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Chinese Regulators Issue Draft Rules for Listings Using Variable Interest Entities

  On December 24, the China Securities Regulatory Commission (CSRC) released draft regulations giving the agency jurisdiction over Chinese companies seeking to conduct IPOs abroad using variable interest entities (VIEs). VIEs are a method of listing overseas used by many Chinese companies operating in sectors that receive increased scrutiny from Chinese regulators, such as e-commerce and technology. Some of China’s best-known global firms, including Alibaba and Tencent, have listed abroad using VIEs. Under the draft regulations, all Chinese companies listing on foreign markets—including those doing so indirectly—will have to submit materials, including a prospectus, to the CSRC within three days of submitting the offshore application, after which the CSRC has 20 working days to decide whether the company can proceed. Currently, the CSRC only has jurisdiction to review listings by companies incorporated in China; VIEs are typically incorporated in the Cayman Islands.

  According to an interview with a CSRC spokesperson, the regulator may ask for supplementary material if it deems an application incomplete. It may also solicit feedback on the application from other agencies in the course of its review, which will not be counted in the 20 working day review period.

China challenges U.S. firms about Uyghur Forced Labor Prevention Act

As the Uyghur Forced Labor Prevention Act becomes law, signals of imminent Chinese retaliation spell difficulties for U.S. companies.

Chinese Communist Party Emphasizes Stability at Key Economic Planning Conference

Heading into a politically sensitive year, the Chinese Communist Party (CCP) looks to prioritize economic stability after regulatory tightening in the technology and property sectors diminished market confidence in 2021.

Bilateral Trade

In November 2021, the monthly U.S. goods trade deficit with China increased to $32.3 billion, with goods imports from China reaching $48.4 billion, their highest level since October 2018.

In Focus: Shein’s Rapid Growth Accompanied by Controversy

A relative newcomer to the fashion industry, Shein has become one of China’s most successful apparel firms worldwide, with an emphasis on quick production and low prices. Amid its growth, Shein has attracted criticism from many observers, including fashion designers, environmentalists, and labor activists.
The CSRC regulations mark a departure from the Chinese government’s previous treatment of VIEs, which was on a sector-by-sector basis. For example, regulations released in July 2021 prohibited the use of VIEs in China’s nonstate education sector. Some observers have said that the issuance of these regulations marks the Chinese government’s acceptance of VIEs, traditionally viewed as a legally murky way to list abroad. According to an op-ed published in Chinese financial publication Caixin, however, the CSRC’s rules do not imply the government’s endorsement of VIEs, which still require the approval of other regulatory agencies, including the National Development and Reform Commission (NDRC, the state economic planner) and the Ministry of Commerce.

As Phase One Deal Expires, China’s Compliance Incomplete and Uneven

On December 31, the Phase One Economic and Trade Agreement† between the United States and China expired. China’s compliance with the agreement has been uneven. For example:

- **Financial services opening**: Among other items, the Chinese government agreed to review pending license applications of U.S. companies in its asset management and securities industries, though these commitments were largely restatements or minor improvements on pledges already in progress. Four U.S. financial services firms have received the Chinese government’s approval to establish wealth management and/or mutual fund businesses.

- **Intellectual property (IP) protection**: The Chinese government agreed to address longstanding concerns over China’s administration of the IP lifecycle as well as develop an action plan to bolster IP protection. From October 2020 to January 2021, China amended its Patent Law, Copyright Law, and Criminal Law, leading some rightsholders to report marginal improvements in IP enforcement. An April 2020 action plan to strengthen IP protection, however, may lack the institutional strength necessary for implementation. Additionally, while the Chinese government has promised time and again it would strengthen IP rights protection, China was again placed on the U.S. Trade Representative’s (USTR) “Priority Watch List” in its 2021 Special 301 Report for the 17th year in a row. The report observed select IP issues remain unresolved, such as continued bad faith trademarks and rampant counterfeiting in the Chinese market.

- **Purchase commitments**: According to Chad Bown, senior fellow at the Peterson Institute for International Economics, U.S. exports to China of products covered under the Phase One agreement from January 2020 to November 2021 stood at $199.2 billion, or 60.2 percent of a prorated Phase One target of $330.9 billion.

