



## U.S.-China Economic and Security Review Commission

Monthly Analysis of U.S.-China Trade Data

April 4, 2014

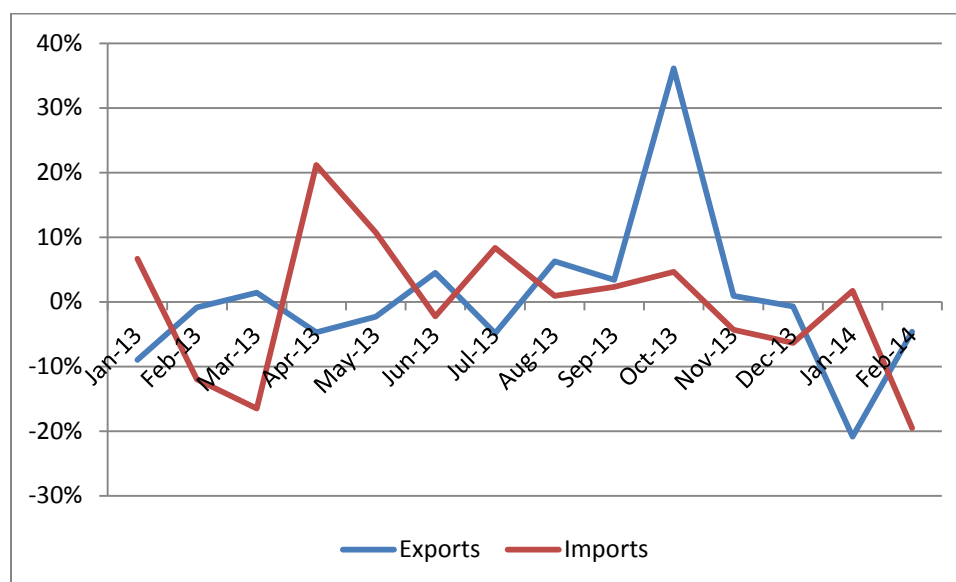
### Highlights of this month's edition

- **Bilateral trade:** U.S.-China bilateral trade fell in February, mostly due to a plunge in U.S. imports from China, with a net positive effect for the U.S. trade balance
- **Bilateral policy issues:** USTR publishes 2014 National Trade Estimate report detailing major trade barriers; WTO hands U.S. victory in rare earth case, but partial win to China on U.S. trade remedies law case
- **China's economy:** February exports drop significantly, resulting in a rare monthly trade deficit; Chinese policymakers say they could tolerate slower growth but evidence is conflicting: the government has allowed two small firms to default, but at the same time, the government has taken new measures to stimulate growth
- **Sector spotlight:** Agricultural products dominate U.S. exports to China, but they are underperforming; bulk items, mostly soybeans, dominate exports, while Chinese government restricts access for U.S. consumer foods

### Imports from China Take a Tumble

U.S. trade with China fell sharply in February. U.S. exports to China declined by 4.6 percent month-on-month. Imports from China took an even bigger tumble—a 19.5 percent decline over January 2014 to \$30.4 billion (see figure 1). This is at least in part explained by Chinese Lunar New Year seasonality. The net result was positive for the U.S. trade balance. The U.S. trade deficit in goods with China totaled \$21 billion in February, a 25 percent fall from the January deficit, and an 11 percent decline year-on-year.

Figure 1: Month-on-Month Change in U.S. Exports to China and Imports from China, 2013-2014, (%)



Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, April 2014). [http://censtats.census.gov/cgi-bin/naic3\\_6/naicCty.pl](http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl).

## Top Exports and Imports

In February 2014, agricultural products once again topped the list of U.S. exports to China, with a 23.6 percent share of total exports, and a 9.7 percent increase year-on-year (see table 1). Transportation equipment, which has seen the strongest gains among major U.S. exports in recent years, continues to perform well. Machinery, though, dropped sharply, reflecting declining investment in capital equipment in China (see China's Economy section of this bulletin). On the import side, computers and electronics, the predominant U.S. import from China, grew to \$9.7 billion, a 23 percent increase year-on-year.

Table 1: U.S. Trade with China: Top-Five Exports and Imports, February 2014  
(in US\$ millions)

U.S. Top-Five Exports to China				U.S. Top-Five Imports from China			
	Exports	Share of total (%)	Change over Feb'13 (%)		Imports	Share of total (%)	Change over Feb'13 (%)
<i>Monthly (February 2014)</i>				<i>Monthly (February 2014)</i>			
Agricultural Products	2,335,049	23.6%	9.7%	Computer and Electronic Products	9,668,989	31.5%	22.9%
Transportation Equipment	1,624,785	16.4%	13.7%	Electrical Equipment	2,497,207	8.1%	26.9%
Computer and Electronic Products	1,141,945	11.6%	22.9%	Miscellaneous Manufactured Commodities	2,369,708	7.7%	38.2%
Chemicals	1,013,953	10.3%	-3.0%	Apparel and Accessories	2,266,807	7.4%	-6.1%
Machinery, Except Electrical	679,393	6.9%	-13.9%	Machinery, Except Electrical	2,193,443	7.1%	-13.9%
Other	3,083,751	31.2%	-	Other	11,744,350	38.2%	-
<b>Total</b>	<b>9,878,876</b>	<b>100.0%</b>		<b>Total</b>	<b>30,740,504</b>	<b>100.0%</b>	
<i>Year-to-date (thru February 2014)</i>				<i>Year-to-date (thru February 2014)</i>			
Agricultural Products	5,171,937.0	25.6%		Computer and Electronic Products	21,883,603	31.7%	
Transportation Equipment	3,247,344.0	16.0%		Electrical Equipment	5,585,762	8.1%	
Computer and Electronic Products	2,259,347.0	11.2%		Miscellaneous Manufactured Commodities	5,351,228	7.8%	
Chemicals	2,149,332.0	10.6%		Apparel and Accessories	5,185,471	7.5%	
Machinery, Except Electrical	1,380,837.0	6.8%		Machinery, Except Electrical	4,690,113	6.8%	
Other	6,027,055.0	29.8%	-	Other	26,240,933	38.1%	-
<b>Total</b>	<b>20,235,852</b>	<b>100.0%</b>		<b>Total</b>	<b>68,937,110</b>	<b>100.0%</b>	

