CHAPTER 2

U.S.-CHINA ECONOMIC AND TRADE RELATIONS

SECTION 1: YEAR IN REVIEW: ECONOMICS AND TRADE

Key Findings

- Though China was the first among major economies to recover following the fallout from the novel coronavirus (COVID-19) pandemic, topline growth figures mask an unbalanced and potentially unsustainable recovery. China's short-term rebound relied on government transfers to boost local spending and support firms, exacerbating the country's substantial debt load. The government's approach failed to revive household consumption.
- China's economic rebound in 2020 into 2021 does not represent a fundamental departure from a decade-long slowdown trend. The 14th Five-Year Plan (FYP) acknowledges underlying structural problems, such as declining investment returns, that prevent the economy from transitioning to a more sustainable model. China's leaders believe they can address these challenges through more state-led technology development and by strengthening, rather than loosening, the government's control over the economy.
- Escalating defaults by Chinese property developers show the challenge regulators face in reining in the highly indebted sector. Cash-strapped developer Evergrande's debt troubles have the potential to trigger broader financial instability given Evergrande's significant footprint within China's economy, including its connections to Chinese households, contractors and suppliers in the property sector, banks, and local government finance vehicles (LGFVs).
- Chinese policymakers seek a self-sufficient technology sector that not only is under the Chinese Communist Party's (CCP) control but also plays a critical international role. In 2021, the Chinese government expanded the breadth of its efforts to foster local technology champions, but it also initiated a range of enforcement actions against major nonstate Chinese tech firms. This crackdown is partly motivated by a desire for greater control of nonstate firms' collection and storage of data, which the government views as a strategic resource and national security priority.

- U.S.-China economic integration is strengthening in some areas but weakening in others. Bilateral trade flows and U.S. portfolio investment into China are increasing. Bilateral foreign direct investment flows are down, but there is an increase in venture capital, private equity, and other investments, and the types of acquisition targets are changing. Despite ongoing political frictions and concerns about discriminatory treatment, many U.S. companies remain committed to the Chinese market.
- The Biden Administration is building on the Trump Administration's assertive approach to addressing China's unfair economic practices, threats to U.S. national security, and denial of human rights by engaging U.S. allies and international institutions in confronting Beijing. Despite tense rhetoric, China's government seeks to prevent commercial tensions with the United States from escalating in order to maintain economic stability, even as both countries seek to strengthen supply chain security.
- China's government is formalizing a legal and regulatory framework to counter foreign trade restrictions and sanctions, aimed especially at U.S. export controls on Chinese companies and financial sanctions on Chinese individuals. The most sweeping of these new measures is the June 2021 Anti-Foreign Sanctions Law, which prohibits companies operating in China from complying with foreign sanctions the Chinese government determines are "discriminatory."

Introduction

In 2021, China's economy continued to confront immediate disruption caused by the COVID-19 pandemic as well as long-term challenges to economic dynamism and financial stability predating the outbreak. Consumed with shoring up short-term growth and projecting an image of strength on the eve of the CCP's centennial, China's leadership resorted to a familiar playbook of government support for industry. The resulting rebound deepened already acute financial risks, prompting China's leadership to taper stimulus by the end of the first quarter in 2021. Despite the Chinese leadership's claim of spearheading global economic resurgence, it faces urgency to identify new domestic drivers of growth, overcome mounting challenges through innovative breakthroughs, and reduce economic and technological dependency on global economic integration, particularly with the United States. China's policy prescriptions to achieve these goals largely restate previous plans.

The CCP's external economic relations in 2021 focused on using China's economic heft for economic gain and geopolitical leverage and formalizing methods of tit-for-tat retaliation for perceived diplomatic slights or threats to national security. China's government laid the legal foundation for stronger reciprocal action against U.S. export controls and investment restrictions in 2021 while increasing economic coercion against countries and companies that speak out against its actions.

This section examines key developments and trends in China's domestic economy, U.S.-China bilateral economic relations, and China's economic coercion. For analysis of the CCP's worldview and policy priorities at the centennial of its founding, see Chapter 1, Section 1, “The Chinese Communist Party’s Ambitions and Challenges at Its Centennial.” China’s 14th FYP and Chinese policymakers’ growing emphasis on achieving technological self-sufficiency are reviewed in Chapter 2, Section 2, “The Chinese Communist Party’s Economic and Technological Ambitions: Synthetic Biology, New Mobility, Cloud Computing, and Digital Currency.” For analysis of the Chinese government’s increasing control over the corporate sector, see Chapter 2, Section 3, “The Chinese Government’s Evolving Control of the Nonstate Sector.” Risks to U.S. national security interests posed by greater financial integration with China are discussed in Chapter 2, Section 4, “U.S.-China Financial Connectivity and Risks to U.S. National Security.”

China’s Domestic Recovery Slows as Economy Confronts Long-Term Imbalances

China’s sharp economic contraction at the onset of the COVID-19 pandemic and quick recovery thereafter interrupted but has not altered the country’s long-term economic trajectory. For the last decade, China’s gross domestic product (GDP) growth rate has been slowing due to decreasing returns on investment and failure to generate new drivers of growth. Although China’s government prioritized reducing the outsized contribution of manufacturing, infrastructure investment, and property construction to GDP growth, these sectors continue to dominate economic activity at the expense of household consumption and the services sector. Debt-fueled recovery and economic decisions following COVID-19 have exacerbated these fundamental imbalances. China’s growth in the second half of 2020 into 2021 was primarily a result of central government transfers to support continued spending by localities, even as fiscal revenue contracted. This strategy propped up production but did not spur a corresponding self-sustaining recovery in consumption and services. At China’s annual legislative session in March 2021, policymakers shifted priorities from shoring up short-term recovery. Addressing mounting risks from China’s significant debt buildup became the new focus, and growth within China’s primary economic engines faltered. The central government has resumed efforts to “deleverage,” or reduce overall debt levels, and “de-risk,” or reduce informal channels to less creditworthy borrowers, targeting the property sector and local governments.

China’s Economic Recovery Falters amid Growing Imbalances

After an early recovery, China’s economic growth moderated in the first half of 2021. According to official data* released by China’s National Bureau of Statistics, China’s economy grew by 12.7 percent year-on-year in the first half of 2021, or 18.3 percent in the first quarter and 7.9 percent in the second quarter.[1] Year-on-year GDP growth, which measures economic output relative to the same period in the preceding year, significantly overstates the actual per-

*Foreign economists, investors, and analysts remain skeptical about the reliability of China’s official reported economic data. As a key metric in official performance evaluations, as well as government legitimacy, economic data are highly politicized at all levels of government. For more on the reliability of China’s GDP, see Iacob Koch-Weser, “The Reliability of China’s Economic Data: An Analysis of National Output,” *U.S.-China Economic and Security Review Commission*, January 28, 2013. For more on the reliability of China’s trade data, see U.S. Congressional Research Service, “What’s the Difference?—Comparing U.S. and Chinese Trade Data,” May 20, 2020.

formance of China's economy. Unlike in most major economies, China's government imposed strict quarantine measures following the onset of COVID-19, leading to an acute contraction during the first quarter of 2020 but a quick recovery in the second quarter as lockdown measures were relaxed. By the fourth quarter of 2020, China returned to pre-pandemic growth levels. The momentum of China's recovery largely abated by the first quarter of 2021, as demonstrated by low quarter-on-quarter GDP growth.* The year 2021 saw the first contraction in factory activity since February 2020, with new orders, output, and exports all down amid production bottlenecks, higher material costs, and electricity rationing.[2]

China's traditional growth drivers slowed in the first half of 2021 as the government curtailed stimulus. China's economic recovery was driven chiefly by infrastructure construction, property investment, and export-oriented manufacturing. The former two sources of growth have slowed as the government reduced access to easy credit from the beginning of 2021. This trend is likely to continue, as contractions in credit growth within China's economy tend to precipitate decreases in economic activity two to three quarters later.[3] Though China's manufacturing output held strong through the first half of 2021, the outlook for the sector is similarly precarious. Its robust performance during 2020 owed in large part to China's early reopening compared to other economies, but in 2021 China faces higher input costs and increased competition from other major exporters.[4]

- *Infrastructure:* Owing to lower fiscal expenditure and local government debt issuance, China's overall infrastructure investment decreased for the first time since the outset of the pandemic in May 2021, falling 3.6 percent year-on-year.[5] By July it had fallen over 10 percent year-on-year.[6] In particular, country-wide fiscal spending on transportation projects such as highways and railroads declined 4.9 percent year-on-year by August 2021, reaching $109.5 billion (renminbi [RMB] 704.3 billion).†[7] To contain local government debt growth, China's central government reduced the amount of "special purpose bonds" local governments could issue to fund infrastructure projects, among other long-term expenditures. China's central government set the special purpose bond quota at $567 billion (RMB 3.65 trillion) in 2021, down from $583 billion (RMB 3.75 trillion) in 2020, and by July local governments had only issued approximately 37 percent of their special purpose bond quota for the year.[8] By contrast, local governments had issued almost 65 percent of their special purpose bonds by the end of the first half of 2020.[9] The central government is also urging local governments to reconsider carrying out potentially loss-making infrastruc-

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* Seasonally adjusted quarter-on-quarter growth shows China's economy grew only 0.4 percent in Q1 2021 compared to 3.2 percent in Q4 2020, marking the lowest growth rate on record with the exception of the pandemic shock in Q1 2020. China's National Bureau of Statistics, *National Economy in the First Half Year Witnessed the Steady and Sound Growth Momentum Consolidated*, July 15, 2021; Logan Wright and Allen Feng, "March/Q1 2021 Macro Data Recap," *Rhodium Group*, April 16, 2021, 2; Evelyn Chang, "China Says Its Economy Grew 18.3% in the First Quarter, Slightly Missing Expectations," *CBC*, April 15, 2021.

† Unless noted otherwise, this section uses the following exchange rate throughout: $1 = RMB 6.43.

ture projects, particularly in the highly indebted rail sector.[10] In the spring of 2021, two high-speed rail projects in Shaanxi and Shandong provinces worth $20 billion (RMB 130 billion) were halted owing to concerns about commercial viability and excessive leverage.[11]

- *Property:* A sharp slowdown in China's property sector* weighed on China's economy in the first half of 2021, contributing to the flagging recovery. Due to stricter regulatory requirements on developers' financial conditions detailed below, growth of outstanding bank loans to the property sector slowed to 9.5 percent year-on-year by the end of June 2021, compared to 17.1 percent in June 2019.[12] Investment in new real estate declined sharply in third-tier cities as a result of both new regulations and population exodus.† [13] Though they are smaller and less wealthy, China's third-tier cities account for roughly the same volume of property sales by floorspace as both first-and second-tier cities combined.[14] Slowing construction in these cities will therefore weigh more heavily on the property sector, further weakening overall economic growth.[15] The impact of the new regulations took longer to become evident in national home sales data due to speculative investment in China's major cities. The effect was clear by August 2021, however, as the value of home sales declined 18.7 percent year-on-year.[16]
- *Export-oriented manufacturing:* Industrial value added, an indicator for the amount China's manufacturing and extractive industries contribute to aggregate economic output, slowed consistently, declining from 14.1 percent year-on-year in March to 5.3 percent year-on-year by August 2021.[17] The slowdown was initially led by lower export demand and decreasing heavy vehicle production, a sign of flagging anticipated domestic construction.[18] A global shortage in semiconductors used in automobiles also contributed to reduced vehicle production in China. According to the China Association of Automobile Manufacturers, passenger vehicle production declined 18.7 percent year-on-year in August, "mostly affected by an insufficient supply of chips," though auto sales remained higher in 2021 than in the same period the preceding year.[19] Closures at Chinese ports in response to localized COVID-19 outbreaks and an ongoing global shipping container shortage contributed to global shipping delays and slowing exports.[20]

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* Loans to the property sector include both individual mortgages and loans to developers of commercial real estate, residential real estate, and government-sponsored low-income housing. People's Bank of China Monetary Policy Analysis Group, *Monetary Policy Implementation Report for Third Quarter of 2021* (中国货币政策执行报告： 2020 年第三季度), November 26, 2020, 46. Translation.