The Biden Administration has not yet commented publicly on China’s compliance with the agreement since it expired, nor has it outlined how future bilateral economic and trade negotiations may be managed. Under
the Phase One agreement, the United States could choose to apply new tariffs or restore those that were reduced as part of the deal to compel additional purchases from China or further action on structural issues, such as forced technology transfer. U.S. Trade Representative Katherine Tai has acknowledged the Phase One agreement “did not meaningfully address the fundamental concerns [the United States] has with China’s trade practices” but also observes the agreement will serve as the “architecture” of the bilateral economic relationship moving forward.

Regional Comprehensive Economic Partnership Effective in 2022

On January 1, 2022, the Regional Comprehensive Economic Partnership (RCEP) came into effect following ratification by 10 of its 15 members. While ASEAN countries have principally steered the deal, China claims the passage as a key geopolitical success and has framed the deal as evidence of its regional leadership. RCEP is expected to streamline some aspects of inter-ASEAN trade; increase flows between Northeast Asia and ASEAN countries; and, in particular, boost trade among China, Japan, and South Korea. The deal is poised to strengthen China’s supply chain resiliency through deeper integration between ASEAN suppliers and Chinese manufacturers. Meanwhile, U.S. products may be less competitive in Asia as both RCEP and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership deepen regional trade integration. U.S. multinational companies may focus or increase production in RCEP member countries to take advantage of the agreement’s more flexible rules of origin that will eliminate longstanding barriers to trade in the region.

Chinese Regulators Issue New Negative List for Foreign Investment

China’s Ministry of Commerce and the NDRC have fully removed foreign investment restrictions for China’s domestic automobile industry with the latest release of the negative list for foreign investment. Restrictions on foreign investment remain in 31 sectors, such as telecommunications, news media, and rare earth mining. For almost three decades, foreign manufacturers could only own up to 50 percent in auto manufacturing joint ventures, although the NDRC announced in 2018 it would phase out investment restrictions in the sector by 2022. Restrictions on investment in new energy vehicle (NEV) manufacturers were removed in 2018, followed by commercial vehicle producers in 2020. New, the revised list lifted the remaining restrictions on investment in passenger vehicle manufacturers, a segment of the auto market which accounts for 80 percent of China’s auto market. Over 65 percent of passenger cars sold in China are foreign branded, and around 10 percent of all passenger cars sold are U.S. brands.

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* Australia, Brunei Darussalam, Cambodia, China, Japan, Laos, New Zealand, Singapore, Thailand, and Vietnam have all ratified RCEP. In February 2022, South Korea will also ratify the deal, with Indonesia, Malaysia, Myanmar, and the Philippines remaining to implement. RCEP’s 15 signatories cover just over 30 percent of the world’s population and global gross domestic product. Association for Southeast Asian Nations, “RCEP Agreement Enters into Force,” January 1, 2022. https://asean.org/rcode-agreement-enters-into-force/.


Controlling ownership of their Chinese operations likely comes too late to change U.S. and other foreign automakers’ approach to the market. China’s long delay in lifting investment restrictions protected local companies from international competition until they were able secure a domestic foothold. As a result, many foreign automakers say they rely on their relationships with Chinese joint venture partners to produce cheaply enough for the Chinese market, making it unlikely that automakers will buy out their Chinese partner’s shares in the joint venture. Even in China’s more dynamic NEV market, so far only Tesla has established a wholly-foreign owned manufacturing plant.

China Consolidates Rare Earths Firms

China is further consolidating its rare earths industry, approving a three-way merger to form one of the world’s largest rare earths companies in December 2021. State-owned miners Aluminum Corporation of China, China Minmetals, and Ganzhou Rare Earth Group, reorganized their rare earths mining and production assets into a new entity based in Jiangxi Province called China Rare Earth Group. The conglomerate will control 40 percent of China’s rare earths mine output, or around one-quarter of global mine production using 2020 figures. Earlier in the month, the state-owned China Northern Rare Earth (Group) High-Tech, which in 2021 controlled around 60 percent of China’s rare earths mine production, formed a strategic partnership with another nonstate rare earths miner, China Rare Earth Holdings. The firms will coordinate to extract and process rare earths in northern province Inner Mongolia, which has over 80 percent of China’s proven rare earths deposits.

