U.S.-China Economic and Security Review Commission

Economics and Trade Bulletin

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Highlights of This Month's Edition

- **Bilateral trade:** U.S. exports to China grew 66 percent year-on-year to $14.7 billion in October 2020, setting a new monthly record; with U.S. imports also increasing to $44.8 billion, the monthly deficit remained higher than a two-year average.
- **U.S.-China trade tensions:** Chinese companies come under renewed pressure to comply with U.S. listing standards as the House of Representatives passes legislation to strengthen oversight of U.S.-listed Chinese companies and U.S. regulators propose new rules on audit requirements; as new restrictions on Chinese companies take effect, the U.S. government continues to counter problematic practices, including forced labor, supplying the Chinese military, and undermining democracy abroad.
- **China policy update:** The Chinese government is stepping up its regulation of the tech sector, including draft antimonopoly rules on platform economies, greater content moderation requirements for livestreaming, and draft rules on data collection by mobile apps.
- **Trends in China's economy:** As Chinese companies backed by the government default on debt, investors question implicit guarantees of government support and reassess credit risks in China's corporate debt market; Alibaba set another record in Singles' Day sales, but questions remain over the resilience of China's consumption recovery; the RCEP was concluded in November, linking China and 14 other Asian countries in a free trade agreement that stands to further integrate regional supply chains.
- **In focus – Alibaba:** The cancellation of last month's planned IPO of Alibaba affiliate company Ant Group has highlighted increasing domestic and international challenges for the world's largest e-commerce company.

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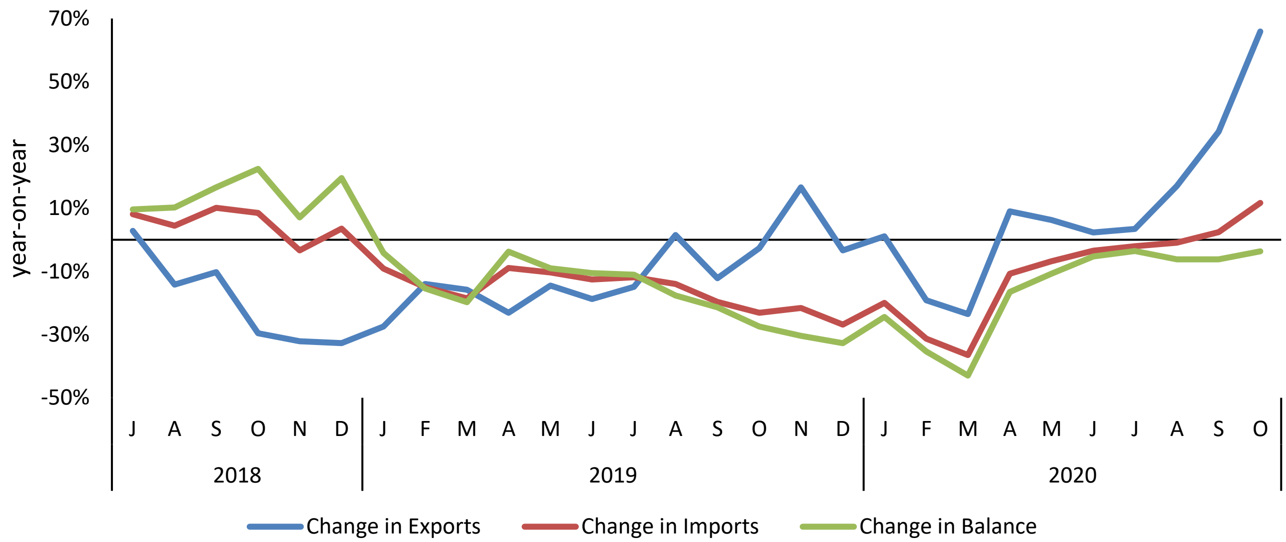
Bilateral Trade

U.S. goods exports to China reached $14.7 billion in October 2020–an increase of 65.9 percent over the same period last year, which eclipses a previous record of $12.6 billion in October 2016 (see Figure 1).[1] The sharp increase was driven primarily by agricultural commodity exports, as China accelerated purchases ahead of the end-of-year deadline to meet targets set by the January 2020 Phase One Trade deal.[2] Purchases of U.S. grain exports also help China address a looming grain shortage, as floods and pests have devasted Chinese farmland in 2020.[*]

The Office of the U.S. Trade Representative (USTR) and U.S. Department of Agriculture (USDA) released analysis in October calculating that China had purchased 71 percent of its 2020 agricultural targets under the Phase One deal,[†] and expressed satisfaction with Chinese imports from the United States, especially given the global economic downturn following the COVID-19 outbreak.[3] In contrast, analysis from Chad Bown, Senior Fellow at the Peterson Institute for International Economics, found China had only purchased 52 percent of its agricultural target as of October 2020, and is on track to purchase 71 percent for the year.[‡4] Across all product categories, Dr. Bown's calculations show China has purchased 44 percent, and is on track to meet 56 percent of its target as of October.[5]

Figure 1: Change in U.S. Exports, Imports, and the Trade Deficit with China, July 2018–October 2020



Source: U.S. Census Bureau, *Trade in Goods with China*, December 4, 2020. *https://www.census.gov/foreign-trade/balance/c5700.html.*

U.S. imports of Chinese goods rose to $44.8 billion in October 2020, bringing the cumulative trade deficit in 2020 to $252.9 billion.[6] While this represents a 14.1 percent decline compared to the cumulative deficit of $294.5 billion

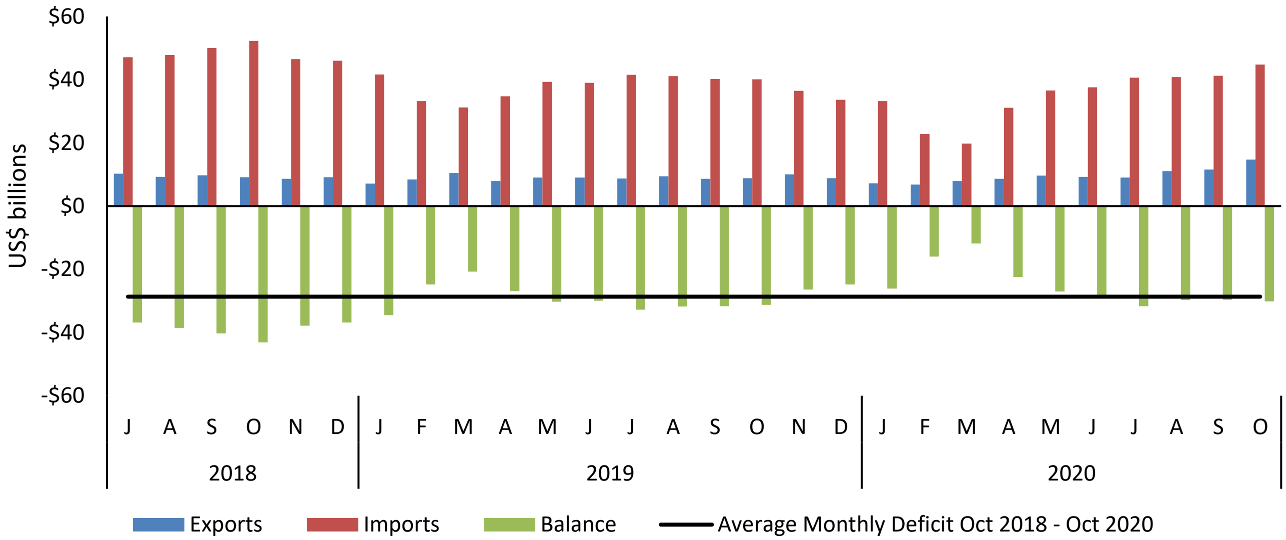
[*] For further discussion of China's grain shortage, see Chapter 2 Section 1, "Year in Review: Economics and Trade" in U.S.-China Economic and Security Review Commission, *2020 Annual Report to Congress*, December 1, 2020, 205-206. *https://www.uscc.gov/sites/default/files/2020-12/Chapter_2_Section_1--Year_in_Review-Economics_and_Trade.pdf*.