† Chinese cities are unofficially but widely grouped into four "tiers" based on population, affluence, and whether they are governed at a provincial level (e.g., Shanghai, Chongqing, Beijing, and Tianjin are provincial-level municipalities), as provincial capitals, or at lower echelons of administrative hierarchy. For example, Shanghai is a first-tier city; Chengdu, the populous capital of Sichuan Province and a regional hub in the southwest, is a second-tier city; Wenzhou, a prefecture-level port city and tourist destination on the coast of Zhejiang Province, is a third-tier city; and Xiangcheng, a county-level city in Henan Province famous foremost as the birthplace of the first president of the Republic of China, Yuan Shikai, is a fourth-tier city. Dorcas Wong, "China's City-Tier Classification: How Does It Work?" *China Briefing*, February 27, 2019.

An Illustration of Supply Chain Challenges: Chinese Port Closures Impact Global Shipping

Localized COVID-19 outbreaks in major Chinese ports and the Chinese government's zero-tolerance approach to containing them have contributed to protracted shipping delays and a steady increase in global shipping prices. For example, after numerous cases of COVID-19 were identified at Yantian container port in Shenzhen in May 2021, Chinese authorities temporarily halted loading new export containers for six days, and the port operated at partial capacity from May 21 to June 24.[21] As operations resumed, terminal congestion led to delays of over 14 days, up from a typical average wait time of a half day.[22] Chinese ports handle almost 30 percent of global shipping container throughput, or the greatest volume of containerized goods handled by a single country globally as of 2019.[23] Recurring closures at Chinese ports have consequently exacerbated already rising shipping prices spurred by container shortages, lagging inventories, and recovering global consumer demand.[24] According to the logistics company Freightos, as a result of the overall rise in global shipping costs, the costs of shipping goods from Asia to the U.S. east and west coasts rose by 315 percent and 330 percent year-on-year, respectively.[25] The cost of shipping goods from China's commodities suppliers in South America to Shanghai, the world's largest port, also rose by 443 percent.[26]

Delays and price increases for shipping routes between China and foreign consumer markets such as the United States have also contributed to mounting costs for businesses, and the rising cost of importing intermediate goods may be contributing to upstream inflation for producers and retailers.[27] Furthermore, since most shipping companies operate on futures contracts that are negotiated annually, current price surges are absorbed into long-term contracts, which will likely result in long-term price increases.[28] Global shipping companies, however, have reported record profits due to price surges. China's state-owned COSCO Shipping Holdings, for example, increased its net profit 32-fold from approximately $179 million to $5.8 billion in the first half of 2021.[29]

Household consumption and services have failed to offset the decline in traditional growth drivers. Driven by stimulus policies that favored investment and producers as well as the rebound in U.S. consumption, China's recovery in the second half of 2020 left behind households and the services sector. Both showed tentative recovery in the first half of 2021, but neither are sufficient to power growth in place of investment and exports, and the contraction in China's overall GDP growth resulting from tapering stimulus may undermine their initial recovery.

- *Household consumption:* After remaining virtually stagnant in 2020, China's household consumption finally rebounded partway through the first quarter of 2021. Retail sales growth, a key gauge of consumption, surged 34.2 percent year-on-year in

March 2021 but decreased thereafter, with growth levels tapering to 17.7 percent in April, 12.1 percent by June, and 2.5 percent by August.[30] Economists suggest that consumers remain cautious regarding China's recovery, and households' propensity to save rather than spend remains high due in part to slow wage growth.[31] Urban disposable income growth, a key driver of consumption, has not kept pace with China's economic recovery, growing 10 percent in the first half of 2021, or 2 percentage points lower than GDP growth rate.[32]

- *Services sector:* At 53 percent, the contribution of the services sector* to GDP growth in the first half of 2021 was far below its contribution before the pandemic: in the first half of 2019, it accounted for 60.3 percent of GDP growth.†[33] Services are a key driver of urban employment in China, with demand for labor-intensive services jobs among migrant workers increasing as factory job availability decreased in the past.[34] This trend is likely to repeat as global economies recover from the pandemic and demand for Chinese exports slows. Slackening demand for Chinese exports will limit manufacturing employment opportunities, while dampened household consumption will limit continued growth of the services sector.[35]

The consequences of uneven recovery are apparent in diverging inflation indicators for China's producers versus consumers. The producer price index, a benchmark for the rate at which production input costs are increasing, grew sharply in 2021, increasing 9.5 percent year-on-year by August.[36] Surging producer inflation primarily reflects increasing commodity prices, driven by extensive manufacturing and construction activity during the preceding year. Meanwhile, China's consumer price index rose by only 0.8 percent year-on-year by August, after being in deflationary territory for the first two months of the year.[38] Continued divergence of producer prices and domestic consumer demand threatens China's recovery, as producers will either need to pass increased input costs to domestic or international consumers or accept lower profit margins.[39]

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*China's National Bureau of Statistics defines the services sector as comprising wholesale and retail; transportation, storage and postal services; accommodation and catering; telecommunications, internet, and software; financial services; real estate, including leasing and business services, property management, real estate intermediary services, and leasing operations; scientific and technological research; water and environmental conservation and public facilities management; residential and repair services; education; healthcare and social work; culture, sports, and entertainment; public administration, social security and civil society organizations; and international organizations. China National Bureau of Statistics Department of Management, *Regulation on the Division of the Three Sectors* (三次产业划分规定), January 14, 2013. Translation; China National Statistics Bureau, *4. Statistical System and Classification Standards*, 四、统计制度及分类标准（ 17 ）, June 19, 2020. Translation.

†By comparison, services contributed 77.3 percent for the United States in 2019. High-income, manufacturing-dependent economies Japan, South Korea, and Germany all have services ratios slightly below 70 percent. World Bank, "Services, Value Added (% of GDP)"; U.S. Central Intelligence Agency, "GDP—Composition, by Sector of Origin," *World Factbook*.

China's Government Increases Economic Data Censorship

To control the official narrative of its economic performance, China's government has increased censorship of economic reporting, including by journalists and nonstate information providers, such as economic consultancies and data services. Economic censorship increases financial and commercial risk for countries, entities, and individuals exposed to China who are unable to obtain accurate information on the performance of its economy. In particular, China's government has tried to contain unofficial estimates of inflation, seemingly to influence market dynamics, and unemployment, which is highly politically sensitive:

- *Inflation:* After monthly producer inflation reached its highest reported level since 2008 in May 2021, China's main economic planning agency and market regulator introduced new compliance requirements for commodity price index reporting.[40] Analysts suggest the compliance requirements are aimed at bolstering the government's ability to censor information that could contribute to further price increases.[41] Prior to modifying the requirements, China's government reportedly censored industry research that reported price escalation, and it suspended a daily indicator on coal prices after the index reported a sharp increase.[42]
- *Unemployment:* At the height of China's lockdown and travel restrictions in February 2020, the official unemployment rate stood at 6.2 percent, versus roughly 4 percent reported by China's government for decades.[43] In late April 2020, the brokerage firm Zhongtai Securities estimated the number of workers who lost their jobs due to the pandemic may have already exceeded 70 million, indicating an urban unemployment rate of at least 20.5 percent.*[44] The figure was quickly retracted after gaining attention online, and on May 1 *Caixin* business magazine reported that Zhongtai Securities removed their research chief from his post following the report's publication and censoring.[45]

Increased censorship of economic data and reporting compounds longstanding practices by propaganda agencies and China's national statistics bureau to paint a favorable picture of the economy in order to control market and societal responses to economic news. For media outlets, China's government routinely issues guidance ordering preemptive censorship of topics deemed politically sensitive, which can include reporting on adverse economic conditions. For instance, following the U.S. imposition of tariffs on Chinese goods in July 2018, the *New York Times* reported China's government forbade reporting on the impact of the tariffs in September 2018.[46] The same government directive forbade coverage of local government debt risks, declining consumer confidence, or

*At the end of 2019, China's National Bureau of Statistics reported that urban employment stood at 442.5 million, with an urban unemployment rate of 3.6 percent. China National Statistics Bureau, *Zhang Yi: The Employment Situation Is Generally Stable* (张毅： 就业形势总体稳定就业预期目标较好完成), January 19, 2020. Translation.

China's Government Increases Economic Data Censorship—*Continued*

economic data suggesting the economy was slowing, among other topics.[47]

As U.S. investors and financial services firms become more involved in China's economy, they face the increasing risk of producing analysis or providing information the Chinese government censors. For instance, according to testimony before the Commission by Rebecca Fair, CEO of data analytics firm Thresher, in late July 2021 the Chinese government removed domestic discussion of U.S. investment managers Merrill Lynch and JP Morgan after they reportedly issued warnings to their investors about the risk of investment in China due to the government's unpredictability.*[48] In this case, censors quashed the narrative among domestic netizens that Chinese government actions had introduced new or heightened risks to the Chinese market.[49]

Deleveraging and De-Risking Target Local Government and Property Developers' Debt

In shoring up short-term growth, China's government increased the fiscal deficit and paused campaigns aimed at reducing overall debt levels and riskier forms of credit during 2020. Despite being small by international standards, credit growth and fiscal support as part of China's 2020 stimulus contributed to the country's already staggering debt load. At the end of 2020, China's debt-to-GDP ratio reached 285 percent, compared to 258 percent in 2019, according to the World Bank.†[50] The ratio declined to 280 percent by the end of the first quarter of 2021, but only because China's GDP increased rather than because the absolute value of China's debt decreased.[51] China's central government increased the fiscal deficit to a record 3.6 percent of GDP in 2020, and later reduced it to 3.2 percent in 2021 amid stronger fiscal revenues.‡[52]

A substantial portion of the debt growth was also fueled by laxer borrowing standards. In March 2020, the People's Bank of China (PBOC) and several other agencies instructed creditors to extend loan repayment intervals and not to recognize loans with

*In order to shape domestic narratives, the Chinese government leverages both artificial intelligence and humans to moderate and generate content about the Chinese economy, domestic and foreign markets, and domestic and foreign companies. Chinese censors shape narratives primarily by deleting, generating, and amplifying content on traditional and social media. Rebecca Fair, written testimony for U.S.-China Economic and Security Review Commission, *Hearing on U.S.-China Relations in 2021: Emerging Risks*, September 8, 2021, 1.

†The World Bank's measure of debt includes the sum of domestic and external debt, including household, non-financial corporate, and public sector debt. Corporate debt includes that of non-state firms and SOEs, as well as local government financing vehicles, special platforms created by local governments to issue debt on their behalf. World Bank Group, "Beyond the Recovery: Charting a Green and Inclusive Growth Path," *China Economic Update* (June 2021), 11.