The merger is designed to strengthen China’s domination of global supply chains for the strategic elements. Rare earth elements’ magnetic and conductive properties make them critical components in high-technology applications such as electric vehicles, smart phones, and wind turbines, and China holds an outsized position in both mining and processing the elements. Mines in China produced around 60 percent of the world’s supply of all rare earths in 2020, according to the U.S. Geological Survey. The country controls an estimated 85 percent of processing to turn rare earths into useful components, such as alloys and permanent magnets. China’s government has been consolidating its rare earths extraction, processing, and export for over a decade, bringing production under six main entities and establishing production and export quotas in attempt to increase prices.

China has both internal and external motivations for further consolidating its rare earths industry:

- **International motivations:** China wants to increase its global pricing power for rare earths; however, domestic competition between multiple rare earths firms has put downward pressure on prices. In a February 2021 press conference, Ministry of Industry and Information head Xiao Yaqing illustrated these dynamics, noting, “Our rare earths did not sell at the ‘rare’ price but sold at the ‘earth’ price ... because of competitive bidding, which

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2 As the U.S. Department of Defense notes, estimates of rare earths markets can be unreliable because “producers and consumers do not report production or consumption data; and although third-party pricing data exists, there is little or no certainty that market participants close their business deals at the published prices.” White House and U.S. Department of Defense, Building Resilient Supply Chains, Revitalizing American Manufacturing, and Fostering Broad-Based Growth, June 2021, 190. https://www.whitehouse.gov/wp-content/uploads/2021/06/100-day-supply-chain-review-report.pdf.

3 The character for “earth” 土 in Chinese is the same as the character for “soil.”
wasted the precious resource.” 33 In line with China’s 14th Five-Year Plan for the Raw Materials Industry, 3 consolidation also fits in with a larger strategy to move up the global raw materials value chain by developing cutting-edge processing as well as new applications for rare earths. 34 Additionally, increasing government efforts to strengthen the competitiveness of China’s rare earths industry may be a reaction to moves by the United States, Japan, and Australia to develop alternative sources. 35

- **Domestic motivations:** Consolidation may be intended to help address the problem of a fragmented domestic market where firms negotiate rare earths prices on an individual basis without a unified price formation mechanism and trading platforms function at the provincial level. 35 By creating fewer industry players, Chinese policymakers hope to reduce transaction costs and market inefficiencies due to such fragmentation. Additionally, consolidation may support China’s efforts to reduce the harsh environmental impact of rare earths mining by shutting down smaller, dirtier operations while increasing centralized oversight to improve regulatory compliance. 36

China’s consolidation in the rare earths industry is a component of broader reforms aimed at strengthening the state’s role in China’s economy, a key point of contention in the U.S.-China economic relationship. Rare earths is one of many industries for which local fragmentation became endemic in the early 2000’s as a result of subnational governments’ support for local champions to boost economic growth and meet industrial policy targets within their jurisdiction. In response, Chinese policymakers have initiated successive waves of industrial consolidation, creating large state-owned conglomerates in sectors like shipping, commerce, construction, steel, and energy to support domestic price stabilization and market unification. 37 Such consolidation has allowed state-owned enterprises (SOEs) to establish domestic monopolies while their access to state subsidies and inexpensive credit gives them an edge over competitors in global markets. Consolidation has also been a component of broader SOE reforms aimed at improving the innovative capacity of state firms by deepening their resources for R&D expenditure while reinforcing their compliance with innovation policy targets. The results of these efforts can be seen in China’s shipping and rail sectors, where SOE mergers and acquisitions helped Chinese firms move up the value chain into the logistics industry. 38