[†] The terms of the agreement require China to purchase an additional $200 billion of covered goods and services above 2017 levels over a two-year period in 2020–2021, increasing by $76.7 billion in 2020 and $123.3 billion in 2021. China's agricultural goods purchase target is $33.4 billion. Covered goods encompass mostly agricultural, energy, and manufactured exports, and encompass 73 percent of U.S. goods exports to China in 2017. Doug Palmer, "U.S. Exports to China Still Well Below Trump's Trade Target," Politico Pro, December 4, 2020; Chad Bown, "U.S.-China Phase One Tracker: China's Purchases of U.S. Goods," *Peterson Institute for International Economics*, November 25, 2020. *https://www.piie.com/research/piie-charts/us-china-phase-one-tracker-chinas-purchases-us-goods*.

[‡] The discrepancy between the two calculations likely owes to methodological differences. In their interim report on the Phase One deal's progress, USTR and USDA indicate China's total imports of U.S. products are calculate using both monthly trade data from the U.S. Census Bureau and weekly Export Sales Reports from USDA, the latter of which is inflated by roughly 25 percent to account for sales not covered in the weekly reports. Dr. Bown's methodology by contrast looks at U.S. Census Bureau Data and Chinese customs data. Chad Bown, "U.S.-China Phase One Tracker: China's Purchases of U.S. Goods," *Peterson Institute for International Economics*, November 25, 2020. *https://www.piie.com/research/piie-charts/us-china-phase-one-tracker-chinas-purchases-us-goods*; Office of the U.S. Trade Representative and U.S. Department of Agriculture, *Interim Report on the Economic and Trade Agreement between the United States of America and the People's Republic of China*, October 2020, 1-2, 4. *https://ustr.gov/sites/default/files/assets/files/interim-report-on-agricultural-trade-between-the-united-states-and-china-final.pdf.*

at the same point last year, the decrease owes mostly to a contraction in U.S. imports of Chinese goods during the first quarter of 2020, when Chinese factories closed due to the COVID-19 outbreak.[7] China's sharp increase in purchases during the month of October has done little to shift the trade deficit. At $30.1 billion, the monthly trade deficit remained above the average of $28.7 billion over the last two years (see Figure 2).[8]

Figure 2: U.S. Exports, Imports, and the Trade Deficit with China, July 2018–October 2020



Source: U.S. Census Bureau, *Trade in Goods with China*, December 4, 2020. *https://www.census.gov/foreign-trade/balance/c5700.html.*

U.S.-China Trade Tensions

SEC and Congress Strengthen Enforcement of Listing Standards on U.S. Exchanges

U.S. regulators and lawmakers took concrete steps in November and December to better enforce listing standards on U.S. exchanges. Absent U.S.-listed Chinese companies' compliance with these standards or U.S. and Chinese audit regulators' negotiation of an alternative solution,* Chinese companies may find it impossible to maintain a presence on U.S. stock markets.

On November 17, the *Wall Street Journal* and Bloomberg reported the U.S. Securities and Exchange Commission (SEC) intends to propose new rules requiring companies listed on U.S. exchanges to use auditors overseen by U.S. regulators or face delisting.[9] This rulemaking would track with recommendations in the *Report on Protecting United States Investors from Significant Risks from Chinese Companies* issued by the Presidential Working Group on Financial Markets earlier this year.[10] The report recommended U.S.-listed Chinese companies provide a "co-audit" from an accounting firm whose records can be inspected by the Public Company Accounting Oversight Board (PCAOB).[11] In this proposed co-audit arrangement, a U.S.-based accounting firm would inspect a Chinese company's financial statements alongside the audit performed by its Chinese affiliate.[12] This would theoretically enable the PCAOB to have access to the work papers of the U.S. accounting firm performing the co-audit.[13]

Separately, on November 23 the Division of Corporation Finance at the SEC published guidance detailing its views regarding disclosure considerations for Chinese companies. The guidance advises Chinese companies to consider including information in their risk disclosures regarding whether PCAOB staff can inspect audit work papers and the ability of U.S. authorities to conduct related investigations; the use of ownership structures that differ from those of U.S. firms and may curtail shareholder rights; and any risks associated with China's regulatory system.

* For background on risks and policy concerns associated with U.S.-listed Chinese companies and related U.S. regulatory oversight challenges, see U.S.-China Economic and Security Review Commission, Chapter 2, Section 2, "Vulnerabilities in China's Financial System and Risks for the United States," in *2020 Annual Report to Congress*; U.S.-China Economic and Security Review Commission, Chapter 3, Section 1, "U.S.-China Commercial Relations," in *2019 Annual Report to Congress*.

Congress took additional steps to address risks posed by U.S.-listed Chinese companies and their links to the Chinese government. On December 2, the House of Representatives passed the Holding Foreign Companies Accountable Act, which would require foreign companies to be delisted from U.S. exchanges if the PCAOB has been unable to review their audit work papers for three consecutive years.[14] The legislation effectively puts Beijing on a timeline to remove its obstruction on the review of audits conducted by accounting firms in China. It also requires companies listed on U.S. exchanges to disclose more information about their ties to foreign governments and the Chinese Communist Party (CCP)—provisions that have not been highlighted in reported SEC rulemaking, its nonbinding disclosure guidance to Chinese issuers, or the *Report on Protecting United States Investors from Significant Risks from Chinese Companies*. The Senate passed a companion legislation in May, and the act is now awaiting President Donald Trump's signature before becoming U.S. law.[15]

Cracking Down on Chinese Companies

As 2020 comes to a close, the Trump Administration continues to take steps to counter harmful behaviors of Chinese companies through enforcement actions and the introduction of new restrictions. These measures remain consistent with previous actions to end U.S. investment in and other indirect support of the Chinese military and scrutinize Chinese imports with connections to forced labor, but new measures also target China's role in supporting authoritarian tactics outside of its borders. Export control restrictions are beginning to demonstrate a clear effect on Huawei, though the clock remains ticking on a potential resolution to a ByteDance sale of Tiktok.

- **Investment into Chinese Companies Military Linkages Prohibited.** On November 12, President Trump issued an executive order prohibiting U.S. investment into companies and publicly traded securities linked to the Chinese military. Companies covered by this order will likely be based on the U.S. Department of Defense's list of "Communist Chinese military companies" operating in the United States, which currently includes Huawei, Hikvision, and a number of prominent Chinese state-owned enterprises (SOEs).[16] Prohibition on investment in these companies will begin on January 11, 2021, but the order allows for a grace period until November 11, 2021 for investors to divest from any covered investments.[17]

- **Huawei Buys U.S. Chips but Sells Honor**. On November 14, Qualcomm received a license from the Department of Commerce to sell 4G chips to Huawei, a rare exception following Huawei's placement on the Entity List in 2019. Numerous U.S. restrictions on Huawei nonetheless have had a dampening effect on Huawei's business. In addition to flagging smartphone sales compared to competitor Xiaomi,[18] Huawei announced the sale of budget phone brand Honor on November 17, citing difficulties from tech restrictions and ability to supply components.[19]

- **Increased Scrutiny of Major Chinese Companies' Ties to Military.** The Trump Administration is likely to announce the addition of leading Chinese chipmaker Semiconductor Manufacturing International Corporation (SMIC) and major oil company China National Offshore Oil Corporation (CNOOC) to the list of "Communist Chinese military companies."[20] The Department of Commerce has already added SMIC to its Entity List, but additional restrictions may follow from its placement on the DOD list.[21]

- **Treasury Targets Venezuela's Maduro and Chinese Support.** On November 30, the U.S. Treasury's Office of Foreign Assets Control (OFAC) sanctioned the China National Electronics Import & Export Corporation (CEIEC) for its support of Nicolás Maduro's regime in Venezuela.[22] OFAC found that CEIEC exported technologies to undermine democracy of the Maduro regime, which the Trump Administration has named illegitimate and targeted with an executive order. U.S. companies have until January 14, 2021 to close out transactions after which all dealings, property, and interests will be prohibited.

