic self-sufficiency and simultaneous integration with the global economy. Repeated mention of this new paradigm by Chinese officials and state media suggests it represents a post hoc attempt unify disparate strains in China's economic response to COVID-19 and escalating geopolitical tensions, rather than a completely new policy direction. China's economic recovery remains vulnerable from reliance on export-driven manufacturing and weak domestic consumption, prompting renewed focus among policymakers on spurring domestic demand as a driver of growth. Mounting geopolitical tensions have also increased Chinese policymakers' urgency to strengthen self-sufficiency, as Chinese tech companies face scrutiny around the world.

According to analyses in state-run media explicating the vision, the "dual circulation" economy describes China's domestic economic cycles, or circulation, as distinct from international economic cycles.[130] At the same time, the vision calls for deepening international economic linkages, the second pillar of circulation, though Chinese officials have offered little explanation for how China will simultaneously insulate itself from exogenous shocks while

* In June 2020, the U.S. Department of Agriculture noted that fall armyworm, a pest that can quickly destroy crops, has spread further in China in 2020 than previous years and may reach farmland in China's northeastern provinces, which have been less impacted by floods before harvests in autumn. Michael Ward, "Fall Armyworm Expected to March into North China Plain in June," *United States Department of Agriculture Foreign Agricultural Service*, June 12, 2020. *https://apps.fas.usda.gov/newgainapi/api/Report/DownloadReportByFileName?fileName=Fall%20Armyworm%20Expected%20to%20March%20into%20North%20China%20Plain%20in%20June_Beijing_China%20-%20Peoples%20Republic%20of_06-10-2020*.

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further integrating with the global economy.[131] While not revoking China's policy of "reform and opening up" that initiated market-based policies and opened parts of the economy to international commerce beginning in 1978, economist stress that "dual circulation" economy represents a new paradigm and global economic reality, in which China's economic growth cannot rely on external sources.[132]

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