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3 China has historically exercised significant pricing power in the global market for rare earths. Since the 1980s, industrial policies, including export tax rebates, export quotas, and the ban on the export of heavy rare earths, have supported Chinese rare earths companies and allowed them to increase their global market share at the expense of competitors like the United States. While the United States once held the majority of global rare earths market share, Chinese state support allowed Chinese companies to undercut U.S. prices and eventually forced the last U.S. rare earths mine in Mountain Pass, California, to close in 2002, though it was later reopened in 2010. Upon solidifying dominance over the global market, China later reduced its export quotas in 2010, causing global rare earths prices to skyrocket, thus harming U.S. tech manufacturers while preserving supply for Chinese competitors. In response, the United States, EU, and Japan filed a number of trade disputes with the WTO, which ruled that China’s policies were discriminatory and forced it to end its policy of export quotas in 2015. Center for Strategic and International Studies, “Does China Pose a Threat to Global Rare Earth Supply Chains?” https://chinapower.csis.org/china-rare-earths/; John Xie, “California Mine Becomes Key Part of Push to Revive US Rare Earths Processing,” Voice of America, December 31, 2020. https://www.voanews.com/a/usa_california-mine-becomes-key-part-push-revive-us-rare-earths-processing/6200183.html.

7 Rare earths comprise a small portion of China’s raw materials industry addressed in the document, which includes other major heavy industries such as cement, aluminum, and steel.


U.S. Reliance on Chinese Rare Earths Prompts Government Action

China’s dominance over the rare earths supply chain creates vulnerabilities for the United States, as China supplied approximately 74 percent of U.S. rare earths imports by value in 2020. China moved to leverage U.S. dependence on its rare earths exports when in 2019, amid ongoing trade tensions, it threatened to cut off rare earths exports to the United States after raising tariffs on its imports of U.S. rare earths. Other major technology-producing nations such as South Korea and Germany also rely on China for rare earths, respectively sourcing 92 and 80 percent of their imports from China in 2020. After China briefly cut off exports to Japan in 2010 amid rising tensions regarding China’s extraterritorial claims over the Senkaku Islands, Japan reduce its reliance on Chinese rare earths by diversifying suppliers and investing in non-Chinese operations internationally. In 2020, 25 percent of Japan’s imports by value came from China, compared to 88 percent in 2010. The U.S. government has pursued several measures to reduce U.S. reliance on Chinese rare earths, including the following:

- **Executive orders:** Since 2017, the White House has issued three executive orders intended to increase U.S. supply chain security for rare earths and other critical minerals.
- **Federal funding to boost U.S. domestic production:** Since 2017, The U.S. Department of Defense has invested over $43 million to increase domestic production through projects including an upgrade at the Mountain Pass mine in California and development of new processing and production facilities in Honda, Texas. In 2018, a U.S. Department of Energy innovation center for critical minerals at the Ames Laboratory developed a new method of recycling rare earth metals. The Department of Energy further announced $28.35 million in research and development cost sharing for rare earths processing technologies in 2021.
- **Multilateral coordination:** The United States, Japan, and Australia have cooperated extensively to diversify the rare earths supply chain and have coinvested in one another’s industries. In 2022, Australia also plans to host a clean energy supply chain summit for the members of the Quadrilateral Security Dialogue (the United States, Japan, and India).

China challenges U.S. firms about Uyghur Forced Labor Prevention Act

On December 23, 2021, President Joe Biden signed the Uyghur Forced Labor Prevention Act into law. The law effectively places a ban on the import of products “mined, produced, or manufactured wholly or in part” from Xinjiang by applying a presumption that such goods were manufactured with forced labor, unless importers can prove otherwise. It also strengthens overall due diligence requirements, requiring importers to review supply chains to ensure goods sourced from China do not have components originating from Xinjiang. The law builds on

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prior Withhold Release Orders\textsuperscript{*} that U.S. Customs and Border Protection (CBP) issued between 2020 and 2021 to prevent the import of tomatoes, cotton, and technology products from Xinjiang. The law also expands authorization for the U.S. Department of the Treasury to enact sanctions on foreign persons connected to forced labor in Xinjiang under the Uyghur Human Rights Policy Act.\textsuperscript{52}