- **Prohibition on Xinjiang Cotton.** U.S. Customs and Border Protection (CBP) issued a detention order on cotton and cotton products from the Xinjiang Production and Construction Corps (XPCC), effectively banning the XPCC shipments from entering the United States beyond ports.[23] The detention order, also called a withhold release order (WRO), follows an earlier CBP issuance of a WRO in September 2020 targeting cotton products made with forced labor from two other Xinjiang-based companies.[24] This is the sixth enforcement action by CBP against forced labor abuses in Xinjiang.

- **ByteDance Gets Another Extension to Sell TikTok**. The Committee on Foreign Investment in the United States provided ByteDance another extension until December 4 to resolve details regarding its sale of TikTok to an American firm. The deadline passed without resolution or a formal announcement of an extension, though the repeated initiation of the TikTok review process may delay a final determination until 2021. President Trump has stated that "conceptually" he would disapprove of ByteDance retaining a majority stake in the company.[25] The U.S. Treasury Department had already granted a 15-day extension from the original deadline of November 12.[26] Negotiations over the appropriate business arrangement for TikTok continue with Walmart and Oracle as the U.S. government also faces ongoing legal challenges to August 6 executive orders on both TikTok and WeChat. The District Court for the District of Columbia will hear oral arguments on the U.S. government's appeal to blockage of its executive order on December 14.[27]

China Policy Update

November saw the central government place increasing restrictions on big tech firms, including through the release of draft *New Anti-Monopoly Guidelines for the Platform Economy*, guidelines on livestreaming, and draft rules on mobile apps and data collection. In addition, high-level government officials issued scathing critiques of technology firms' handling of personal information and the negative influence of online media and data collection on the public. The moves come as the role of tech companies in China's economy is increasing. The "new economy," which includes the platform economy, accounted for 16.3 percent of China's gross domestic product (GDP) in 2019.[28] E-commerce's share of the retail market has continued to grow this year, driven by pandemic lockdowns that forced more customers to shop online. (For more on the role of e-commerce in China's consumption, see "Alibaba Reports Record Singles' Day Sales amid Shaky Consumption Trends.")

Draft New Anti-Monopoly Guidelines for the Platform Economy

On November 10, China's State Administration for Market Regulation (SAMR) released draft *New Anti-Monopoly Guidelines for the Platform Economy*. The draft rules expand the definition of monopoly to also consider user engagement and control of data that may be difficult to value in monetary terms. This definition goes beyond China's current antimonopoly law, which identifies monopolies based on market share. Draft revisions to the antimonopoly law released by SAMR on January 6, 2020, would similarly redefine monopolies to consider tech companies' control of data and the online ecosystem.[29] Analysts from Morgan Stanley argue the tech conglomerates Alibaba and Tencent, e-commerce firms JD.com and Pinduoduo, and platform delivery company Meituan would be most impacted by the new regulations due to their market dominance and use of business models targeted by the new guidelines (including the use of subsidies and locking in merchants) make them a particular target for regulators.[30] The analysts noted these companies' decline in market share given the rise of new competitors means the impact of the guidelines will be less severe than it would have been a few years ago.[31] Alibaba, Tencent, Meituan, JD.com, and Xiaomi (a smartphone company) lost a combined $280 billion in market value the day after the regulations were released.[32]

The new antimonopoly regulations will also address variable interest entities (VIEs), a financial structure often used by Chinese tech companies to avoid the Chinese government's restrictions on foreign investment in the tech sector.* Alibaba and JD.com, for example, are listed on U.S. exchanges (the New York Stock Exchange [NYSE] and NASDAQ, respectively) through the use of VIEs. The new guidelines specifically note concentrations using VIEs will be included in SAMR's merger reviews, a shift from previous practice, which effectively exempted mergers and acquisitions through VIEs from SAMR oversight.[33]

Behaviors identified for regulation under the guidelines on the platform economy include the use of user profiles to target different users with different prices (known as "big data backstabbing"), locking online merchants into exclusively using one e-commerce platform ("pick one of two"), and dominating the market through the use of subsidies and predatory pricing.[34] Although the draft rules highlight potential areas of increased regulation, Shen

* For a more in-depth explanation of VIEs and associated risks, see U.S.-China Economic and Security Review Commission, *2019 Annual Report to Congress*, 176–177. *https://www.uscc.gov/sites/default/files/2019-11/Chapter%203%20Section%201%20-%20U.S.-China%20Commercial%20Relations.pdf*.

Weiwei, associate professor at China University of Political Science and Law, notes that the rules "provide only general guidance, rather than explicit terms," with vague "safe harbor clauses" allowing platforms to continue discriminatory treatment.[35] Shen believes the limited enforcement of previous regulation may suggest the new guidelines may be similarly ineffective: instances of online retail platforms being fined by regulators or successfully sued by users for monopolistic behavior are rare due to the close ties between companies and regulatory agencies and the difficulty of proving monopolistic behavior.[36]

The release of the draft antimonopoly guidelines comes as the Chinese government has become increasingly concerned over the growing role of technology and tech companies in Chinese economy and society. At the same time, the Chinese government's desire to move China's economy up the value-added chain and achieve technological leadership limits its willingness to regulate "national champions" like Alibaba and Tencent.

Restricting Online Media Spaces, New Rules for Livestreaming

On November 19, 2020, vice director of the Central Propaganda Department Xu Lin told the annual China New Media Conference that China must "resolutely guard against digitalization diluting the party's leadership [and] resolutely prevent the risk of capital manipulating public opinion."[37] The vice director's speech also illustrated the Chinese government's concern that the combination of capital and new online platforms can allow for alternative power centers, with was illustrated recently by Jack Ma's condemnation of financial regulation.[*] Xu reminded listeners that "digitalization could bring about changes in media but no matter what kind of media outlet … there is but one criterion for guidance, there is no space outside the law, no enclave for public opinion."[38] Online media outlets had been a critical source of information during the novel coronavirus (COVID-19) pandemic, with Chinese social media users employing various creative methods to circumvent censorship and share articles that had been taken down by regulators.[39]

The livestream sector has been the target of two new regulations this month that require greater content moderation and also seek to counter scams and the sale of counterfeit goods on livestream platforms. The sector, which has shown significant growth over the past year, derives revenue both from virtual gifts from users to online hosts and from goods orders via live streams. The market for virtual gifts was $27 billion in 2019, with $64.3 billion in goods ordered via live streams in the same year, according to market research firm iResearch.[40] As of March 2020, livestream users accounted for 560 million of China's 904 million internet users (61.9 percent), according to the China Internet Network Information Center.[41] In the first half of 2020, more than 400,000 livestream hosts made ten million e-commerce broadcasts, according to China's Ministry of Commerce.[42] On November 13, two days after the Singles' Day shopping festival, the Cyberspace Administration of China released draft rules regulating the livestreaming agency, including requiring livestreamers to provide their real names.[43] On November 23, the National Radio and Television Administration issued a similar directive requiring users to register with their real names and be verified through facial recognition, capping the tips that can be given by each user, requiring that platforms report live broadcasts by celebrities and foreigners, and mandating one human moderator for every 50 live streams.[44] The guidelines recommend that the platform register moderators with the government, indicating that these new directives are likely to increase avenues for government monitoring and censorship on the platforms.