‡Increasing the annual budget deficit above 3 percent of GDP represents an important threshold for Chinese policymakers. Since China introduced economic reforms in 1978, the fiscal deficit-to-GDP ratio has mostly been below 3 percent and right at 3 percent during an economic slowdown in 2016 and 2017. By comparison, the U.S. fiscal deficit for 2021 is projected to be 13.4 percent of GDP. Liao Qiaoyi, "China Could Lift Deficit-to-GDP to Highest on Record amid COVID-19," *Global Times*, April 19, 2020; Yawen Chen and Ryan Woo, "China Says Higher 2019 Budget Deficit Will Spur Growth, Won't Open Floodgates," *Reuters*, March 6, 2019; U.S. Congressional Budget Office, *An Update to the Budget and Economic Outlook: 2021 to 2031*, July 2021.

missed payments as delinquent or downgrade the credit rating of borrowers.[53] Additionally, in July 2020 China's chief banking regulator extended a year-end deadline on 2018 regulations meant to reduce shadow banking, or off-balance-sheet lending, to avoid regulatory capital requirements.[54] Banks and asset managers were granted until the end of 2021 to comply with the new requirements.[55] Even prior to the pandemic, China's government had already been easing off its deleveraging and de-risking campaigns following a sharp escalation in borrowing costs that threatened to dampen overall growth, particularly for China's small- and medium-sized enterprises (SMEs).[56]

Local government expenditure to keep local businesses operating was a key pillar of China's post-pandemic recovery.[57] To incentivize firms to retain employees, in February 2020 China's central government cut and, in some cases, exempted firms' contributions to social programs, including pension, unemployment, and workers' compensation, which are administered by local governments and amounted to $240 billion (RMB 1.54 trillion) from February through the end of 2020.[58] In March 2020, the central government refunded small firms the payments they made toward unemployment insurance in 2019, provided those firms did not reduce employment.[59] Responding to central government guidance, many local governments introduced other incentives to help businesses weather the economic contraction.[60] These included providing subsidies for purchasing teleworking equipment and services, allowing corporate income tax deductions for other expenditures related to COVID-19 prevention and control, and cutting a number of other taxes and administrative fees.[61] Other fiscal incentives notably aligned with China's policy priorities. For instance, China's government subsidized research and development costs for smaller firms and granted substantial tax breaks for research and development expenditure related to COVID-19 prevention and control.[62]

Because local governments' fiscal revenues contracted substantially due to the economic slowdown and tax breaks for businesses, they borrowed heavily through both formal and informal channels to meet their expenditure obligations. According to China's Ministry of Finance, by July 2021 outstanding local government debt reached approximately $4.4 trillion (RMB 27.9 trillion), or 27 percent of GDP in 2020, up slightly from $4 trillion (RMB 25.6 trillion) or 25 percent of GDP at the end of 2020.[63] The actual amount of local government debt is likely much larger, however, due to "implicit debt" raised through LGFVs, special platforms created by local governments to issue debt on their behalf.[*][64] A Chinese government-linked think tank estimated that by the end of 2020, local government implicit debt had reached approximately

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*Prior to 2015, municipal governments could not issue debt directly, with exception to a few pilot programs authorized by China's central government. Because local governments' revenue bases were often insufficient to meet their expenditure obligations, they used LGFVs to evade these restrictions, a practice that has continued since China legalized municipal debt issuance in 2015. China's Ministry of Finance calls funding raised through LGFVs "implicit debt," and it is explicitly recognized as corporate debt rather than a government obligation, but investors often treat LGFV bonds as backed by the government, creating moral hazard. Frank Tang, "China Debt: State Council Says Local Governments Must 'Tighten Their Belts' and Cut Debt to Reduce Financial Risks," *South China Morning Post*, March 16, 2021; Zhiguo He, written testimony for the U.S.-China Economic and Security Review Commission, *Hearing on China's Quest for Capital: Motivations, Methods, and Implications*, January 23, 2020, 6, 10.

$2.3 trillion (RMB 14.8 trillion).[65] This estimate would bring total local government debt up to approximately $6.3 trillion (RMB 41 trillion) in 2020, or 40 percent of GDP, 15 percentage points higher than the official figure.

China's central government renewed efforts to rein in official and implicit local government debt, which ballooned in 2020. In addition to reducing the annual quota for special purpose bonds, or municipal debt local governments may issue to fund items such as infrastructure projects, China's government moved more slowly to issue debt within the limits it set in 2021. In the first four months of the year, local governments only sold or planned sales of special purpose bonds totaling $34.6 billion (RMB 222.7 billion), compared to $113.5 billion (RMB 729.6 billion) in the same period in 2019 and $178.8 billion (RMB 1.15 trillion) in 2020.[67] In April 2021, China's State Council also issued a circular on budget management, attempting to curb implicit local government debt growth by holding local cadres personally accountable for "problematic" debt raised during their terms, converting LGFVs into state-owned enterprises (SOEs) and stripping their municipal financing functions, and instructing LGFVs to restructure or declare bankruptcy if they cannot avoid default.[68] Chinese analysts questioned the timetable to convert LGFVs into regular companies, as well as the likelihood China's government would tolerate increasing LGFV defaults. One analyst noted that defaults from a single city-level LGFV bond are likely to cause refinancing problems for every LGFV in the entire province regardless of their creditworthiness, a reflection of the potential financial turbulence China's government faces in exercising greater market discipline.[69]

Chinese policymakers are increasingly relying on tighter banking oversight to remedy China's highly leveraged real estate sector, which is also a target of Beijing's de-risking efforts. Announced in late 2020, the Chinese government's "three red lines" policy cuts off new bank loans to real estate developers that do not meet certain prudential requirements. These requirements include the following: (1) setting a ceiling for developers' debt-to-asset ratios at 70 percent, (2) setting net debt-to-equity ratios at 100 percent, and (3) capping short-term borrowing on par with cash reserves.[70] Economic research firm Rhodium Group analysts Logan Wright and Allen Feng describe the policy as likely "the most important tightening policy targeting the property sector introduced in recent years."[71] They note that blanket requirements on developers' capitalization impose financial discipline regardless of the source of funding, where previous attempts to rein in property sector debt had focused narrowly on formal channels such as bank loans.[72] The effect of the three red lines policy has been apparent as developers' property pipelines have begun to shrink. Between January and August 2021, the square footage of land area purchased for real estate development decreased by 10.2 percent relative to the same period in 2020, while land prices also decreased by 6.2 percent amid weakening new construction.[73] The PBOC has also instructed banks to strengthen due diligence screenings to ensure operating loans made to businesses are not being used for real estate speculation. At the same time, local governments are imposing tighter property purchasing restrictions, including requiring purchasers to hold real estate assets longer before reselling them.[74] For example, new regulations in Hangzhou require owners to hold newly built homes sold through a lottery* for five years before reselling.[75]

Three Red Lines Policy Increases Potential for Property Developer Defaults

China's three red lines policy has threatened the survival of multiple developers in China's highly leveraged property sector. For example, in September 2021 indebted property developer Evergrande announced it would delay payments on its investment products, which it used to raise capital to address funding gaps and pay back other creditors.[76] By September 30, 2021, Evergrande missed $131 million in payments to its offshore bondholders, casting doubt that it could make another $162.4 million in offshore bond payments due in October.† [77] By October 4, trading in Evergrande's shares had been suspended on the Hong Kong Stock Exchange per Evergrande's request.‡

According to its unaudited interim financial reports, Evergrande's total liabilities reached $306 billion (RMB 1.97 trillion) as of the end of June, of which $37.3 billion (RMB 240 billion) was debt due within one year.[78] Debt risks from Evergrande also extend beyond China's domestic economy, as the developer accounts for nearly 5 percent of offshore, dollar-denominated bonds from Chinese issuers.[79]

Stricter rules on property developers' capital adequacy have hampered Evergrande and other developers' abilities to raise cash through new loans. Property development in China is a highly leveraged business, with developers funding land purchases and housing construction through loans, bonds, and deposits from home buyers rather than revenue. Because China's three red lines policy restricts property developers' ability to take on new debt, Evergrande and other developers have struggled to pay suppliers and contractors, meet existing debt payments, and finance continued expansion to raise more capital.[80] The impact of the new regulations has been readily apparent in missed bond payments. Property developers accounted for bond defaults totaling roughly $8 billion (RMB 51.2 billion) from the beginning of 2021 to August, with more expected.[81] For example, in October property developer Fantasia Holdings Group Co. Ltd. failed to repay principal amounting to $206 million on its dollar-denominated offshore bonds.[82]

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*Because the number of potential buyers far exceeds the number of available housing units in major Chinese cities, multiple cities have implemented score-based lottery systems in which potential buyers are scored based on their ability to meet criteria including their current housing status, historical payments into local social security, and prior home purchases. Potential home buyers with the highest scores are then entered into a randomized lottery in which they may be selected to purchase housing. Shanghai Metals Market, "Shanghai Xinfang Lottery Launches a Points System to Give Priority to 'Families without Houses,'" February 6, 2021.

†Evergrande's creditors can trigger a default once its bond payments are 30 days past due. Narayanan Somasundaram, "China Evergrande Misses Bond Payment Deadline," *Nikkei Asia,* September 24, 2021.

‡Chinese state media reported that Hopson Development Holdings Limited (Hopson) planned to purchase a 51 percent stake in Evergrande's property services unit, Evergrande Property Services, prompting both Evergrande and Hopson to request a suspension in trading of their shares. Hopson has not yet confirmed the acquisition. Tom Westbrook and Donny Kwok, "Evergrande Eyeing $5 Bln Property Unit Sale; Rival Fantasia Misses Payment," *Reuters*, October 4, 2021.

While deleveraging, China's government is attempting to allocate more credit and fiscal support to marginalized nonstate firms. China's SMEs, which are far more likely to be nonstate firms, suffered disproportionately from the economic fallout following COVID-19 as initial government stimulus policies favored state-dominated sectors. In spring 2021, China's government took a series of measures aimed at keeping SMEs afloat. Most constitute a familiar playbook: local governments have slashed fees and taxes for smaller businesses and in some cases offered tax breaks to property owners who cut SMEs' rents, while the PBOC has encouraged banks to increase lending to SMEs, keep borrowing costs low for SMEs, and extend loan forbearance granted in 2020 into 2021.[83] These policies expand upon many previous tax breaks and monetary benefits the Chinese government offered SMEs at the end of 2018 into 2019.[84] A separate policy from several agencies—including China's Ministry of Industry and Information Technology, the primary ministry responsible for technology development—pledges state support for SMEs in targeted industries that can help China meet its technological self-sufficiency goals under the 14th FYP.[85] The continued necessity of special support for SMEs in spite of China's recovery highlights the impediments to overcoming deeper structural changes that could support a more dynamic nonstate sector. Past efforts to achieve a balancing act in credit expansion—reining in debt growth within leveraged sectors while fostering it in others—have failed, as Chinese regulators have been unable to block avenues for new loans to be redirected toward speculation.[86]

CCP's "Common Prosperity" Slogan Elevates Campaign against Inequality

In an August 2021 speech highlighting "common prosperity," General Secretary of the CCP Xi Jinping signaled the Chinese government's increasing focus on addressing China's income inequality. At a meeting of the Central Commission for Financial and Economic Affairs, one of China's top economic deliberation bodies, General Secretary Xi said the CCP should focus on common prosperity while creating an "olive-shaped [income] distribution, where the middle is large and the two ends are small."[87] General Secretary Xi said the CCP should "strengthen the regulation and adjustments of high income" and "fairly regulate excessive income."[88] According to Chinese state media outlet Xinhua, the meeting also indicated the need to expand the middle class while increasing earnings for low-income individuals.[89]

Concrete policy implications for common prosperity remain unclear. The August meeting emphasized the need for a "tertiary distribution mechanism" consisting of "primary distribution" (allocation of wealth according to labor, capital, and other factors), "redistribution" (through taxation, social security, and transfer payments), and "tertiary distribution" (charitable donations).[90] The government has not yet announced major policy changes in pursuit of common prosperity and Chinese policymakers and state media have sought to reassure the business community that common prosperity would not result in radical income redistribu-

CCP's "Common Prosperity" Slogan Elevates Campaign against Inequality—*Continued*

tion. Despite this, Chinese regulators have already taken significant enforcement actions against high-income individuals, and nonstate companies have announced large charitable donations in the name of common prosperity.

- On August 26, China's State Tax Administration announced it would crack down on tax evasion and increase supervision of high-income individuals.[91] The next day, the State Tax Administration announced over $2 billion (RMB 13 billion) in tax fines on several corporations as well as a $46 million (RMB 300 million) fine on actress Zheng Shuang.[92] An article in the state-backed tabloid *Global Times* commenting on Zheng's tax case noted, "Such supervision will be further tightened with harsher punishments as China marches toward common prosperity."[93]
- According to *Bloomberg*, by the end of August, seven of China's wealthiest billionaires had already announced $5 billion in charitable donations in 2021.[94] Tech companies, which remain subject to a government crackdown, have been particularly vocal in their donations. Since the August meeting, Tencent, Pinduoduo, and Alibaba have announced charitable donations that together total $24.8 billion (RMB 160 billion).[95] Food delivery giant Meituan also pledged to pay closer attention to the welfare and needs of its delivery drivers, with the company's founder Wang Xing telling investors common prosperity is "built into the genes" of the company.[96]

China's 14th FYP Acknowledges Long-Term Challenges but Does Not Offer New Solutions

China's leadership is decreasing emphasis on quantitative targets, looking to correct imbalances. The 14th FYP is a blueprint intended to guide China's development for the 2021–2025 period, setting the stage for goals as far out as 2035 and 2049. Within the 14th FYP, Chinese policymakers pledge to focus on transitioning to "higher quality growth" in recognition of the consequences of China's "growth at all costs" development model, such as acute environmental degradation and rising income inequality.[97] In the annual legislative session in March, China's leaders set a more modest target of 6 percent GDP growth for 2021, and the 14th FYP itself deviates from previous plans by setting no topline GDP growth goals and reducing the number of other economic targets.[98] (For more on the 14th FYP's goals, see Chapter 2, Section 2, "The Chinese Communist Party's Economic and Technological Ambitions: Synthetic Biology, New Mobility, Cloud Computing, and Digital Currency.") Chinese policymakers have previously issued blueprints prioritizing addressing economic imbalances and improving investment efficiency. They abandoned these goals, however, when faced with economic turbulence or pushback from blocs of politically favored SOEs that benefit from inefficient investment growth.[99] Even as China's leadership reiterated pledges to move away from its old model, China's lopsided post-pandemic recovery has exacerbated imbalances to shore up short-term growth.[100]

In practice, the 14th FYP revisits and solidifies self-sufficiency and technological breakthroughs as central pillars of China's economic vision under the dual circulation strategy. Chinese leaders believe China should establish a self-sufficient economy, both in localizing entire supply chains and driving economic growth through domestic consumption. They have reframed this approach as the dual circulation strategy, first proposed by China's leadership in May 2020 to address weak global demand and strained bilateral relations with the United States and later integrated into the 14th FYP. According to the strategy, China's economy would grow principally by increasing domestic demand and reorienting Chinese producers to cater to the local market rather than producing for export.[101] At the same time, it would reduce the risk of being cut off from critical foreign technologies by strengthening supply chain security.[102] Neither emphasizing China's domestic economy nor reducing dependence on foreign technology are new ideas, though the goals bear new urgency for the CCP in what it views as an increasingly hostile and uncertain external environment.[103] (For more on dual circulation, see Chapter 1, Section 1, "China's Ambitions and Challenges at the Chinese Communist Party's Centennial.")