**U.S. companies face increasing challenges trying to comply with U.S. law and appease the Chinese government.** In December, Intel publicly apologized on Chinese social media after it sent a letter to its suppliers with instructions to cease sourcing labor and goods from Xinjiang.\textsuperscript{53} Chinese netizens also alleged Walmart subsidiary Sam’s Club removed Xinjiang-origin products from its online app, though a Sam’s club representative said Chinese customers did not find products from Xinjiang because the app did not support searches based on place names.\textsuperscript{54} In response to the allegations, the CCP’s anticorruption agency, the Central Commission for Disciplinary Inspection, released a statement intimating repercussions and implicitly threatening a boycott.\textsuperscript{55} The statement noted China’s status as Walmart’s second-largest market and referenced clothing retailer H&M’s March 2020 divestment from Xinjiang cotton, which sparked a boycott of the company by Chinese customers and e-commerce firms.\textsuperscript{56} As a Jamestown Foundation *China Brief* elucidates, the CCP has some 20 million online commentators it could muster to change the online information environment against Walmart and other brands that comply with the Uyghur Forced Labor Prevention Act.\textsuperscript{57}

China’s recently enacted Anti-Foreign Sanctions Law, which formally prohibits all companies operating in China from complying with foreign sanctions, will likely compound difficulties for U.S. firms. While the law could be punitively directed at foreign companies themselves, it is also likely to limit Chinese partners’ ability and willingness to help U.S. companies achieve the clarity they need to prove their supply chains are clean.\textsuperscript{58} Additionally, any sanctions resulting from the implementation of the Uyghur Forced Labor Prevention Act are likely to result in Chinese countersanctions. Such a response would be similar to prior Chinese sanctions on U.S. officials, such as those applied to former Secretary of State Mike Pompeo in response to Global Magnitsky Act sanctions on Chinese officials for human rights violations in Xinjiang.\textsuperscript{59}

**The year-long campaign to pass the Uyghur Forced Labor Prevention Act and its successful turn to law have inspired other governments to consider similar legislation.** In December 2021, *Politico* reported that several United Kingdom (UK) legislators called for a similar import ban, while UK Trade Minister Penny Mordaunt indicated that the government is looking at taking action “very carefully.”\textsuperscript{60} In August 2021, Australia’s Senate passed a similar bill, though it ultimately failed to pass the full parliament.\textsuperscript{61} The EU is also pursuing a more rigorous due diligence strategy aimed at eradicating forced labor and other human rights abuses from its supply chains in lieu of a full import ban.\textsuperscript{62}

### Chinese Communist Party Emphasizes Stability at Key Economic Planning Conference

At its annual Central Economic Work Conference (CEWC), the Chinese Communist Party (CCP) emphasized the importance of stabilizing China’s economy as the Party heads into a politically significant year. On December 8–10, 2021, the CCP convened its annual CEWC, the Party’s economic planning conference in which it sets the agenda for economic policy in the year ahead.\textsuperscript{63} CCP leaders placed special emphasis on “stability” at the conference, with the word appearing 25 times in a 4,700-character readout of the event.\textsuperscript{64} The sharp focus on economic stability points to the Party’s sensitivity to key political events in 2022 as the CCP prepares Beijing to host the 2022 Winter Olympics in February and convenes its 20th Party Congress in the latter half of the year.\textsuperscript{65}

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\textsuperscript{*} A Withhold Release Order (also called a denial order) suspends the import of specified goods CBP determines to be produced or manufactured in whole or in part from forced labor (including prison labor and child labor). Importers are still eligible to receive the goods if they can submit evidence disproving CBP’s forced labor determination along with a certificate of origin within three months of the order’s issuance. M.E. Dey & Company, “Withhold Release Order (WRO),” September 2020. \url{https://www.medey.com/wp-content/uploads/2020/09/Withhold-Release-Order-WRO.pdf}.

\textsuperscript{†} By comparison, the character for stability (稳, wěn) appeared only 13 times in the 2020 CEWC readout, suggesting a returned focus to economic stability in the 2021 readout. The character appeared 24 and 29 times in the 2019 and 2018 CEWC readouts, respectively.
The emphasis on stability also reflects a renewed focus on shoring up economic growth, a cornerstone of the CCP’s legitimacy, as headwinds buffet China’s economy. According to a readout of the conference, China is grappling with “threefold pressures” of weak demand, insufficient supply, and diminished market confidence.66 These pressures weighed on China’s economy in 2021, with growth slowing in the third quarter to 4.9 percent year-on-year and just 0.2 percent quarter-on-quarter.*