Tightening Restrictions on the Use of Personal Data by Mobile Apps

The government has also continued tightening restrictions on the use of personal data, building on the release of a draft data security law in July 2020 and a draft personal information protection law in October 2020. At a November meeting to discuss the draft personal information protection law, which has penalties comparable to the European Union's General Data Protection Regulation (GDPR), tech companies argued that the law would negatively impact advertising revenues.[45] Research firm eMarketer estimates that digital ad spending in China will reach $75.3 billion

[*] The condemnation came at a financial forum in Shanghai on October 24, where Ma said the Basel Accords, a set of international banking standards, are "more like a club for the elderly." Ma also said that China "lacks a financial ecosystem" and described Chinese banks as being like "pawnshops" that "cannot support the financial needs of world development." Eliza Gkritsi, "China Voices: The Unsigned Op-eds That Foreshadowed Ant Group IPO Suspension," *TechNode*, November 9, 2020. *https://technode.com/2020/11/09/china-voices-the-unsigned-op-eds-that-foreshadowed-ant-group-ipo-suspension/*; Shuli Ren, "Jack Ma's Blunt Words Just Cost Him $35 Billion," *Bloomberg*, November 10, 2020. *https://www.washingtonpost.com/business/jack-mas-blunt-words-just-cost-him-35-billion/2020/11/03/bd2ef486-1ded-11eb-ad53-4c1fda49907d_story.html*.

in 2020, 71.5 percent of the $105.3 billion in all forms of ad spending in the country.[46] On November 13, the Cyberspace Administration of China identified 35 mobile apps that were violating personal data collection rules, including at least eight apps whose privacy violations stemmed from the use of software development kits (SDKs, small blocks of code for common functions that can be used to build mobile apps) provided by Tencent.[47] At a conference on app security on November 27, Lu Chuncong, deputy director of the Ministry of Industry and Information Technology's Information and Communications Administration, criticized major app operators for violations of consumer data privacy. Lu, who noted that some apps "still haven't learned their lessons," specifically called out Tencent for ongoing problems meeting regulatory requirements.[48] According to *Caixin,* Chinese regulators penalized more than 8,000 apps and 478 companies in the first seven months of this year.[49] On December 1, the Cyberspace Administration of China released draft guidelines on mobile apps' collection of personal data that limit data collection to "necessary data," which the guidelines identify for different categories of apps, including ride-hailing and online payment.[50]

First Ruling on Facial Recognition amid Growing Concerns

November also saw the first ruling penalizing the improper use of facial recognition technology, which relies heavily on personal data. The Hangzhou Fuyang People's Court determined that the Hangzhou Safari Park, which had altered its membership agreement to require the use of a facial recognition system, must delete the plaintiff's photos and pay compensation.[51] The plaintiff noted that while the ruling addressed his individual case, it did little to address the systemic use of facial recognition.[52] In late November, reports of the use of facial recognition by real estate agents prompted widespread criticism on Chinese social media.[53] Use of facial recognition has raised growing concerns in China: a 2020 survey on the application of the technology found that 60 percent of people in China think it is overused, and a survey released by *Southern Metropolis News* found that 80 percent of respondents wish they could delete data captured by facial recognition technology.[54]

Individual jurisdictions have banned mandatory facial recognition in certain areas, with Tianjin limiting the use of facial recognition information by private and state-owned companies and Nanjing ordering the removal of facial recognition technology from real estate sales offices. The bans may prove difficult to enforce. For example, Hangzhou has banned mandatory facial recognition by residential communities, but the bans still allow the installation of the technology by communities.[55] Furthermore, punishments for violating these regulations on the collection of facial recognition data may be too light to deter abuse, according Zhu Wei, a law professor at China University of Political Science and Law.[56] The draft personal information protection law might address the collection of data for facial recognition, but enforcement remains unclear.[57]

The Chinese government's willingness to regulate abuse of facial recognition is in question, however, given its use of the technology for widespread social monitoring and oppression, particularly against Uyghurs and other ethnic minorities. In addition, facial recognition is a technology targeted for development and promotion by the Chinese government's industrial policy. Several Chinese facial recognition technology companies, including SenseTime, which led a group of countries in developing national standards on the application of facial recognition, have been targeted by U.S. sanctions for their involvement in human rights violations in Xinjiang.[58]

Trends in China's Economy

SOE Defaults Shake Investor Confidence in Guarantees of Government Support

A string of defaults on bonds issued by Chinese SOEs as well as companies backed by local governments is challenging long-held assumptions that the Chinese government will always be there to bail out struggling companies.* That these defaults are occurring among companies close to the state, and in some cases in sectors prioritized for China's national development, heightens investor anxiety and hints at challenges Beijing faces in

* For background on the Chinese government's market interventions to prevent bankruptcies, defaults, and financial losses in China's banking sector and corporate bond market, see U.S.-China Economic and Security Review Commission, Chapter 2, Section 2, "Vulnerabilities in China's Financial System and Risks for the United States," in *2020 Annual Report to Congress*. *https://www.uscc.gov/sites/default/files/2020-12/Chapter_2_Section_2--Vulnerabilities_in_Chinas_Financial_System_and_Risks_for_the_United_States.pdf*.

managing public impressions of China's economic health and simultaneously maintaining economic stability. This tension is leading investors to reassess credit risk in China's corporate debt markets and is tightening credit conditions in a painful maturation of China's financial markets.

On November 10, Yongcheng Coal and Electric Holding Group, a Henan Province SOE, defaulted on a $153 million bond.[59] The company mainly engages in the investment and management of coal, electricity, railway infrastructure, chemicals, and mining.[60] Chinese financial media speculated the default could be attributable to the expansion of Yongcheng's parent company, Henan Energy, into unprofitable business lines outside its traditional strength in energy and utilities.[61] On November 16, Huachen Automotive, one of the largest automotive manufacturers in Liaoning Province that is backed by its provincial government, announced it would seek restructuring after defaulting on a bond in October. Separately, Tsinghua Unigroup, a national SOE involved in China's push for self-reliance in semiconductors, defaulted on a privately placed bond worth $197 million on November 17.[62]

The diversity of these defaults in terms of geographic location, industry, and proximity to local versus central levels of China's government suggests Beijing is signaling to the market it will not always bail out struggling firms it otherwise supports. The suggestion is leading companies to reconsider planned bond issuance as prospects of tightened credit markets come into sharper relief. According to data from financial information provider Wind, at least 20 Chinese companies suspended plans for new corporate debt issuance totaling $2.4 billion in the week following Yongcheng's default, citing "recent market turmoil."[63] Data from Chinese corporate finance intelligence platform East Money adds that the average coupon rate for newly issued SOE bonds has hit 5.7 percent since October, one percentage point higher than the 4.7 percent rate recorded in the first three quarters of 2020.[64] The increase in coupon rates on SOE bonds further suggests investors are reevaluating credit risk in China's corporate debt markets. According to Logan Wright, director at Rhodium Group, investors are repricing risk as Beijing's tentative attempts to break its implicit guarantee of government support evolves from the banking sector and private corporate debt markets to include bonds issued by companies backed by local governments and SOEs.[65] Dr. Wright also notes, however, that the People's Bank of China is likely to provide some short-term liquidity to the banking system if necessary to restore calm in China's financial markets.[66] Investors are meanwhile likely to increasingly consider fiscal conditions, local GDP growth, prospects for land sales, and other indicators of local governments' financial health in considering whether to buy SOE debt.[67]

Alibaba Reports Record Singles' Day Sales amid Shaky Consumption Trends

Alibaba reported a record $75.9 billion (renminbi [RMB] 498.2 billion) in sales during its annual Singles' Day promotion from November 1 to 11, a 26 percent increase over the same period last year.[68] Unlike previous years, Alibaba did not release detailed breakdowns of sales figures by product.[69] First launched by Alibaba in 2009, Singles' Day has become the most popular shopping day in the world, far outpacing online revenues for U.S. shopping days Black Friday ($9 billion in 2020 sales) and Cyber Monday ($10.8 billion), according to Adobe Analytics.[70] Aside from Alibaba, Singles' Day has become a key sales event for other Chinese e-commerce firms. Rival e-commerce firm JD.com posted sales of $41.3 billion (RMB 271.5 billion), up from $31.5 billion (RMB 204.4 billion) in 2019.[71]