China's leaders see technological breakthroughs as key to overcoming a host of economic challenges, including income inequality and demographic change.[104] The 14th FYP also reaffirms a vision of China's role in the international economy in which China establishes dominance by systematically reducing its dependence on international trade and investment to strengthen its own security while increasing other countries' dependence on Chinese trade and investment to gain leverage. As discussed later in this section, this vision is central to China's objectives in its economic relationship with the United States.

China's Government Strengthens Control over Technology and Data

In 2021, the Chinese government increased support to critical sectors to advance its technological self-sufficiency goals. At the same time, it tightened regulatory oversight of data-intensive industries, in some cases damaging the commercial performance of some of China's most successful tech giants. The latter trend follows efforts by the Chinese government to regulate data both as a strategic asset and a potential national security risk, curb the nonstate financial sector's growth at the expense of state banks, and assert greater political control over nonstate firms in general. The split approach of simultaneous support and scrutiny of tech firms reflects the CCP's hopes of promulgating a homegrown technology sector coupled with its deep suspicion of tech giants' accumulation of power and wealth. Ultimately, the Party seeks to retain control of both the technologies and the companies themselves and views both state and nonstate tech firms as strategic assets to advance its policy objectives. (For an in-depth assessment of China's self-sufficiency drive, see Chapter 2, Section 2, "The Chinese Communist Party's Economic and Technological Ambitions: Synthetic Biology, New Mobility, Cloud Computing, and Digital Currency.")

Chinese Regulators Crack Down on Big Tech

In 2021, Chinese regulators took unprecedented action against many of China's top technology firms. The Chinese government pursued these actions under the guise of productive reforms to address genuine problems in the industry, but the actions provide the government with greater control. Companies such as Alibaba and Tencent enjoy monopolistic control over large parts of China's economy and collect valuable data on China's population in excess of what the Chinese government itself is currently able to collect.[105] Trivium China, a research consultancy, argues that the increased scrutiny of technology firms comprises "three separate and simultaneous campaigns" that share similar goals but involve different regulatory bodies and are motivated by distinct concerns:[106]

- *Addressing systemic risks to China's financial system:* Concerned over the potentially destabilizing effects of tech firms' expansion into the financial sector, China's regulators, led by the PBOC, have imposed stricter regulations on fintech firms. Ant Financial (Ant), an Alibaba affiliate, was the first major fintech company to run afoul of Chinese regulators. In November 2020, the government halted Ant's initial public offering (IPO) days before it was set to occur.[107] Regulators were in part acting out of concern that the scope of Ant's microlending business, which was previously not subject to the same standards as bank lending, posed a systemic threat to China's financial system.[108] In April 2021, Ant released a statement outlining a restructuring plan it had developed in coordination with China's financial regulators, including conversion to a financial holding company, subjecting Ant to stricter capital requirements similar to those imposed on banks.[109] Soon after Ant's announcement, regulators ordered 13 tech firms with financial services operations, including industry leaders Tencent, JD, Baidu, and ByteDance, to stop the "disorderly expansion of capital"[110] and to comply with requirements similar to those in Ant's restructuring plan.[111] While an announcement issued by the PBOC after the meeting did not set a deadline for the 13 tech firms to comply with the rectification requirements, Chinese business magazine *Caixin* reported in May that regulators had ordered Tencent to establish a financial holding company for its finance operations.[112]
- *Addressing anticompetitive behavior by tech firms:* In 2021, the State Administration for Market Regulation (SAMR), China's antitrust enforcer, launched a campaign against Chinese tech firms' anticompetitive practices. In February, SAMR issued a set of guidelines aimed at addressing different types of anticompetitive behavior among platform firms, including price fixing, restricting sales, or selling below cost in order to squeeze out competitors.[113] In April, SAMR announced a record fine of $2.8 billion (RMB 18.2 billion) on e-commerce giant Alibaba for its practice of forcing merchants to pick Alibaba as their exclusive distribution channel. This practice, known as "pick one of two," is prohibited under the February SAMR guidelines.[114] In Au-

gust, SAMR released draft regulations prohibiting additional types of anticompetitive behavior, including posting fake product reviews and using technology to disrupt consumers' ability to use rival platforms.[115] In October, following a months-long investigation, SAMR fined food-delivery firm Meituan for $535 million (RMB 3.4 billion) on the basis of antitrust violations similar to those of Alibaba.[116] SAMR's heightened and high-profile enforcement actions against Chinese firms mark a change from China's past antitrust practice, which has historically focused on preventing foreign firms from amassing substantial market influence.[117]

- *Restricting tech firms' collection and transfer of data:* During 2021, Chinese policymakers increased the government's oversight of the collection and storage of data by foreign and domestic nonstate firms. The July investigation into Chinese ride-sharing giant Didi Chuxing (Didi) following its IPO on the New York Stock Exchange, as well as two other Chinese tech companies that had recently listed on U.S. exchanges, epitomizes this trend. (For more on the investigation into Didi, see the textbox "Beijing's Scrutiny of Chinese Companies Listed Overseas Highlights U.S. Investor Risks" later in this section.) For the CCP, the global expansion of China's tech firms offers advantages but also poses a potential risk to the CCP as companies become subject to foreign regulatory provisions, which often include higher transparency requirements.[118] Chinese regulators have continued to increase scrutiny of foreign listings. After launching the investigation into Didi, China's State Council announced it would tighten regulations on a range of securities activities, including listing abroad.[119] These regulations could stop the use of variable interest entities, a regulatory loophole used by many Chinese tech firms to list on U.S. exchanges.* Separately, in July the Cyberspace Administration of China published draft rules requiring any Chinese company with user data of more than one million users to complete a review with the Cybersecurity Review Office before listing abroad.[120] In August, *Reuters* reported that Chinese regulators are contemplating requiring Chinese firms seeking foreign listings to hand over management of their data to third-party Chinese information security firms.[121] Such a requirement would allow the information security firms, likely to be backed by China's government, to monitor Chinese companies' data.[122] This could limit the ability of Chinese firms to transfer data overseas while increasing the Chinese government's access to and control of data. The Chinese government's efforts to gain control over data are leading it to assume greater ownership stakes in nonstate firms.† In September, *Bloomberg* reported the Beijing

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* China's government legally prohibits foreign direct investment in certain industries, including many high-tech sectors, and maintains strict controls on foreign exchange and capital flows. To circumvent these restrictions, mainland Chinese companies interested in raising funds on U.S. exchanges create offshore corporate entities for foreign investment using a complex structure called a variable interest entity (VIE). 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.

† On April 30, 2021, ByteDance sold a 1 percent equity stake and gave a board seat to Wangtou Zhongwen (Beijing) Technology, which is owned by the China Internet Investment Fund (con-

municipal government had proposed an investment that could potentially give SOEs a seat on Didi's board and veto power over important corporate decisions.[123]

The CCP's Push for Domestic and International Data Control

In June 2021, the National People's Congress passed the Data Security Law, the first comprehensive piece of data security legislation in China. The law contains several significant provisions, including restrictions on transferring data outside of China and a requirement that handlers of data "cooperate" with Chinese public security forces.[124] The Data Security Law applies to all domestic and foreign organizations handling data in China. The law broadly extends liability to overseas data handling activities that cause "harm to the national security, the public interest, or the lawful rights and interests of individuals or organizations" of China, which are otherwise not specified.[125] Many of these provisions in the Data Security Law build on or reinforce requirements of other Chinese laws, such as the 2017 National Intelligence Law and the 2017 Cybersecurity Law.[126] The Chinese government is developing more specific regulations and standards in sectors of particular concern. In May 2021, Tesla announced that all data from cars sold in China would be stored locally in a new data center, following the release of a draft standard for automobile data.[127]

While some of China's protections on data appear similar to those in other countries, they are generally more restrictive. The National People's Congress has also completed China's Personal Information Protection Law, effective November 2021.[128] The law contains many protections against the collection of personal information by nonstate companies, similar to those of the General Data Protection Regulation (GDPR), the EU's data protection law.[129] Compared with the GDPR, however, China's Personal Information Protection Law is wider-ranging and includes potentially more restrictive requirements on cross-border data transfer. Like the GDPR, the law would allow organizations to transfer personal information collected in China overseas for "business reasons." Where the GDPR prescribes clear criteria for such transfers, however, the Personal Information Protection Law does not define the term and mandates that such transfers must pass a security assessment.[130] The GDPR's requirements for cross-border transfer are generally less obstructive and do not require a government-operated security assessment for each instance of cross-border information transfer, instead operating on the basis of agreements or contracts at a national or company level.[131] China's Personal Information Protection Law also applies to all individuals inside China, including foreign nationals, meaning that organizations outside of China must still meet specific technical requirements to process data of foreign nationals residing in China.[132] While the GDPR similarly applies to data of all EU res-

trolled by the Cyberspace Administration of China and the Ministry of Finance), China Media Group, and Beijing Municipality Cultural Investment Development Group. The deal granted the CCP greater supervision and control over ByteDance's domestic social media platforms, Douyin and Toutiao, but not TikTok, a subsidiary of an offshore ByteDance entity. For more background on the sale, see Chapter 2, Section 3, "The Chinese Government's Evolving Control of the Nonstate Sector." Juro Osawa and Shai Oster, "Beijing Tightens Grip on ByteDance by Quietly Taking Stake, China Board Seat," *Information*, August 16, 2021.

idents, China's already strict technical requirements carry greater compliance burdens for organizations outside of China.[133]

The laws support China's promotion of cybersovereignty, in which cyberspace, data, and networks are regarded as sovereign territory subject to local laws of individual countries. China's development of its data governance regime is also part of a broader pattern of CCP attempts to influence global data governance norms. The Data Security Law says the Chinese government intends to create a domestic standardization system for data and participate in "formulation of international rules and standards."[134] In September 2020, Chinese Foreign Minister Wang Yi presented a Global Initiative on Data Security, which Foreign Ministry spokesman Zhao Lijian characterized as "contributing China's wisdom to international rules-making" for data.[135] The initiative urges countries not to weaponize the use of data while also encouraging cybersovereignty and local data storage—a policy that has raised concerns among human rights experts as well as U.S. tech firms.[136]

China Expands Lawfare to Respond to Foreign Sanctions

In late 2020 and 2021, the Chinese government developed a legal and regulatory framework to counter foreign restrictions on Chinese companies and individuals. A central objective in China's expanding legal arsenal is to impose costs on foreign companies that limit technology exports to China in compliance with U.S. restrictions. General Secretary Xi emphasized the need to rely on lawfare in the buildup to the Party's centennial, saying, "We must use the law as a weapon and occupy the moral high ground of the rule of law."[137] This expanded set of tools focuses on broadly defined "national security and interests" and "national security with Chinese characteristics," which covers military, political, economic, and "development security."[138] The laws and measures adopted to achieve this vision of national security target companies, organizations, nongovernmental organizations, think tanks, and the family members or affiliates of any such persons inside or outside of China whose actions or statements run contrary to the CCP's interests (see Table 1).