- **Demand-side pressures:** Scattered shutdowns of China’s city centers and regional travel restrictions enacted in pursuit of a “zero-COVID” approach to pandemic control have weighed on consumer demand, with retail sales growth slowing to just 3.9 percent in November 2021.67 While the CEWC readout pledged China will continue to guard against imported COVID-19 cases, the omission of the “zero-COVID” wording suggests Chinese leaders are concerned about alleviating demand-side pressures and may be reconsidering the zero-tolerance approach.68

- **Supply-side pressures:** Rising global commodity prices, increased shipping costs, and supply disruptions arising from power outages and government-directed production curbs have weighed on China’s productive capacity and increased producer prices.69 In October 2021, China’s Producer Price Index grew 13.5 percent year-on-year, a 26-year high.70

- **Diminished market confidence:** Regulatory tightening campaigns against China’s property and internet technology sectors have dimmed market sentiment.71 Property construction and sales, key drivers of economic growth in China, tumbled in 2021 following government efforts to rein in debt-fueled housing construction and curb speculative property purchases in major cities.72 Financial markets also reflected dimming confidence, with China’s CSI 300 Index—an index composed of 300 large- and mid-capitalization stocks traded on the Shanghai and Shenzhen stock exchanges—down 6.2 percent for the year.† 73

**CCP leaders intend to provide targeted but not expansive support to counteract these pressures.** The CEWC readout calls for “proactive fiscal policy” that strengthens support for small- and medium-sized enterprises (SMEs) and encouraged continued infrastructure investment “moderately ahead of schedule.”74 Monetary policy similarly seeks to ensure SMEs, technological innovation, and green development are all supported.75 Analysts debate the extent to which fiscal or monetary policy will play a decisive role in providing economic support. According to Logan Wright, partner at Rhodium Group, consistent with the People’s Bank of China December 6 announcement that it would cut banks’ reserve requirement ratios, monetary policy may play a more prominent role in supporting the economy in 2022.76 Contrastingly, Trivium China analysts observe that the CEWC readout’s focus on boosting infrastructure spending, accelerating fiscal expenditure, and implementing tax and fee reductions for business all point to a more prominent role for fiscal policy. CCP leaders are signaling both will be deployed in a “coordinated” way to undergird economic stability and in service of economic policy priorities CCP leaders have espoused since the pandemic’s disruptions took hold of China’s economy in 2020, including supporting SMEs and technological development.77 China’s authorities are moving quickly to realize the CEWC’s objectives, with China’s Ministry of Finance allocating $228.9 billion (renminbi [RMB] 1.5 trillion) in quotas for 2022 special-purpose bonds in mid-December, ahead of schedule.‡ 78

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The CEWC readout points to CCP leaders’ acknowledgement that some of their policy choices in 2021 may have been too forceful. Reductions in coal production in 2021 to meet China’s ambitious carbon neutrality goals contributed to power outages that year, while the Party’s “common prosperity” campaign* sapped market sentiment. The CEWC readout advises Chinese officials to moderate the tenacity with which both goals are pursued. For example, it notes that carbon neutrality cannot be achieved “in one fell swoop” and observes that wealth in China should grow further before it is redistributed. The longer-term focus placed on both goals underlines the CCP’s short-term objective of economic stability and shored-up growth. Similarly, just before the CEWC, a meeting of China’s top political body affirmed it would support “reasonable housing demand,” a statement analysts interpreted as signaling loosening policies toward the property sector.

Bilateral Trade

Bilateral trade continued to surge in November 2021, maintaining a trend started in October by easing global supply chain disruptions. Strong U.S. consumer spending ahead of the holidays also contributed to U.S. imports of Chinese goods totaling $48.4 billion in November, marking their highest level since October 2018 (see Table 1). Rising imports brought the U.S. goods trade deficit to $32.3 billion. Despite a deepening deficit, cumulative goods exports to China for the first 11 months of 2021 grew 25 percent year-on-year, while imports grew 16 percent year-on-year. The total volume of bilateral goods trade reached $594.5 billion, versus $502.8 billion over the same period in 2020 (see Figure 2).