The Singles' Day event underscores the growing importance of livestreaming sales in China. Taobao Live, an Alibaba livestreaming platform, saw $7.5 billion in transactions in the first 30 minutes of presales events beginning on October 21. According to Taobao, livestreaming sales in 2020 reflected a 400 percent increase over a year ago.[72] According to a report by Coresight Research, China's livestreaming retail market will expand to $125 billion this year, up from $63 billion in 2019.[73] (For more on new regulations in China's livestreaming market, see "Restricting Online Media Spaces, New Rules for Livestreaming.") The event also showcased the importance of Alibaba affiliate Ant Group to Alibaba's sales model. Huabei, an Ant microlending service, significantly increased credit limits for some users ahead of Singles' Day, according to posts on Chinese social media.[74] Alibaba and Ant have not disclosed the proportion of Singles' Day sales funded by Huabei loans since 2016, when it reported that 20 percent of sales used Huabei loans.[75]

Despite the record-breaking sales figures, this year's Singles' Day event was accompanied by troubling developments for Alibaba. Share prices for the company fell nearly 16 percent throughout November as SAMR issued draft laws defining anticompetitive behavior for the first time.[76] Investors fear these new rules could upend the business models of China's e-commerce giants.[77] For instance, the rules could potentially prevent Alibaba from cross-subsidizing money-losing businesses, as it has done with its fast-growing but still unprofitable cloud services division.[78] (For more on Alibaba's businesses, see "In Focus: Alibaba.")

More broadly, the retail market in China remains shaky, even as China has led major economies in growth throughout 2020. Economists disagree over whether record-setting Singles' Day revenues represent a trend of growing consumption. According to Lin Huanyu and Chen Li, analysts at Huatai Securities, the performance of Singles' Day "not only demonstrated the strong potential for Chinese domestic demand, but is also an important fulcrum for internal circulation in the Chinese economy."[79] Other observers believe that Singles' Day merely represented a concentration in sales as consumers shifted the timing of their purchases, including staple items such as laundry detergent. Wu Jincao, an analyst at Soochow Securities, said the stimulus from Singles' Day was "essentially just concentrating consumer spending from the end of the year to the Singles' Day sales period."[*] [80]

RCEP Concludes, Delivering Symbolic Victory for China

On November 15, all ten members of the Association of Southeast Asian Nations (ASEAN),[†] as well as China, Japan, South Korea, Australia, and New Zealand signed the Regional Comprehensive Economic Partnership (RCEP).[81] Under negotiation for eight years,[‡] the RCEP is a free trade agreement (FTA) focused chiefly on lowering tariffs for intra-regional goods trade, effectively formalizing many existing bilateral deals rather than advancing a wholly new framework.[82] It eschews labor and environmental standards and rules on state-owned enterprises that could notionally give signatories protection against China's trade distorting economic practices.[83] Despite a narrow scope compared to other FTAs, the sheer size of RCEP's membership makes the deal economically significant. With members comprising the RCEP constituting 30 percent of global GDP and of the world's population, the trade deal is among the world's largest.[84]

The RCEP began as an ASEAN-led initiative, and constitutes a victory for the bloc in negotiating with larger regional powers.[§] [85] Since China joined negotiations in 2012, however, it has become a driving force in bringing it to completion and, as the largest signatory, benefits symbolically during a period of heightened geopolitical tensions with many other signatories.[86] Key facets of the RCEP's impact vis-à-vis China are outlined below.

The RCEP will further integration Northeast Asian multinationals with their Southeast Asian suppliers. Provisions in the RCEP further reduce costs and administrative requirements to establish cross-border supply chains within the region. Uniform agreement on rules of origin stipulate that transnationally shipped goods within RCEP member states count as locally produced and qualify as exempt from tariffs as long as at least 40 percent of the content originates from any combination of RCEP members. Other provisions aim to reduce non-tariff barriers such as customs and quarantine procedures and incongruous technical standards. These changes improve the flexibility and ease with which firms can establish supply chains spanning several countries, standing to benefit Japanese and South Korean multinationals' regional production networks in Southeast Asia.[87] While also facilitating Chinese firms' expansion in the region, the RCEP will likely accelerate the growing role of Vietnam, Malaysia, and Thailand as alternative manufacturing destinations to China for non-Chinese multinationals.[88]

The scope of goods, services, and regulatory standards covered in the RCEP is narrow. The agreement encompasses about 90 percent of tariffs, comparatively low for an FTA, and is light on services trade and

[*] For more on consumption patterns in China, see U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, November 9, 2020, 12–14. *https://www.uscc.gov/sites/default/files/2020-09/September_2020_Trade_Bulletin.pdf*.

[†] ASEAN includes Brunei, Vietnam, Laos, Cambodia, Thailand, Myanmar, Malaysia, Singapore, Indonesia, and the Philippines.

[‡] India was initially involved in the RCEP, but left talks in October 2019 over concerns its domestic market would be flooded with cheap Chinese goods, harming Indian manufacturers, and membership would exacerbate its existing trade deficits with the majority of RCEP countries. Harsh V. Pant, Nandini Sarma, "Modi Was Right. India Isn't Ready for Free Trade," *Foreign Policy*, November 19, 2019. *https://foreignpolicy.com/2019/11/19/modi-pull-out-rcep-india-manufacturers-compete-china/*.

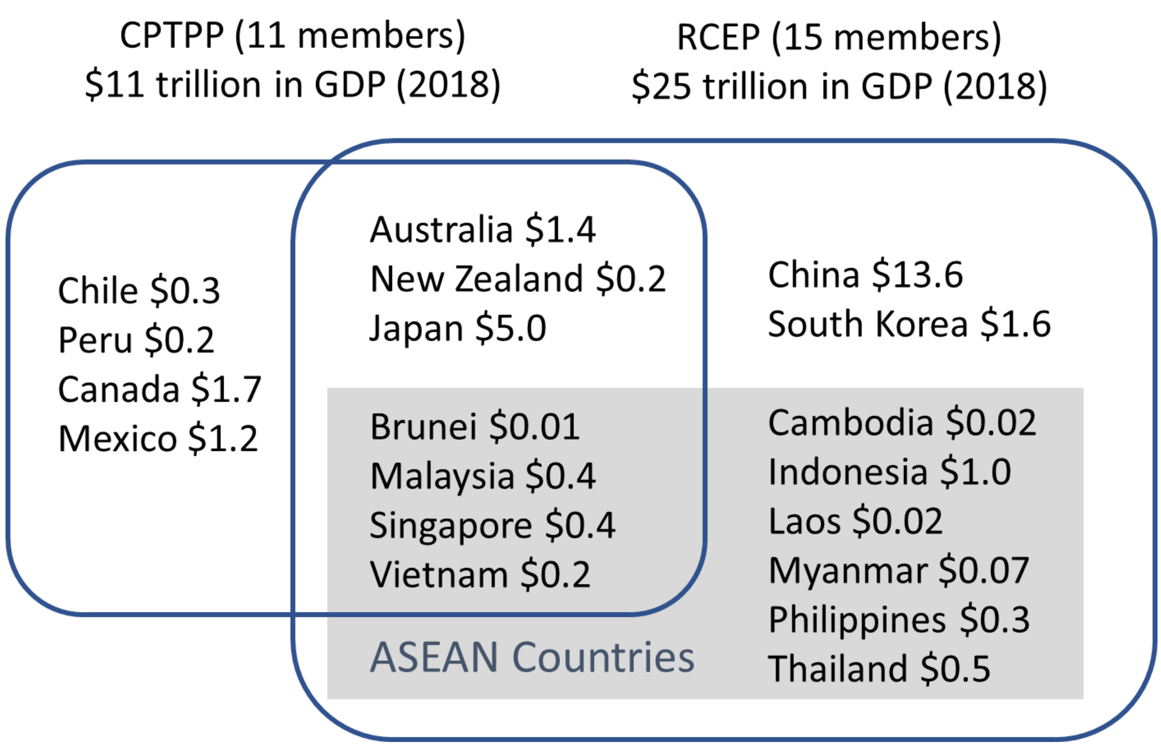
[§] Though the agreement was signed on November 15, it will not come into force until 60 days after it is ratified by at least six ASEAN countries and three non-ASEAN signatories, a process that could take months to over a year. Under the terms of the agreement, membership could continue to grow. New signatories may join the agreement 18 months after it goes into effect, though India, India, as an original negotiating partner, may join at any time after the deal is in effect. James Pearson, "Explainer: What Happens Now the RCEP Trade Deal Has Been Signed?" *Reuters*, November 16, 2020. *https://www.reuters.com/article/us-asean-summit-rcep-explainer/explainer-what-happens-now-the-rcep-trade-deal-has-been-signed-idUSKBN27W0WC*.