Where China's government had already pursued retaliation against foreign critics, it has now formalized tools and punishments. For instance, between July and August 2020, the CCP sanctioned 11 U.S. lawmakers and nongovernmental organization leaders critical of repression in Hong Kong but did not clarify the scope of these sanctions.* Even as China's Anti-Foreign Sanctions Law was under development, the CCP moved ahead with visa sanctions on a range of individuals in the United States and Europe, many of whom criticized the Chinese government's treatment of Uyghurs. In January 2021, China sanctioned 28 members of the Trump Administration just after they left office, including former Secretary of State Mike Pompeo.[139] In July 2021, in retaliation for the

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*Sanctioned individuals included U.S. Senators Tom Cotton (R-AK), Josh Hawley (R-MO), Marco Rubio (R-FL), and Pat Toomey (R-PA); U.S. Representative Chris Smith (R-NJ); Carl Gershman (then National Endowment for Democracy President); Derek Mitchell (National Democratic Institute President); Kenneth Roth (Human Rights Watch Executive Director); Daniel Twining (International Republican Institute President); and Michael Abramowitz (Freedom House President). Eva Dou and Anna Fifeld, "China Puts Sanctions on U.S. Lawmakers, NGO Chiefs, in Tit-for-Tat Retaliation," *Washington Post*, August 10, 2020.

Table 1: Select Chinese Measures Enacted or Introduced in 2020–2021

Title	Purpose	Date
Blocking and Retaliation		
Export Control Law	Regulates dual-use technology and codifies license regime for sensitive products, services, and other transfers.	Effective December 2020
Measures for Blocking Improper Extraterritorial Application of Foreign Laws and Measures	Creates authority for China's government to block implementation of secondary sanctions and prohibit compliance with some foreign laws and measures.	Effective January 2021
Measures for Security Review of Foreign Investment	Establishes security review process for all inbound foreign investment.	Effective January 2021
Anti-Foreign Sanctions Law	Creates legal tool for reciprocating against foreign sanctions and authority to impose retaliatory sanctions on a wide variety of targets, along with family members and affiliates.	Effective June 2021
Data Governance		
Data Security Law	Establishes system of data classification and obligations for organizations handling data, including security requirements and assessments for its protection, collection, use, and transfer internally and overseas.	Effective September 2021
Personal Information Protection Law	Establishes rights to personal information for all individuals in China and obligations for organizations handling personal information for its protection, collection, use, and transfer internally and overseas.	Effective November 2021
Several Provisions on the Management of Automobile Data Security (Draft)	Outlines obligations for organizations on the collection, protection, sharing, and use of data collected by automobiles.	Introduced May 2021
Cybersecurity Review Measures (Draft)	Outlines security review procedures for operators of critical information infrastructure and organizations handling data sensitive to national security, including IPOs and organizations handling data of more than one million users.*	Introduced July 2020
Opinions on Strictly Cracking Down on Illegal Securities-Related Activity in Accordance with Law	Calls for stronger supervision and enforcement of cross-border listings, including improvement of laws and regulations related to data security, transfer, and management involved in such listings.	Introduced July 2021
Internet Information Service Algorithmic Recommendation Management Provisions (Draft)	Establishes new security, privacy, and content management rules for internet services that rely on algorithmic recommendations. Providers allow consumers greater control to enable or disable algorithmic recommendations.	Introduced August 2021

Source: Compiled by Commission Staff.

*The Cybersecurity Administration of China released a new draft of the Cybersecurity Review Measures in July 2021 but added several amendments to the draft later that month, including the one million user threshold.

Biden Administration's joint Hong Kong Business Advisory, Beijing announced its sixth set of sanctions against U.S. individuals and organizations this year. The list named those who have long stood by Hong Kong in defense of human rights and democracy, including the Chairman of this Commission.*

The Chinese government's economic and trade-related rules create broad new authorities and restrictive processes with little to no redressability. Many provisions relating to trade and investment, such as those in the *Measures for Security Review of Foreign Investment*, are focused on "key technologies and other important sectors," but the rules do not provide clear definitions of these terms. These laws also provide regulators and enforcement agencies with broad powers to assess foreign entities and transactions, such as potentially intrusive security reviews for foreign investors, or to erect new temporary restriction mechanisms without specification of standards or processes. Many of these laws also lack any recourse mechanism for parties that object to or find fault with an agency's judgment. For example, China's Export Control Law, released in October 2020 after three years of drafting, introduces a "temporary license" scheme that would give agencies authority to prohibit exports for at least two years, regardless of the end user.[140] Chinese authorities could weaponize this mechanism to cut off countries from critical inputs such as rare earth minerals, for which China currently dominates production.

Released in January 2021, the Measures for Security Review of Foreign Investment require a broad range of inbound investments to China across several sectors to undergo a security review. A joint office under China's National Development and Reform Commission and the Ministry of Commerce conducts the review, but the measures provide neither a rubric or standards for passing or failing the review, nor any redress for rejected investors.[141] Furthermore, the Chinese review will be mandatory rather than voluntary and potentially apply to a broad set of inbound transactions.[142] With its vague definitions and potentially arbitrary rejection or delay of investments, China's foreign investment review could be used to retaliate against companies or coerce countries with companies seeking to invest in China.[143]

Chinese lawmakers have added more legal tools to directly counter U.S. policies with "reciprocal measures," which are susceptible to abuse and arbitrary application. The Export Control Law provides agencies with explicit authorization to "take reciprocal measures" against foreign "abuses" of export control rules. The law also gives Chinese export control authorities the right to investigate entities outside of China that either violate the law's provisions or hinder China's nonproliferation and related international obligations.[144] In January 2021, the Ministry of Commerce also issued *Mea-*

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*Sanctioned individuals included Wilbur Ross (former Secretary of Commerce), Carolyn Bartholomew (U.S.-China Economic and Security Review Commission Chairman for the 2021 Annual Report Cycle), Jonathan Stivers (former Staff Director of Congressional-Executive Commission on China), DoYun Kim (National Democratic Institute International Affairs staff), Adam Joseph King (International Republican Institute senior program manager), and Sophie Richardson (Human Rights Watch China Director). Ben Hooper, "China Announces Sanctions Against Wilbur Ross, Six Others in U.S.," *UPI*, July 24, 2021.

sures for Blocking Improper Extraterritorial Application of Foreign Laws and Measures to protect Chinese entities from foreign measures or laws designed to inhibit China's economic and trade activities. The measures allow relevant Chinese authorities to issue a "prohibition order" to nullify the relevant extraterritorial foreign measures that would obstruct Chinese economic, trade, or related activities.[145] Chinese lawmakers are also developing a legal framework for countering foreign data security or personal information protection restrictions. Both China's new Data Security Law, passed in June 2021, and Personal Information Protection Law, passed in August 2021, establish the Chinese government's authority to enact reciprocal restrictions against any foreign country that targets China.[146]

In 2021, the Chinese government introduced its Anti-Foreign Sanctions Law to target a wider range of threats beyond trade and investment restrictions. Scholars of China's legal system believe the primary purpose of the Anti-Foreign Sanctions Law is to formalize China's sanctions process as well as prohibit all companies operating in China from complying with foreign sanctions.[147] The scope of punishable entities under the law is exceptionally broad. It targets "persons or organizations that directly or indirectly participate in the drafting, decision-making, or implementation of the discriminatory restrictive measures."[148] The law also extends potential retaliation to family members, associates, and affiliated organizations of any such person or organization identified with China-directed sanctions.*[149] In particular, the law puts foreign companies operating in China in an even more precarious position as they navigate bilateral tensions and compliance with conflicting legal regimes.[150] The law also provides for the Chinese government to retaliate against those with "conduct endangering our nation's sovereignty, security, or development interests."[151] Along with punishing companies that comply with foreign sanctions, the Anti-Foreign Sanctions Law provides that the government may sue violating companies for any related compensation loss.[152] For instance, a Chinese supplier placed on the Entity List could sue a foreign purchaser in Chinese court for canceling a contract in compliance with U.S. law.

U.S.-China Commercial Ties Deepen despite Continued Friction

Even as Washington and Beijing work to reduce economic interdependence, bilateral trade is returning to pre-tariff levels and U.S. capital flows to China are on the rise, weaving the two economies closer together. The Biden Administration is consolidating a complex mix of the Trump Administration's policy initiatives to defend against China's unfair economic policies and threats to U.S. national security. The Biden Administration has signaled that its priorities are to secure U.S. supply chains, boost U.S. competitiveness, and coordinate with U.S. allies and partners. China's government is seeking to mitigate its vulnerability to foreign economies and legal systems, particularly U.S. actions, while deepening other countries' economic dependence on China. The Chinese government's crack-

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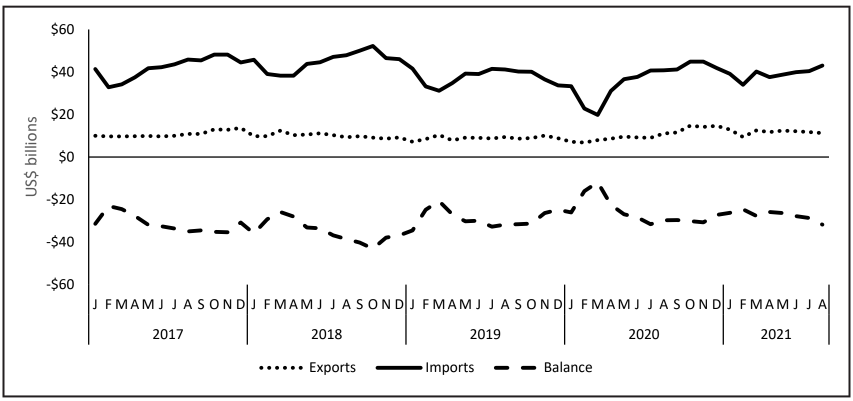
* Under Article 6 of the Anti-Foreign Sanctions Law, punishments for violators include, but are not limited to, denial or cancelation of visas, deportation, asset seizure or freezing, and prohibition or restriction on transactions. "Countermeasures" may include any of the punishments under Article 6 of the law but are otherwise not defined and may be broader in practical implementation. China Law Translate, "Law of the PRC on Countering Foreign Sanctions," June 10, 2021.

down on Chinese tech firms listed on U.S. exchanges led to billions of dollars of losses for U.S. investors and on U.S. capital markets.

Overview of U.S.-China Commercial Ties in 2021

The bilateral trade imbalance is returning to pre-tariff levels. According to Chad Bown, senior fellow at the Peterson Institute for International Economics, in the first eight months of 2021 Chinese purchases of U.S. products covered under the Phase One Economic and Trade Agreement* stood at $89.4 billion, accounting for 69 percent of a year-to-date prorated target of $129.9 billion.†[153] Despite China's purchase commitments made under the Phase One agreement, year-to-date the U.S. goods deficit with China has continued to grow, nearing levels last seen before the U.S. government imposed tariffs on Chinese imports in 2018 (see Figure 1). The resurgence of the deficit in 2021 is attributable to recoveries in both U.S. consumption and Chinese production following sharp contractions throughout 2020 due to the COVID-19 pandemic.[154] In the first eight months of 2021, the U.S. trade deficit with China reached $219 billion, up 13.4 percent year-on-year.[155] U.S. goods exports to China in the first eight months jumped 35.2 percent year-on-year to reach $94.1 billion.[156] U.S. imports from China also continued to climb in the same period, reaching $313 billion, a year-on-year increase of 13.4 percent.[157] (The Chinese government's Phase One commitments and compliance status are summarized in the Addendum.)

Figure 1: U.S. Bilateral Trade with China, January 2017–August 2021



Source: U.S. Census Bureau, *Trade in Goods with China*, October 5, 2021.

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*The "Phase One" agreement was signed on January 15, 2020, and formed part of an effort to resolve trade tensions ongoing since March 2018, when the U.S. Trade Representative published its Section 301 investigation into China's unfair trade practices related to forced technology transfer, intellectual property theft, and innovation. For more on the Phase One agreement, see U.S.-China Economic and Security Review Commission, *The U.S.-China "Phase One" Deal: A Backgrounder*, February 4, 2020.