Table 1: Key Indicators for U.S.-China Trade in Goods, November 2021

<table>
<thead>
<tr>
<th>Value</th>
<th>Year-on-Year Change</th>
</tr>
</thead>
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<td>U.S. Exports to China</td>
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</tr>
<tr>
<td>U.S. Imports from China</td>
<td>$48.4 billion</td>
</tr>
<tr>
<td>U.S. Trade Deficit with China</td>
<td>$32.3 billion</td>
</tr>
</tbody>
</table>

Source: U.S. Census Bureau, Trade in Goods with China, January 6, 2022.

Figure 2: U.S.-China Goods Trade, November 2017–November 2021

Source: U.S. Census Bureau, Trade in Goods with China, January 6, 2022.

In Focus: Shein’s Rapid Growth Accompanied by Controversy

On January 25, Reuters reported that Chinese clothing retailer Shein (pronounced “she-in”) was renewing its plans to conduct an initial public offering (IPO) on U.S. markets. The revival of the company’s IPO plans, which reportedly began about two years ago before being shelved, underscores Shein’s status as one of the fastest-growing apparel companies in the world over the past several years. This rapid growth has been underpinned by controversy, however, as Shein’s quickly manufactured, inexpensive clothing has raised concerns over plagiarism, negative environmental impact, and unfair labor practices. Additionally, the company owes its profitability in part to exemption from U.S. tariffs on Chinese goods under current trade rules. Recently proposed legislation could challenge this factor in Shein’s business model, while proposed state legislation would require more transparency of its supply chains.

Shein’s Expansion Worldwide

A pioneer in “ultra-fast fashion,” Shein has no brick-and-mortar locations and instead sends clothes directly to online consumers worldwide. According to the company’s own disclosures, 2020 revenues were nearly $10 billion (RMB 63.5 billion), higher than the online revenues of fast-fashion giant Zara. According to a Bloomberg report, as of June 2021 the company’s valuation was as high as $30 billion. Last May, it briefly overtook Amazon as the most downloaded shopping app in the United States.

Shein was originally founded in 2008 in Nanjing by Chris Xu, who did not have a background in fashion but rather in search engine optimization. Originally focusing on wedding dresses, the company later branched out into all women’s clothing and then expanded further to include apparel for men and children, beauty items, and home décor and furnishings. Initially, Shein only sold items designed and manufactured by third-party firms, but not producing designs or maintaining any inventory. In 2014 it bought Chinese e-commerce retailer Romwe and began building an integrated supply chain. The company’s revenues have steadily grown since then, reportedly seeing revenue growth of over 100 percent for eight consecutive years. U.S. sales growth took off at the beginning of the novel coronavirus (COVID-19) pandemic, when store closures diverted shoppers to online options (see Figure 1 below).

Figure 1: Shein U.S. Sales Growth, January 2020–April 2021

Shein has become a significant supplier to customers in almost every region in the world. As an export-focused business, Shein has almost no presence in mainland China, but it ships to consumers in 220 countries. The
Economist reported in October that the United States is Shein’s top market, accounting for 35–40 percent of sales, followed by Europe at 30–35 percent.93

A Tech-Savvy Emphasis on Inexpensive Goods, Aided by Tariff Breaks

A key factor in Shein’s success is the low price of its products, which cost under $11 on average—partly because they receive favorable treatment under both U.S. and Chinese trade law.94 Shein has been able to avoid paying U.S. tariffs that have been levied on many other Chinese textiles because the company ships hundreds of thousands of small individual order shipments separately, rather than exporting products in bulk shipments. U.S. law typically does not require duties on packages with a value of under $800. Shein ships directly to its consumers, so the majority of its shipments fall under this threshold.95 At the same time, Shein benefited from policies the Chinese government adopted in 2018, as U.S.-China trade tensions were rising, that cut export tariffs for most direct-to-consumer businesses.96 The exemption from both U.S. and Chinese tariffs gives Shein an advantage over larger rivals, especially those that maintain brick-and-mortar stores and move inventory in bulk. The Import Security and Fairness Act, a bill introduced in the House Ways and Means Committee on January 18, 2022, could end these exemptions for Shein if it becomes law.97 Among other provisions, the act would impose tariffs on packages valued under $800 if they come from countries that are both (1) designated by the U.S. Department of Commerce as non-market economy countries and (2) on the U.S. Trade Representative’s Priority Watch List for IP issues.* 98