agricultural goods.[89] Beyond its narrower scope, the RCEP in many cases codifies elimination of tariffs on items already exempted through other agreements.[90] For China, RCEP overlaps with existing FTAs with ASEAN, Australia, South Korea, and New Zealand; Japan is the only signatory with whom it does not have a prior FTA.[91] The agreement also allows signatories to keep tariffs in sectors they consider sensitive, potentially enabling broad latitude to walk back reductions included in the agreement.[92]

Complete absence or at best superficial provisions on labor, environmental, and other standards leave China's economic policy practices and business environment unchecked, but could also limit the agreement's impact as a regional framework. The RCEP deal is weak in establishing intellectual property protections, as well as e-commerce provisions, with no agreement on rules governing cross-border data flows.[93] Chapters on state-owned enterprises, industrial subsidies, environmental protection, and labor standards are not included at all.[94]

The agreement overlaps with, but is not nearly as ambitious as the CPTPP. The RCEP has been framed in some analyses as in competition with the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), a free trade agreement between 11 Pacific Rim countries formed in 2018 under Japan's leadership (see Figure 3).[*] [95] Seven countries are in both agreements, but notably CPTPP excludes China. It also includes far more ambitious provisions than the RCEP, potentially facilitating greater integration among its signatories despite comprising a smaller economic footprint. For goods and services trade, CPTPP encompasses nearly 100 percent of tariffs.[96] It also includes rules on personal information protection and restrictions on data localization, where absence of any common data governance framework could limit the RCEP's effectiveness in shaping increasingly substantial digital services trade.[97]

Figure 3: RCEP Membership versus CPTPP Membership and GDP
(US$ trillions)



Source: Peter A. Petri and Michael Plummer, "RCEP: A New Trade Agreement That Will Shape Global Economics and Politics," *Brookings Institution*, November 16, 2020.

The RCEP is an agreement between mostly exporter nations, further limiting its benefit to signatories. Outside of facilitating greater supply chain integration, the RCEP has limited potential to reshape regional trade

* The CPTPP succeeds the Trans-Pacific Partnership (TPP), a free trade agreement that included all 11 CPTPP members as well as the United States, following U.S. withdrawal in January 2017. Keith Bradsher and Ana Swanson, "China-Led Trade Pact Is Signed, in Challenge to U.S.," *New York Times*, November 15, 2020. *https://www.nytimes.com/2020/11/15/business/china-trade-rcep.html*.

because of its members' export and import baskets.[98] The 15 member countries represent a diverse mix of economies in levels of development and primary industries; however, nearly all have export-oriented economies but currently sell few final goods within Asia.[99] With no major consuming economies in the consortium, complementary trading relationship are largely constrained to those that enable production of goods to be sold outside of RCEP. In other words, the primary destination of RCEP country exports remains developed countries whose demand remains stagnant in the aftermath of the COVID-19 pandemic.[100]

RCEP constitutes a symbolic geopolitical victory for China. China's already patchy relations with its East Asian neighbors generally soured further in 2020, due to anger over China's initial concealment of the COVID-19 outbreak, as well as continued provocative assertions of extra-sovereign claims in the South China Sea.[*] [101] Concluding the RCEP reaffirms Chinese leaders' claims to regional economic leadership in spite of escalatory geopolitical tensions, even as China wields trade and market access as a retaliatory tool against perceived diplomatic slights. Following Australian leaders' suggestion for an investigation into the origins of COVID-19 in April, China has suspended beef imports and restricted and discouraged other imports from Australia.[102]

In Focus: Alibaba

Rise of China's E-Commerce Giant

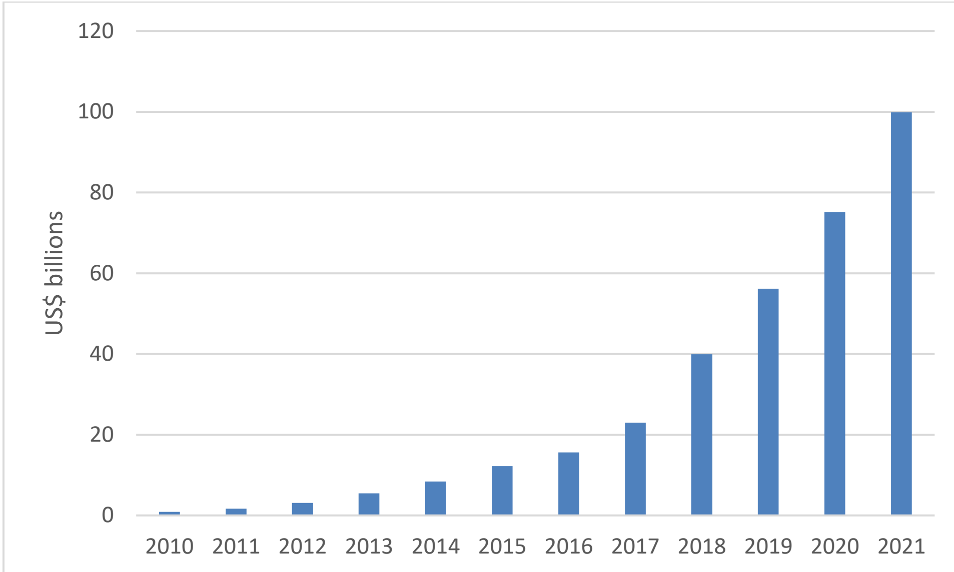
The Ant Group and parent company Alibaba Group Holding Company made headlines in November as the Chinese government put the brakes on Ant's would-be initial public offering (IPO), which would have been the world's largest at over $34.5 billion.[†] Alibaba Group's reign as a top global e-commerce player remains secure, though its continued ambitions for growth are increasingly challenged by policy headwinds at home and abroad. China's regulatory posture toward Alibaba has significantly shaped the Chinese tech environment as well as U.S. companies' access to Chinese consumers. Global tech competition has also intensified as Alibaba sets its sights beyond China's borders, wielding the power to shape digital rules and potentially attract exclusive partnerships to corner different areas of the market. Reflecting its stronghold on the Chinese market, Alibaba has also positioned itself as a "gateway to China" for foreign producers and brands, offering not only to list products from foreign companies, but also to provide appropriate marketing to Chinese customers.[103] In fact, Alibaba has focused on attracting global brands and forming exclusive deals to cut off competition from other e-commerce companies in China.[104]

Founded in 1999, Alibaba has evolved from a startup to an internet conglomerate of 14 businesses and investments across a range of sectors.[105] As of 2019, Alibaba maintained 55 percent of China's e-commerce market, which is the largest in the world with estimated sales just below $2 trillion in 2019.[106] Alibaba's revenues have grown significantly year-on-year for the past decade and are projected to reach nearly $100 billion in 2021 (see Figure 4).