†As part of its Phase One trade deal commitments, China pledged to increase purchases of particular U.S. "manufactured goods, agricultural goods, energy products, and services," whereby purchase amounts "exceed the corresponding 2017 baseline amount by no less than $200 billion." Research by Chad Bown, senior fellow at Peterson Institute for International Economics, tracks China's purchases of U.S. goods covered by the agreement and compares them to annual targets prorated on a monthly basis. For more on the methodology, see Chad Bown, "U.S.-China Phase One Tracker: China's Purchases of U.S. Goods," *Peterson Institute for International Economics*, September 27, 2021.

U.S. information and communications technology (ICT) product imports led the U.S. trade deficit in advanced technology products (ATP)* with China in 2021. In the second quarter of 2021, the U.S. trade deficit in ATP with China narrowed 5 percent year-on-year to $24.6 billion, a record low in the quarterly deficit.[158] ICT products continued to constitute the vast majority of U.S. ATP imports from China in the second quarter of 2021.[159] Excluding ICT products, the United States had a $6 billion surplus in ATP with China, up 12.6 percent from the previous quarter ($5.3 billion).[160]

While bilateral foreign direct investment (FDI) flows continue to decline, portfolio investment flows are strengthening. According to data compiled by Rhodium Group, FDI flows between the United States and China fell to an 11-year low of $15.9 billion in 2020.[161] Portfolio investment flows, on the other hand, are increasing and vastly outpacing FDI. U.S. investors held as much as $1.2 trillion in equity and debt securities issued by Chinese entities at the end of 2020, up 57.5 percent from $765 billion in 2017, while Chinese holdings of U.S. securities reached $2.1 trillion at the end of 2020.[162] (For more on U.S. investor participation and interest in China's financial markets, see Chapter 2, Section 4, "U.S.-China Financial Connectivity and Risks to U.S. National Security.")

Beijing's Scrutiny of Chinese Companies Listed Overseas Increases U.S. Investor Risks

Chinese regulators' investigations into Didi Chuxing in July 2021 and elevated scrutiny of Chinese nonstate tech and education companies listed overseas underscored the distinct political risks posed by U.S.-listed Chinese companies to U.S. investors. A Cyberspace Administration of China (CAC) probe into Didi's data security practices days after its IPO on the New York Stock Exchange saw the company's share price plummet nearly 20 percent from $15.53 on July 2 to $12.49 on July 6, prompting shareholder lawsuits and calls for a U.S. Securities and Exchange Commission (SEC) investigation.[163] CAC's scrutiny of Didi was followed by the joint issuance of the *Opinions on Strictly Cracking Down on Illegal Securities Activity in Accordance with Law* by the General Office of the CCP Central Committee and State Council.[164] The opinions pledge to strengthen oversight of Chinese companies issuing securities overseas by, among other things, enhancing data security protection and oversight of cross-border data flows.[165] The Chinese government's focus on data security for overseas-listed firms is underlined in separate draft CAC draft rules requiring mandatory review for any company collecting personal information of more than one million users prior to listing abroad.[166]

While the opinions do not directly address Chinese companies' use of the variable interest entity (VIE)† structure to list over-

*Advanced technology products are a broad range of high-technology goods, including advanced elements of the computer and electronic parts industry, biotechnology, aerospace, and nuclear technology. U.S. Census Bureau, *Advanced Technology Product Code Descriptions*, September 10, 2021.

†U.S.-listed Chinese firms most attractive to investors operate in high-growth sectors such as technology, e-commerce, and telecommunications. Because these sectors are deemed sensitive by

Beijing's Scrutiny of Chinese Companies Listed Overseas Increases U.S. Investor Risks—*Continued*

seas, such firms may encounter more scrutiny moving forward. For example, legal experts note there may be rules requiring VIE-structured firms to obtain approval from Chinese regulators before additional stock issuance.[167] As Chinese regulatory constraints on U.S.-listed Chinese companies rise, the value of U.S. investor holdings of such companies may decline.[168] On July 24, China's State Council unveiled rules that would, among other things, ban China's private education companies from making profits and prohibit them from raising new foreign capital by using a VIE structure.[169] As a result of the Chinese government's regulatory actions, U.S.-listed Chinese companies lost around $400 billion in value in July 2021.[170] On September 20, the SEC issued an investor bulletin warning U.S. investors about the risks of investing in Chinese VIEs.[171] The SEC had previously directed SEC staff to ensure Chinese VIEs provide more robust disclosure in their filings.*

While there were 248 Chinese companies listed on U.S. exchanges with a total market capitalization of $2.1 trillion as of May 5, 2021, this number does not reflect the value of U.S. investor holdings of U.S.-listed Chinese companies.[172] This is because U.S. investors in U.S.-listed Chinese companies are only minority investors.

China remains a priority market for U.S. companies despite rising concerns about China's business environment and heightening political tensions. According to the 2021 American Chamber of Commerce in China (AmCham China) Business Climate Survey, nearly 85 percent of respondents are not considering relocating manufacturing or sourcing from China.† [173] Despite this deep commitment to the Chinese market, respondents indicate rising concern about China's business environment. For example, concerns about data security and increasing Chinese protectionism ranked as AmCham China member companies' fifth- and seventh-highest concerns, respectively, after being unranked in the previous year.[174] For the first

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the Chinese government, direct foreign ownership in them is restricted. Chinese firms thus use VIE structures to circumvent these restrictions and raise capital in overseas financial markets. These structures create effective foreign ownership of the company through an abstract mix of legal contracts and equity ownership while still loosely complying with Chinese foreign ownership laws. For more on the risks associated with VIE structures, see U.S.-China Economic and Security Review Commission, Chapter 3, Section 1, "U.S.-China Commercial Relations," in *2019 Annual Report to Congress*, November 2019, 175–179; Kevin Rosier, "The Risks of China's Internet Companies on U.S. Stock Exchanges," *U.S.-China Economic and Security Review Commission*, September 12, 2014.

*SEC staff have been directed to ensure a Chinese VIE discloses a number of factors, including whether it faces "uncertainty about future actions by the government of China that could significantly affect the operating company's financial performance and the enforceability of the contractual arrangements," whether the VIE received or was denied permission from China's authorities to list in the United States, and detailed information on the financial relationship between the China-based company and its VIE. Gary Gensler, "Statement on Investor Protection Related to Recent Developments in China," *U.S. Securities and Exchange Commission*, July 30, 2021.

†The 2021 AmCham China Business Climate Survey was completed by 345 U.S. companies operating in China from October 21 to November 23, 2020. Grady McGregor, "The Outlook of U.S. Firms in China Changed Dramatically after Biden's Election," *Fortune*, March 9, 2021; John Liu and Yujing Liu, "U.S. Firms in China See Growth, Improved Ties after Pandemic," *Bloomberg*, March 8, 2021.

time in the survey's history, member companies identified rising tensions in U.S.-China relations as the top challenge to doing business in China, up from the third spot in 2020.* [175] According to AmCham China Chairman Greg Gilligan, friction in the bilateral relationship is resulting in discriminatory treatment for U.S. companies, with local Chinese government officials "offer[ing] preference to domestic industry," though public reports of such unfair treatment are unavailable.[176] AmCham China member companies also worry about the prospect of consumer boycotts against them should they speak out about China's policy choices.[177] In March 2021, Swedish apparel retailer H&M and other foreign brands were met with an online backlash from Chinese consumers following reports the companies had voiced concern about forced labor in China's Xinjiang Province.[178]

Biden Administration Maintains Pressure on China

In a speech outlining the Biden Administration's foreign policy, U.S. Secretary of State Antony Blinken noted the U.S. relationship with China "will be competitive when it should be, collaborative when it can be, and adversarial when it must be."[179] The Biden Administration has identified the Chinese government's disregard for democratic values in Hong Kong, abuse of human rights in Xinjiang, intimidation of Taiwan, cyberattacks on the United States, and economic coercion toward U.S. allies as key priorities to manage in the bilateral relationship.[180] While the Biden Administration has highlighted the same challenges in the U.S.-China relationship as the Trump Administration did, its frequent engagement with U.S. allies and international institutions points to a focus on multilateralism as a means of confronting Beijing.

The Biden Administration is continuing heightened use of export controls and financial sanctions to respond to Chinese threats to U.S. interests. A defining feature of the Trump Administration's approach to addressing China's unfair trade and human rights practices was the use of unilateral restrictions to prevent the flow of U.S. technology to Chinese military end users, entities engaged in human rights abuses, and companies supporting China's extraterritorial land reclamation efforts. Additionally, the Trump Administration introduced financial sanctions on key officials responsible for repressing civil liberties in Hong Kong. The Biden Administration appears to be continuing both trends. On July 9, 2021, the Bureau of Industry and Security at the U.S. Department of Commerce announced the addition of 14 Chinese companies to its Entity List due to their role in enabling the Chinese government's repression in Xinjiang.[181] The Bureau of Industry and Security also placed export controls on seven Chinese supercomputer developers in April 2021, citing the entities' involvement in China's efforts to develop nuclear and other advanced military weapons.[182] Sep-

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* "Rising tensions in U.S.-China relations" first appeared as a business challenge in the 2018 AmCham China Business Climate Survey, when 45 percent of respondents ranked it as the third-highest challenge. 45 and 41 percent of AmCham China member companies continued to rank it as the third-highest business challenge in both the 2019 and 2020 Business Climate Surveys, respectively. In the 2021 Business Climate Survey, 78 percent of AmCham China member companies ranked it as the top challenge to doing business. AmCham China, *2020 China Business Climate Survey Report*, March 2020, 51; AmCham China, *2019 American Business in China White Paper*, April 2019, 8.

arately, while visiting Japan and South Korea, Secretary Blinken announced sanctions for financial institutions that conduct transactions with 24 Chinese and Hong Kong officials per the Hong Kong Autonomy Act on March 17, 2021.[183]

Escalating trade frictions, intensifying U.S.-China technological competition, and the outbreak of the COVID-19 pandemic catalyzed U.S. efforts to address supply chain vulnerabilities vis-à-vis China. Executive orders issued by then President Donald Trump resulted in, among other actions, preliminary studies into U.S. dependence on China for critical minerals and pharmaceuticals and the removal of Chinese firms from U.S. telecommunications networks.* The Biden Administration's actions in 2021 underline a continued focus on mitigating the risks of bilateral economic interdependence in select sectors and heightening U.S. capabilities in others to better compete with China economically. On June 8, 2021, the Biden Administration released a 250-page report assessing supply chain risks and vulnerabilities in semiconductor manufacturing, large-capacity batteries, critical materials and minerals, and pharmaceuticals and active pharmaceutical ingredients.† [184] The United States relies on imports and faces risks of supply chain disruption across all four product categories, with China either dominating large portions of their supply chain (e.g., critical materials and minerals, pharmaceuticals, and active pharmaceutical ingredients) or seeking to secure global leadership (e.g., semiconductors, large-capacity batteries). The review builds on initial investigations undertaken by the Trump Administration and prioritizes reshoring production to the United States to bolster U.S. economic competitiveness. The report is also notable in signaling the use of trade enforcement actions to defend against China's unfair economic practices. For example, a U.S. Trade Representative-led "trade strike force" aims to coordinate unilateral and multilateral enforcement actions against unfair foreign trade practices harming U.S. supply chains and ensure "supply chain resilience [is] incorporated into the U.S. trade policy approach towards China."[185] Separately, as part of a comprehensive review of U.S. supply chains, the Biden Administration indicated the Department of Commerce will explore whether to initiate a Section 232 investigation‡ into the

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*For example, former President Trump's Executive Order 13953 on Addressing the Threat to the Domestic Supply Chain from Reliance on Critical Minerals from Foreign Adversaries and Supporting the Domestic Mining and Processing Industries and Executive Order 13944 on Combating Public Health Emergencies and Strengthening National Security by Ensuring Essential Medicines, Medical Countermeasures, and Critical Inputs Are Made in the United States sought to further investigate and rectify U.S. productive gaps in critical minerals and pharmaceutical products, respectively. Executive Office of the President, "Addressing the Threat to the Domestic Supply Chain from Reliance on Critical Minerals from Foreign Adversaries and Supporting the Domestic Mining and Processing Industries," *Federal Register* 85:193 (September 30, 2020); Executive Office of the President, "Combating Public Health Emergencies and Strengthening National Security by Ensuring Essential Medicines, Medical Countermeasures, and Critical Inputs Are Made in the United States," *Federal Register* 85:158 (August 6, 2020).