The firm’s success also comes from its emphasis on quick production and real-time sales analytics. Reflecting its founder’s background in search engine optimization, Shein relies on algorithms that analyze online search terms to determine new fashion trends and quickly turn around new designs, produced at first in small batches of 50–100 items.99 This allows Shein to sell new designs in as little as ten days, far faster than the several months it takes for traditional clothing retailers or even other fast-fashion outlets like Zara, which typically take five weeks to turn around new products.100 According to CEO Molly Miao, the company now releases between 700 and 1,000 new items daily.101 These goods enjoy brisk sales due in part to the company’s pervasive presence on social media platforms such as Instagram and TikTok, which includes advertisements, collaborations with celebrities and influencers, and user-generated video reviews of Shein products.102

Shein’s Success Accompanied by Criticism over Business Model

Despite its success, Shein’s practices have given rise to controversies as well. Many of these issues are not specific to Shein, but exemplify broader controversies over the fast-fashion industry, scrutiny over Chinese supply chains, and concerns about Chinese firms’ theft of U.S. intellectual property.

• **Plagiarism.** Several fashion companies and independent designers have accused Shein of infringing on their designs. In June 2021, AirWear International, the parent company of shoe seller Dr. Martens, filed a lawsuit against Shein for its alleged “clear intent to sell counterfeits” and for copying the company’s designs.103 Under U.S. copyright law, however, copying many aspects of clothing designs is not legally actionable, leading to many such occurrences by fast-fashion brands.104

• **Environmental impact.** Shein has also drawn criticism for the environmental impacts of its business model. According to a 2018 UN study, the fashion industry accounts for as much as 8 percent of global carbon emissions.105 Industry experts have pointed to fast fashion as a particularly harmful segment of the fashion industry due to its high volume of sales and its use of polyester fabrics that do not biodegrade.106 In 2021, Good On You, an organization that assesses the social and environmental impact of fashion companies, gave Shein its lowest rating for environmental impact.107

• **Improper labor practices.** A 2021 report by Swiss nongovernmental organization Public Eye interviewed workers at Chinese companies supplying Shein and found that some were working 75-hour weeks, with only one day off per month.108 While such working conditions for Chinese textile workers are not unique to Shein, they violate Chinese labor law as well as Shein’s own supplier code of conduct, which calls for

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suppliers to “arrange working hours reasonably.” The company has also come under fire for job listings on recruitment sites that reportedly excluded certain ethnicities, including Uyghurs, from applying.

Recent proposed legislation in New York could force companies such as Shein to be more transparent about supply chains and labor practices. In January 2022, the Fashion Sustainability and Social Accountability Act was introduced in the New York state legislature. If passed, the law would require fashion companies with revenues over $100 million that sell in New York to “map” at least 50 percent of their global supply chains and publish environmental and social due diligence policies. Companies violating the law could be fined up to 2 percent of their annual revenues.

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66 Zhao Leji, Wang Yang, Li Zhanhsu, Wang Yang, Zhao Leji, and Han Zheng All Attended the Meeting” (栗战书汪洋王沪宁赵乐际韩正出席会议），December 10, 2021. Translation.


94 Lora Jones, “Shein: The Secretive Chinese Brand Dressing Gen Z,”

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91 Michelle Toh, “The Mysterious Chinese Fashion App That’s as Popular as Amazon,”

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79 "The Central Economic Work Conference Was Held in Beijing, Xi Jinping and Li Keqiang Delivered Important Speeches, Li Zhanhuh, Wang Yang, Wang Huning, Zhao Leji, and Han Zheng All Attended the Meeting" (中央经济工作会议在北京举行 习近平李克强作重要讲话 栾战书汪洋王沪宁赵韩出席), December 10, 2021. Translation.


74 Lora Jones, “Shein: The Secretive Chinese Brand Dressing Gen Z,”

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103 Dave Lee, “Chinese Ecommerce Site Shein Hit with Trademark Disputes,” Financial Times, June 13, 2021. https://www.ft.com/content/b87df56a-cb71-4b6a-8c36-6e2db9a52c7c.