[*] For further details on China's coercive activities in the South China Sea in 2020, see "Chapter 3 Section 1: Year in Review: Security, Politics, and Foreign Affairs," in U.S.-China Economic and Security Review Commission, *2020 Annual Report to Congress*, December 1, 2020, 357-361. *https://www.uscc.gov/sites/default/files/2020-12/Chapter_3_Section_1--Year_in_Review-Security_Politics_and_Foreign_Affairs.pdf*.

[†] For more on the failed Ant IPO, see U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, November 9, 2020, 14–15. *https://www.uscc.gov/sites/default/files/2020-11/November_2020_Trade_Bulletin.pdf*.

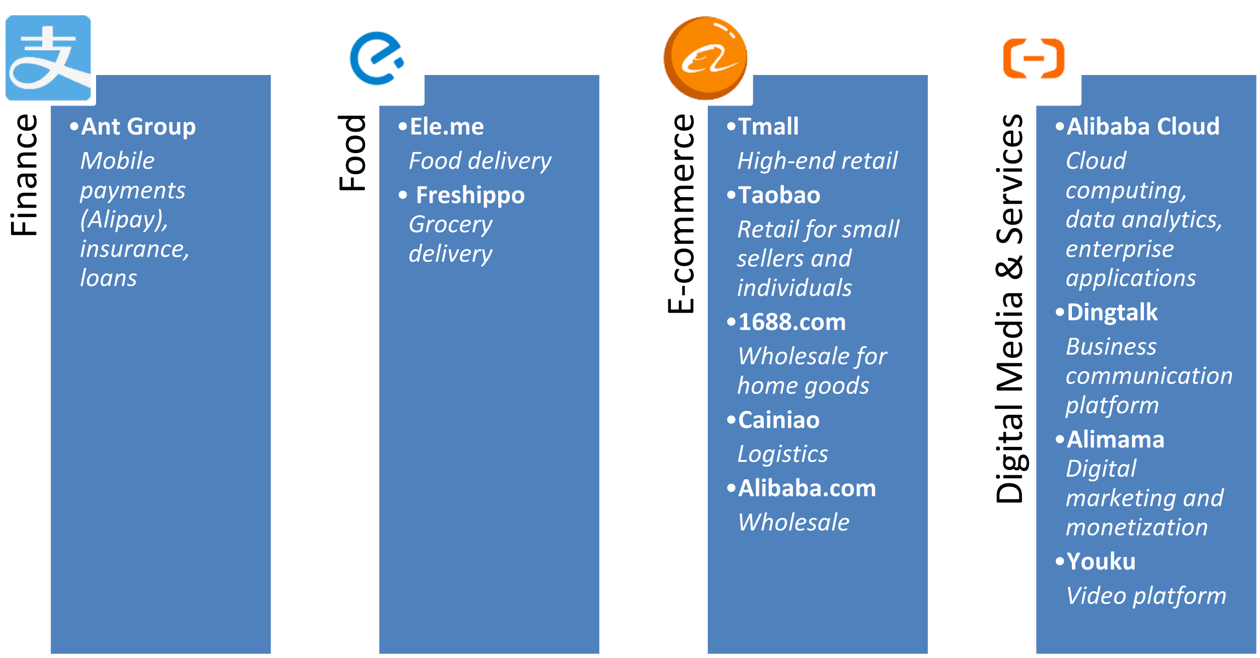
Figure 4: Alibaba's Total Revenue, 2010–2021



Source: Various.[107]

The use of big data and machine learning has been crucial to Alibaba's success and ability to meet immense logistics needs for its nearly 650 million Chinese customers.[108] Over time, Alibaba's businesses have covered various aspects of the retail supply chain, connecting producers, wholesale sellers, retailers, small and medium-sizes enterprises (SMEs), and even individual resellers. In recent years, Alibaba has bought controlling stakes in more brick-and-mortar stores, notably big box retailers, integrating its technology offerings and providing consumers with greater choices online and offline.[109] This expansion into various forms of data-driven B2B and B2C businesses reflects founder Jack Ma's vision for a comprehensive online retail ecosystem (see Figure 5).

Figure 5: The Alibaba Ecosystem in China



Source: Created by Commission staff. Alibaba Group, "Our Businesses." *https://www.alibabagroup.com/en/about/businesses*.

The online retail ecosystem is not Ma's only big-picture vision. In a 2017 letter to shareholders, Ma outlined a "Five New" strategy underscoring digital integration in five key areas: retail, finance, manufacturing, technology, and energy.[110] Ma's vision, which he described as a future "Alibaba economy," is clearly reflected in Alibaba's other businesses and acquisitions. The Alibaba Group built on the foundations of its big data operations to expand into key sectors of cloud computing and financial services. Established in 2004, Ant Group's premier product Alipay has since captured over 50 percent of mobile payments transactions in China, competing fiercely with rival WeChat Pay.[111] Alipay remains an exclusive form of payment on many of Alibaba's direct-to-consumer platforms like Tmall and Taobao. Alipay's core product offering is its digital wallet, where payments from a linked bank account are enabled by scanning QR codes. Increasingly, Ant's revenue is tied to other financial products, including credit, microloans, and insurance.[112] Products like Huabei pioneered microlending in China, offering individual borrowers as little as seven dollars, often to finance purchases on Alibaba platforms.[113] Meanwhile, Sesame Credit targeted SMEs, companies that generally are shut out of borrowing from China's big banks.[114]

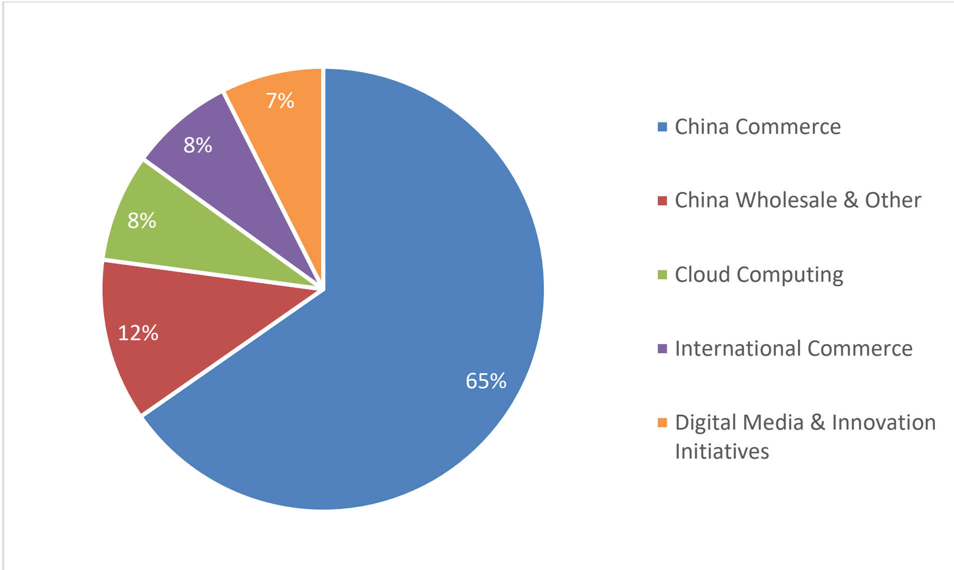
Cloud computing is another key part of the Alibaba economy, as Alibaba Cloud has a steady lead in China's cloud market with a 44.5 percent share in 2020, growing 1.5 percent from 2019.[115] China's policies have long restricted U.S. foreign investment and entrance into the telecommunications sector, including cloud computing, leaving growth of Chinese companies largely unhindered by preeminent global leaders in cloud computing like Amazon.[116] Alibaba Group's extensive network of businesses and relationships across the retail sector make Alibaba Cloud an easy choice for many individual and enterprise cloud users, as the group provides a convenient integration of multiple products and services to store, analyze, and use data for enterprise management. Alibaba Cloud offers its own "China Gateway 2.0" with its top-to-bottom suite of technology tools and "local expertise" to support businesses hoping to enter the Chinese market.[117]

If implemented, the "Five New" strategy will facilitate Alibaba's growth in the near future, but regulatory challenges are on the horizon. Online platforms are coming under increased scrutiny as the Chinese government struggles to crack down on counterfeit products[118] and protect consumer privacy and data. (For more on China's crackdown on tech platforms, see "China Policy Update.") With the increasing scrutiny over Chinese technology, Alibaba is encountering difficulties with regulation abroad as well as at home.