†The report compiled individual reviews by the Department of Commerce on semiconductor manufacturing and advanced packaging, Department of Energy on large-capacity batteries, Department of Defense on critical materials and minerals, and Department of Health and Human Services on pharmaceuticals and active pharmaceutical ingredients. The reviews were completed pursuant to Executive Order 14017, America's Supply Chains, which also mandates a separate one-year review of the overall resilience of the defense, healthcare, technology, energy, transport, and agricultural sectors. White House, *Executive Order on America's Supply Chains*, February 24, 2021.

‡Under Section 232 of the Trade Expansion Act of 1962, the Department of Commerce can investigate any product to determine whether it "is being imported into the United States in

national security impact of neodymium magnets used in automotive and electric vehicle motors and industrial applications and sourced chiefly from China.[186]

The U.S. government is continuing to work to ensure U.S. telecommunications networks are free from Chinese technology providers. On March 17, the Department of Commerce announced it had served subpoenas on "multiple Chinese companies that provide ICT services in the United States," without specifying which firms were targeted.[187] The move was completed pursuant to former President Trump's Executive Order 13873: Securing the Information and Communications Technology Services Supply Chain, for which the Department of Commerce issued implementing rules in January 2021.[188] Separately, the Federal Communications Commission published a new list of ICT equipment and services "deemed to pose an unacceptable risk to the national security of the United States or the security and safety of United States persons."* The list identified five Chinese companies—Huawei, ZTE, Hytera Communications, Hikvision Digital Technology, and Dahua Technology—as posing such a risk.[189]

The U.S. government pursues unilateral action and multilateral coordination. The Biden Administration's emerging multilateralism capitalizes upon shared values to rally allies and partners against Chinese domestic abuses like forced labor in Xinjiang while building alliances to address more pragmatic concerns such as strategic competition in the technology sector and supply chain security.

- *Coercion and human rights:* In March 2021, the U.S. Office of Foreign Assets Control, in conjunction with authorities in the United Kingdom (UK), EU, and Canada, sanctioned a number of Chinese officials for their involvement in human rights abuses in Xinjiang.[190] The United States has also released separate joint statements with Japan and the Group of Seven (G7)† reflecting common opposition to China's antidemocratic and coercive policies. The statements condemned Beijing's human rights abuses in Xinjiang, repression of Tibetans, stifling of democracy in Hong Kong, and aggression in the Taiwan Strait and South China Sea, as well as economic coercion applied to countries speaking out against Chinese policies.[191]
- *COVID-19 assistance and relief:* In March 2021, Quadrilateral Security Dialogue (Quad)‡ members the United States, Japan,

such quantities or under such circumstances as to threaten to impair the national security" of the United States. If the Department of Commerce finds imports impair or threaten to impair U.S. national security, the president may impose tariffs or quotas to adjust imports. In March 2018, then President Trump imposed 10 percent and 25 percent tariffs on aluminum and steel imports, respectively, including those from China, as a result of a Section 232 investigation undertaken by the Department of Commerce. Rachel E. Fefer et al., "Section 232 Investigations: Overview and Issues for Congress," *Congressional Research Service*, May 18, 2021.

*This list was developed pursuant to Section 2(a) of the Secure and Trusted Communications Networks Act of 2019, which became law in March 2020.

†The G7 consists of seven democratic advanced economies: Canada, France, Germany, Italy, Japan, the UK, and the United States. The countries' heads of state as well as representatives from the EU meet annually to discuss economic policies and issues of global governance. The UK hosted the 2021 G7 Summit in June. Sophie Morris, "What Is the G7? 2021 Summit Sees Boris Johnson Host Biden, Macron and Others in Cornwall," *Sky News*, June 6, 2021.

‡The Quadrilateral Security Dialogue is an informal alliance among democracies Japan, Australia, India, and the United States that supports their coordination on a range of issues of

India, and Australia announced the Quad Vaccine Partnership. The Quad intends to expand vaccine manufacturing capacity in India and deliver at least one billion vaccine doses to Indo-Pacific countries by the end of 2022.[192] The partnership will seek to counter China's global vaccine diplomacy, which uses vaccines as leverage to accomplish political objectives in recipient countries.

- *Technology competition and cybersecurity:* In June 2021, the United States and the EU launched the U.S.-EU Trade and Technology Council, which will likely focus on combatting China's domination of components of vital technology supply chains and its drive to shape global standards for emerging technologies.[193] Additionally, in July 2021 the Biden Administration in coordination with allies in NATO, the EU, Australia, the UK, Canada, Japan, and New Zealand condemned China's state-sponsored hack of Microsoft Exchange email server software as well as China's broader cyberespionage activities targeting governments, political organizations, and key industries.[194]

U.S.-China Climate Cooperation Complicated by Bilateral Tensions

Climate change has emerged as a potential area for U.S.-China cooperation, though China's attempts to condition deeper cooperation on U.S. compliance with its geopolitical objectives may derail incipient collaboration. After both parties signed a joint statement in April 2021 affirming their commitment to cooperation on climate, Foreign Minister Wang indicated that "smooth cooperation" would only be possible if the United States "no longer interferes in China's internal affairs," a blanket term used by China's government to condemn international criticism of its policies in Xinjiang and Hong Kong as well as its claims over Taiwan and the South China Sea.[195] Competition over leadership in clean energy technology will likely further complicate U.S.-China climate cooperation. Reflecting this point, Secretary Blinken said, "It's difficult to imagine the United States winning the long-term strategic competition with China if we cannot lead the renewable energy revolution."[196] At present, China is a market leader in the sector, and accounts for eight of the top ten solar companies globally, for example.[197] China also dominates world supply chains for components used in clean energy technologies, including refining critical minerals such as lithium, rare earth minerals, and copper.[198] The Biden Administration's 100-day supply chain review pursuant to Executive Order 14017 investigated large-capacity batteries and critical minerals and ultimately issued recommendations for reshoring production of renewable energy supply chain components to the United States.[199]

mutual interest, including regional security, economic growth, climate change, and global health. Sumitha Narayanan Kutty and Rajesh Basrur, "The Quad: What It Is—And What It Is Not," *Diplomat*, March 24, 2021; White House, *Quad Leaders' Joint Statement: "The Spirit of the Quad,"* March 12, 2021.

China Seeks to Project Strength but Preserve Bilateral Economic Relations

To maintain economic stability without appearing conciliatory, the CCP continues to enlist U.S. business to advocate for easing commercial tensions. Even as China's government emphasizes the importance of the domestic economy to drive growth, strong exports to the United States during 2020 and 2021 underscore the mutual dependence between the Chinese and U.S. economies. China's government has consequently tried to forestall further deterioration of commercial ties with the United States, but without moderating its stance on Xinjiang, Hong Kong, or other self-declared "internal affairs." Two resulting patterns have emerged in China's approach to the United States in 2021.

- *Proportional but not escalatory policy and rhetoric:* Ryan Hass, China expert at the Brookings Institution, observes that in the lead-up to the conclusion of the Phase One Trade Agreement in January 2020, China's leadership was calibrated and at times even conciliatory in response to U.S. policy action toward China.[200] Even as relations soured further following the outbreak of COVID-19, China's tit-for-tat exchanges with the United States have remained proportional, for instance closing the U.S. embassy in Chengdu in response to the U.S. closure of China's embassy in Houston for alleged involvement in stealing scientific research.[201] By contrast, China's retaliatory actions against U.S. allies and partners have been unrestrained and escalatory, described further under "Coercion in China's Global Economic Relations" below.
- *Courting U.S. businesses to safeguard commercial ties:* China's government applies pressure on the United States, touting the openness and strength of China's economy and engaging U.S. companies, investors, and lobbyists to advocate for smooth commercial relations. China hosted a number of prominent business leaders at the April 2021 Boao Forum, an annual economic conference likened to a Chinese version of the World Economic Forum. According to the forum's General Secretary Li Baodong, U.S. executives from Goldman Sachs, Qualcomm, and asset manager Bridgewater Associates, along with former U.S. Treasury Secretary Henry Paulson, attended a closed-door meeting with Chinese officials to discuss how to defuse trade frictions.[202] Chinese tech firms have also expanded their lobbying presence in Washington, while Wall Street remains eager to maintain smooth commercial ties as China's government opens its financial services sector to foreign investment.[203]

China's government is simultaneously attempting to decrease its dependence on the United States while increasing the rest of the world's dependence on China. A key element of China's bid to secure supply chains is to increase its role in higher-value supply chains even as it reduces its reliance on foreign inputs. Matt Pottinger, distinguished visiting fellow at the Hoover Institution and former deputy national security adviser, called this strategy "offensive decoupling" or a "one-way decoupling" in testimony before the Commission, noting that China aims to use economic leverage to advance geopolitical goals.[204] As part of its effort to strengthen "one-way" economic integration while reducing exposure to the United States, China's government has pursued increased multilateral cooperation in late 2020 and 2021, intending to expand its regional influence and undermine transatlantic cooperation against China, among other blocs of allied resistance.

- *China-Southeast Asia trade pact:* In November 2020, China, the 10 ASEAN countries, South Korea, Australia, New Zealand, and Japan finalized the Regional Comprehensive Economic Partnership (RCEP). Still requiring ratification from its 15 signatories before going into effect, the trade agreement largely codifies existing tariff schedules but reduces barriers to intraregional production.[205] In increasing the ease with which RCEP signatories can transship intermediary goods, RCEP will likely strengthen supply chain integration between Southeast Asian countries and China, further deepening the region's economic dependence on China.[206]
- *China-EU investment agreement:* Additionally, China and the EU finalized the Comprehensive Agreement on Investment (CAI) at the end of 2020. China seemingly agreed to concessions after the CAI had been in discussion for seven years and 35 rounds of talks to conclude the agreement ahead of President Joe Biden's inauguration.[207] The future of the CAI remains in doubt, however, since the EU Parliament refused to ratify it after China imposed sanctions on European officials and academics, described in the following section.[208]
- *China's application to join transpacific trade pact:* In September 2021, China's Ministry of Commerce submitted a formal application to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).* [209] Beijing's application followed the announcement of AUKUS, a trilateral security pact between Australia, the UK, and the United States,† though General Secretary Xi had signaled interest in joining CPTPP in November 2020.[210] Geopolitical frictions between China and CPTPP signatories as well as Beijing's distortive economic practices are likely to frustrate Beijing's bid to join the trade pact.

Coercion in China's Global Economic Relations

In 2020 and 2021, China's government significantly expanded its use of economic coercion to punish critics and compel behavior it desires from foreign countries and firms. Though it has long used access

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*The CPTPP is a free trade agreement between Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, Peru, New Zealand, Singapore, and Vietnam signed in March 2018 and entered into force for all signatories by September 2021. CPTPP signatories began accession negotiations with the UK in June 2021. Australian Government Department of Foreign Affairs and Trade, *Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)*, 2021.

†AUKUS was announced on September 15, 2021. Under the pact, the United States, the UK, and Australia agreed to hold consultations over 18 months to determine how to best build a new nuclear-powered submarine fleet for Australia. The three countries also intend to deepen cooperation on a range of other security and defense priorities, including strengthening joint capabilities and interoperability in cyber, artificial intelligence, quantum technologies, and additional underseas capabilities. Michael Clarke, "The AUKUS Nuclear Submarine Deal: Unanswered Questions," *Diplomat*, September 22, 2021; U.S. Department of State, *Secretary Antony J. Blinken, Secretary of Defense Lloyd Austin, Australian Foreign Minister Marise Payne, and Australian Defence Minister Peter Dutton at a Joint Press Availability*, September 16, 2021; White House, "Remarks by President Biden, Prime Minister Morrison of Australia, and Prime Minister Johnson of the United Kingdom Announcing the Creation of AUKUS," September 15, 2021.

to China's domestic market and other forms of economic leverage as both a stick and a carrot, China's government is increasing the frequency and breadth of its coercive tactics, as well as the variety of issues that trigger retaliation. For instance, ostensibly nonstate firms, particularly Chinese e-commerce companies, have removed foreign firms from their platforms for raising concerns over forced labor in Xinjiang's cotton and textile industry.*[211] Chinese consumers are boycotting even more foreign firms for the same reason.[212] Additionally, where in the past China retaliated on matters it terms "core interests," such as the status of Taiwan, China's government is now acting when countries move against its economic interests, such as excluding Huawei from their telecommunications networks. Aside from heightened retaliation, in 2021 China's government mounted a pressure campaign against countries around the world to defer to China's geopolitical priorities in exchange for access to its indigenously developed COVID-19 vaccines. China's use of inducements to influence domestic policy decisions in South American countries reflects a growing tendency to attempt to intervene in other countries' affairs.

China Increases the Scope and Frequency of Economic Retaliation

Following Australia's support for an independent inquiry into China's handling of the early stages of COVID-19, China imposed import bans on multiple Australian products. Initially, China's trade restrictions targeted agricultural products, including wine, barley, and beef, but later extended to a ban on coal.†[213] Prior to the ban, which has not been officially acknowledged by the CCP, China was Australia's second-largest export market for coal, accounting for 21 percent of Australian coal exports in 2020.[214] Following the ban, Australian coal producers have been able to divert shipments to other countries, most notably Brazil and India.[215] Consequently, the impact on Australian coal producers appears to have been minimal, with the Australian government reporting that the overall value of Australia's global coal exports rose 12.7 percent year-on-year in June 2021.[216] Furthermore, the overall volume of Australian exports to China has remained relatively unchanged, with strong sales of iron ore. Beijing has refrained from placing trade restrictions on Australian iron ore, for which there are no

*The Trump Administration banned U.S. imports of cotton and tomatoes from Xinjiang on January 13, 2021, due to forced labor concerns. On June 24, the Biden Administration announced a withhold release order on U.S. imports of solar panel materials from Xinjiang-based metal producer Hoshine Silicon Industry over forced labor concerns. According to the U.S. Department of Labor, artificial flowers, bricks, Christmas decorations, coal, cotton, electronics, fireworks, fish, footwear, garments, gloves, nails, toys, hair products, polysilicon, textiles, thread and yarn, and tomato products are all produced in China using forced labor. The last five categories, in particular, are produced using forced labor from Muslim minorities, including Uyghurs. Bernreuter Research, "What the U.S. Ban on Hoshine Silicon Means for the PV Industry," June 25, 2021; Ana Swanson, "U.S. Bans All Cotton and Tomatoes from Xinjiang Region of China," *New York Times*, January 13, 2021; U.S. Department of Labor International Bureau of Labor Affairs, *Against Their Will: The Situation in Xinjiang*.

†The specific trade restrictions have varied by product. For instance, Beijing placed duties of 80.5 percent on Australian barley and up to 218 percent on Australian wine after antidumping investigations. Chinese authorities suspended imports from several Australian beef producers for what they claimed were health and labeling problems. Saheli Roy Choudhury, "Australia Weighs Taking China to the WTO Again—This Time for a Dispute over Wine," *CNBC*, June 2, 2021; Saheli Roy Choudhury, "Here's a List of the Australian Exports Hit by Restrictions in China," *CNBC*, December 17, 2020.

readily available substitutes.[217] Meanwhile, the coal ban has contributed to rising coal prices in China, as prices for both domestic and other foreign sources of coal have risen.[218] The ban has also exacerbated domestic coal supply constraints. In June, coal shortages in Guangdong Province led factories in several cities to ration their use of electricity.[219]

Chinese economic coercion against European political bodies, individual governments, companies, and individuals rose significantly in 2021. The escalation occurred in tandem with Chinese trade negotiators working with the EU to finalize the text of the CAI. The most prominent of these actions was the Chinese government's March 2021 announcement of sanctions against ten European individuals in government and academia, along with four European organizations, including the Mercator Institute for China Studies.[220] Rather than pressure the EU into ratification, the CCP's economic coercion tactics have instead stalled the possibility of progress on the bilateral investment deal. The European Parliament committed to cease talks on the CAI and the possibility of ratification until China lifted sanctions.[221] The latest example of country-specific retaliation involves the Chinese government recalling its ambassador to Lithuania in early August 2021 after the Lithuanian government announced it would allow Taiwan to set up a de facto embassy in July.* China then demanded Lithuania recall its ambassador to China, and the following week it unofficially ordered a halt to direct freight rail from China to the Balkan country.[222] Lithuanian food producers and agricultural exporters also reported that the Chinese government had refused or halted renewal of their export permits, alleging the presence of pests and crop diseases.[223] The economic impact for Lithuania is likely to be insubstantial, as importers can still acquire Chinese goods through indirect routes and Lithuania's total trade volume with China is relatively low.[224] (For more background on these sanctions, see Chapter 3, Section 1, "Year in Review: Security, Politics, and Foreign Affairs.")

Increasingly sensitive to commentary on the CCP's actions in Xinjiang, the Chinese government has not spared foreign private companies from retaliation. In March 2021, Chinese social media and state media rediscovered statements from Swedish fast fashion giant H&M, German sportswear company Adidas, and several other foreign brands on avoiding sourcing cotton from Xinjiang.†[225] Chinese social media platforms teemed with outrage over the companies' statements and state television networks called for boycotts of the brands.[226] Tmall, China's largest business-to-consumer e-commerce platform, removed H&M from its website, and H&M reported a 23 percent drop or $74 million loss in sales in Q2 2021.[227] H&M released a statement at the end of March that did not

*Taiwan maintains "representative offices" that function as de facto embassies in many European countries, but these are generally called "Taipei representative offices" in deference to China's claim that Taiwan is part of its sovereign territory. By contrast, Taiwan's office in Lithuania will be called a "Taiwan representative office." Reid Standish, "Beijing's Spat with Lithuania Sets the Stage for Shaky New Era of Europe-China Ties," *Radio Free Europe Radio Liberty*, August 17, 2021.

†These companies also participate in the Better Cotton Initiative, a nonprofit focused on sustainable and ethical cotton production that referenced forced labor abuses in Xinjiang throughout 2020. Better Cotton Initiative, "Task Force on Forced Labour and Decent Work," January 2021.

explicitly mention Xinjiang or cotton but reiterated commitments to both "responsible sourcing" and the Chinese market.[228] While Adidas remained available on Tmall, its sales in April 2021 dropped 78 percent year-on-year.[229] Adidas did not release a statement and neither company has issued an apology or restarted sourcing of Xinjiang cotton, as the Chinese media mob had demanded. The Chinese government has indicated it will use other administrative means, such as product labeling requirements and safety warnings, to limit market access for foreign companies critical of the CCP's actions.

The CCP has also demonstrated a willingness to apply economic coercion on behalf of its national champions. In response to Sweden's ban on Huawei equipment incorporation in the country's 5G infrastructure, the CCP has threatened Swedish company Ericsson with exclusion from the Chinese market.[230] Ericsson is a top competitor of Huawei in 5G equipment, but in Q2 2021, revenue in China declined for the first time in three years with a sharp decrease of 63.4 percent.[231] Chinese negotiators had previously attempted to insert language into the CAI on penalizing EU member states for banning Huawei from 5G networks and made vague threats to the UK when UK Prime Minister Boris Johnson announced a similar prohibition on Huawei.[232] Despite this increasing political risk, a 2021 business outlook survey conducted by the European Chamber of Commerce in China reported that European firms are nonetheless "committed to the China market now more than ever."[233]

Addendum: China's Phase One Trade Agreement Commitments and Compliance Status

Phase One Commitment	Commitment Target	Interim Result	Outstanding Concerns
Purchase Targets	Beijing committed to increase purchases of U.S. goods by at least $200 billion over 2017 levels over two years: $76.7 billion in 2020 and $123.3 billion in 2021.	As of August 2021, Chinese imports of U.S. goods stood at 69 percent ($89.4 billion) of a prorated $129.9 billion target.	Beijing has leveraged SOEs for some of the purchases, raising concerns that it is using the agreement to strengthen government actors in the economy.[234]
Address Intellectual Property (IP) Violations	The agreement included changes to address longstanding concerns over China's administration of the IP lifecycle: patenting, licensing, and civil and criminal enforcement. The agreement required China to establish an action plan to deter IP theft and counterfeiting, as well as to enforce court judgments. Other IP provisions aim to create a level playing field for foreign firms and ensure stronger IP protection in valuable markets such as pharmaceuticals.	On April 20, 2020, the China National Intellectual Property Administration (CNIPA) released a 2020–2021 plan to implement guidance on strengthening IP protection. From October 2020 to January 2021, China amended its Patent Law, Copyright Law, and Criminal Law, leading some rightsholders to report some degree of improvement in IP enforcement.	China legal expert Mark Cohen noted that while the CNIPA guidance appears to reflect the Phase One agreement in its timetables and delegation of responsibility, CNIPA is administratively subordinate to the State Administration of Market Regulation and may lack the authority to implement the plan.[235] Local-level implementation is an additional concern, as amendments to national laws governing IP rights do not necessarily create binding obligations at the provincial and lower levels of government in China.[236]
Eliminate Forced Technology Transfer	The agreement prohibits China from conditioning market access on transfer of technology—reiterating a commitment China made in its 2001 WTO accession protocol—and directing overseas investment with the explicit aim of acquiring technology to fulfill industrial policy goals.[237]	The agreement includes no monitoring guidelines, enforcement mechanisms, deadlines, or targets.	The agreement lacks metrics to evaluate Beijing's compliance. Chinese law already prohibits conditioning regulatory approvals on technology transfer, but requests continue. U.S. companies are reluctant to come forward in cases of forced technology transfer for fear of reprisal.

Addendum: China's Phase One Trade Agreement Commitments and Compliance Status—*Continued*

Phase One Commitment	Commitment Target	Interim Result	Outstanding Concerns
Liberalize Financial Services	China agreed to remove investment restrictions, reduce regulation, and review pending license applications of U.S. companies in its domestic banking, credit rating, electronic payments, asset management, insurance, and securities industries.	In 2020, China committed to allow U.S. credit ratings agencies to acquire majority ownership in existing joint ventures and review U.S. companies' applications for credit rating services for onshore securities. In 2021, China approved U.S. firms owning a majority stake in wealth management joint ventures and having sole ownership over fund management companies.*[238]	Many of Beijing's financial services commitments are restatements or minor improvements on pledges in progress. U.S. financial services firms report licensing requirements can be excessively onerous, hindering entry into and expansion within the Chinese market.[239]
Increase Agricultural Market Access	China agreed to permit the import of beef, pork, and processed meat that passes inspection by the U.S. Food and Drug Administration Food Safety and Inspection Service. Beijing also committed to reduce the review and approval period for genetically modified products to "no more than 24 months," down from the prior approval period of five to seven years.	According to former trade negotiator Darci Vetter, provisions on U.S. meat, poultry, and specialty dairy products appeared promising in terms of increasing market access. The deal text also pledged to reduce burdensome registration, licensing, and bureaucratic processes for U.S. agricultural exporters.[240]	Trade association BIO expressed continuing concerns regarding U.S. biotech developers' lengthy wait for product approvals, as Chinese regulators will not begin the approvals process until U.S. regulators have completed their review.[241]

Source: Compiled by Commission staff.

* Four U.S. financial services firms have received the Chinese government's approval to establish wealth management and/or mutual fund businesses. In May 2021, BlackRock and Goldman Sachs received regulatory approval to establish majority-owned wealth management joint ventures. In September 2021, the China Securities Regulatory Commission approved Neuberger Berman Group to establish a wholly owned mutual fund business. The green light for Neuberger Berman Group followed similar approvals for U.S asset managers Fidelity and BlackRock to establish wholly owned China mutual fund businesses in August 2021 and August 2020, respectively. Yue Yue and Tang Ziyi, "China Awards Wholly Owned Mutual Fund License to Third Foreign Firm" *Caixin*, September 27, 2021; Yue Yue and Han Wei, "Fidelity Cleared to Open Its Own China Mutual Fund Business," *Caixin*, August 7, 2021; Charlie Zhu and Jun Luo, "Goldman Forms Wealth Venture with China's Largest Bank," *Bloomberg*, May 25, 2021.

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