Alibaba's Expansion Abroad

While Alibaba derives the majority of its revenue from its Chinese retail marketplaces like Taobao and Tmall, the opportunities for further growth in the Chinese market are narrowing (see Figure 6). According to Gil Luria, director of research at wealth management firm D.A. Davidson, Alibaba is beginning to reach saturation in the Chinese market.[119] In order to find new sources of growth, Alibaba has therefore expanded into markets beyond China. One of Alibaba's most significant investments abroad is Lazada, a Singaporean e-commerce company serving Southeast Asia. In 2016, when Alibaba purchased a controlling stake in Lazada, the company was the largest e-commerce company in Southeast Asia; since then, Alibaba has invested at least $4 billion in the company.[120] Lazada's growth has flagged, however, and last year the company fell behind rival e-commerce firm Shopee in average monthly users in Indonesia and Malaysia.[121]

Figure 6: Alibaba's FY 2020 Revenues by Business Division



Source: Trefis Team, "Alibaba's Revenues: How Does Alibaba Make Money?" *Forbes*, January 7, 2020. *https://www.forbes.com/sites/greatspeculations/2020/01/07/what-are-the-key-sources-of-revenue-for-alibaba/?sh=5d51aa0f811e*.

Alibaba has also expanded into other developing markets. In October, Alibaba's Cainiao Smart Logistics Network concluded a deal with airline Atlas Air to charter regular flights to Chile and Brazil to cut delivery times to South America.[122] In Africa, Alibaba has concluded deals with the governments of Rwanda and Ethiopia to join the electronic world trade platform (eWTP), an Alibaba-led e-commerce platform to set up international e-commerce rules.[123] The number of Alibaba users in many African countries has grown steadily, particularly as the COVID-19 pandemic has led many African consumers and businesses to favor e-commerce over in-person trading. The number of active Alibaba users in May 2020 increased 130 percent in South Africa and 100 percent in Egypt compared with May 2019, according to company reports.[124]

Alibaba has also made attempts to establish footholds in more mature markets. In Europe, Alibaba has cut sellers' fees on its AliExpress platform in order to attract European merchants away from rival platforms such as Amazon. Alibaba has seen mixed success on this front, as smaller businesses have joined Alibaba while many larger brands have stayed away.[125] In July 2019, Alibaba announced that small U.S. businesses could sell their products on Alibaba.com. Previously, U.S. businesses had only been able to use the site to purchase from other businesses.[126] In 2020, Alibaba expanded its push to attract small and medium U.S. businesses, with features including more flexible payment terms, freight shipping for bulk orders, and online "trade shows" to showcase products.[127]

Beyond its core businesses, Alibaba's cloud computing arm has also grown considerably abroad. In 2019, Alibaba Cloud was the largest cloud computing services firm in the Asia Pacific region and third largest worldwide behind Amazon Web Services and Microsoft's Azure.[128] The company currently has 27 availability zones around the world, including two in the United States.[129] In April, Alibaba Cloud announced it would increase its infrastructure investment by approximately $28 billion (RMB 200 billion) over the next three years.[130]

Concerns over Alibaba's International Presence

As Alibaba has expanded into the United States, the company has faced pushback based on economic and national security concerns. In the United States, the Clean Network program to safeguard U.S. data from intrusion by malign actors contains a line of effort known as the "Clean Cloud" initiative that has designated cloud services offered by Alibaba, as well as Chinese companies Baidu and Tencent, as unsafe, though the U.S. government has not yet taken any steps to curtail these companies' operations.[*] [131] Alibaba's capital-raising prospects may also be curtailed by the likely enactment of the Holding Foreign Companies Accountable Act, which was passed by the House of Representatives on December 2 after being passed by the Senate in May.[132] (For more on the Holding Foreign Companies Accountable Act and related rules proposed by the SEC, see "SEC and Congress Move to Strengthen Oversight of U.S.-listed Chinese Companies.")

Alibaba's affiliate company Ant Group has met setbacks in the United States as well. In 2018, the Committee on Foreign Investment in the United States blocked Ant's attempted purchase of MoneyGram, a U.S. money transfer company, on national security grounds.[†] [133] This October, the U.S. Department of State also reportedly submitted a proposal to the U.S. Department of Commerce to place the Ant Group on the Entity List out of fears that Ant could give U.S. users' sensitive banking data to the Chinese government.[134] Observers viewed placement of a fintech company such as Ant on the Entity List as a largely symbolic move, and sources familiar with the matter have said the Department of Commerce has since shelved those plans.[135]

[1] U.S. Census Bureau, *Trade in Goods with China*, December 4, 2020. *https://www.census.gov/foreign-trade/balance/c5700.html*.

[2] Doug Palmer, "U.S. Exports to China Still Well Below Trump's Trade Target," Politico Pro, December 4, 2020; Office of the U.S. Trade Representative and U.S. Department of Agriculture, *Interim Report on the Economic and Trade Agreement between the United States of America and the People's Republic of China*, October 2020, 1-2. *https://ustr.gov/sites/default/files/assets/files/interim-report-on-agricultural-trade-between-the-united-states-and-china-final.pdf*.

[3] Chad Bown, "US-China Phase One Tracker: China's Purchases Of US Goods," *Peterson Institute for International Economics*, November 25, 2020. *https://www.piie.com/research/piie-charts/us-china-phase-one-tracker-chinas-purchases-us-goods*; Office of the U.S. Trade Representative and U.S. Department of Agriculture, *Interim Report on the Economic and Trade Agreement between the United States of America and the People's Republic of China*, October 2020, 1-2. *https://ustr.gov/sites/default/files/assets/files/interim-report-on-agricultural-trade-between-the-united-states-and-china-final.pdf*.

[4] Doug Palmer, "U.S. Exports to China Still Well Below Trump's Trade Target," Politico Pro, December 4, 2020; Chad Bown, "US-China Phase One Tracker: China's Purchases Of US Goods," *Peterson Institute for International Economics*, November 25, 2020. *https://www.piie.com/research/piie-charts/us-china-phase-one-tracker-chinas-purchases-us-goods*.

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[*] For more on the U.S. Department of State's Clean Network initiative, see U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, August 6, 2020, 6–7.

[†] Although Ant was blocked from purchasing MoneyGram, Alipay has been able to receive licenses to operate on a state-by-state basis in the United States. As of September 2020, Alipay holds money transfer licenses in 44 states, Puerto Rico, and the District of Columbia. Even before receiving licenses, Alipay had been able to enter the U.S. market through partnerships with U.S. companies already engaged in the payment transfer market—a common practice by U.S. firms who want to avoid the licensing process. For example, Alipay only secured a New York money transfer license in February 2020, but could be used to pay for taxis in New York City since 2017 due to a partnership with Verifone, a California-based company that provides technology for processing payments. Faisal Khan, "How to Get Money Transmitter License Coverage for Your Startup?" *Medium*, September 9, 2016. *https://blog.faisalkhan.com/money-transmitter-license-application-d9dd32286871*; Nationwide Multistate Licensing System, "NMLS Consumer Access: Alipay US, Inc." *https://www.nmlsconsumeraccess.org/EntityDetails.aspx/COMPANY/1277102*; Verifone, "Verifone and Alipay Are First to Simplify Taxi Payments for Chinese Travelers in North America," October 17, 2017. *https://www.verifone.com/en/us/press-release/alipay-taxi-payments*.

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