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, April 2014). [http://censtats.census.gov/cgi-bin/naic3\\_6/naicCty.pl](http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl).

## Advanced Technology Products

The U.S. trade deficit with China in advanced technology products was \$6.7 billion in February 2014, with information & communications technology dominating, as in previous years (see table 2). The U.S. deficit in ATP with China fell by \$2 billion compared to the first two months of 2013. Excluding information and communications technology, in February 2014 the U.S. had an ATP surplus of \$761 million.

Table 2: Advanced Technology Product Trade, February 2014  
(in US\$ millions)

	Monthly		
	Exports	Imports	Balance Feb'14
<b>TOTAL</b>	<b>1,976</b>	<b>8,851</b>	<b>-6,875</b>
(01) Biotechnology	32	6	26
(02) Life Science	211	135	76
(03) Opto-Electronics	24	367	-343
(04) Information & Communications	321	7,957	-7,636
(05) Electronics	411	242	169
(06) Flexible Manufacturing	185	60	125
(07) Advanced Materials	12	16	-4
(08) Aerospace	777	59	718
(09) Weapons	0	9	-9
(10) Nuclear Technology	3	0	3

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, April, 2014). [http://censtats.census.gov/cgi-bin/naic3\\_6/naicCty.pl](http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl).

## Bilateral Policy Issues

### USTR Releases the 2014 National Trade Estimate (NTE) Report

Prepared by the Office of the U.S. Trade Representative (USTR), the NTE report provides an inventory of the principal foreign barriers to U.S. exports of goods and services and the violation abroad of intellectual property rights. For China, the key trade barriers identified in the 2014 report center on the perennial bugbears of China's lax intellectual property rights (IPR) protection, promotion of industrial policy, and poor market access for U.S. services. Main points are summarized below:

Intellectual Property Rights: In 2013, China's inadequate IPR protection regime again landed it on the Priority Watch List in the Special 301 report.<sup>1</sup> In addition to common counterfeiting and piracy, the USTR found "most troubling" the thefts of trade secrets that benefit Chinese companies by private actors and entities affiliated with the Chinese government. Such quasi-official spying was a "serious problem that has attained a higher profile in recent years."<sup>2</sup> Similarly, the USTR continues to raise concerns over China's violation of patents and coercive technology transfer requirements.

Industrial Policies: The USTR found that in 2013, policies aimed at promoting "indigenous innovation" continued to represent an important component of China's industrialization efforts, despite China's 2011 promises to delink indigenous innovation policies at all levels of the Chinese government from government procurement preferences. The USTR also put a spotlight on China's efforts to promote its domestic industries, including the "Strategic Emerging Industries"<sup>i</sup> through discriminatory subsidies and tax policy, government procurement regimes favoring domestic producers, opaque and prejudicial enforcement of

<sup>i</sup> Strategic Emerging Industries were identified in the 12th Five-Year Plan for priority development in order to move China's manufacturing up the value-added chain. They include (1) energy-saving and environmental protection; (2) new generation information technology; (3) biotechnology; (4) high-end equipment manufacturing; (5) new energy; (6) new materials; and (7) new-energy vehicles. For more information, see U.S.-China Economic and Security Review Commission, *2011 Report to Congress* (Washington, DC: November 2012), pp. 88-106. [http://www.uscc.gov/Annual\\_Reports/2012-annual-report-congress](http://www.uscc.gov/Annual_Reports/2012-annual-report-congress).

antimonopoly policies against foreign companies, and import-substitution policies. In particular, the USTR reported that in 2013 U.S. industry has expressed concern about insufficient predictability, fairness and transparency in investigations by China's National Development and Reform Commission (NDRC), "including NDRC pressure to 'cooperate' in the face of unspecified allegations or face steep fines." U.S. industry also has reported "pressure from NDRC against seeking outside counsel, in particular international counsel, or having counsel present at meetings."<sup>3</sup>

Services: The Chinese government has made the promotion of its services sector a national priority as part of its efforts to rebalance the economy away from its dependence on exports and large scale fixed investment. The demand in China for services such as banking, insurance, investment, and medical care presents an opportunity for U.S. service providers. However, Chinese policies in a variety of service sectors continue to create significant impediments for entry of foreign providers. As in previous years, in 2013, the USTR found that Chinese regulators continued to use discriminatory regulatory processes, informal bans on entry, burdensome licensing and operating requirements, and other means to "frustrate efforts of U.S. suppliers of banking, insurance, telecommunications, Internet-related, audiovisual, express delivery, legal and other services to achieve their full market potential in China."<sup>4</sup> Some sectors, including electronic payment services and audiovisual services, have been the subject of WTO disputes. In both cases, the WTO handed victories to the United States, but China's track record on compliance remains poor. For example, in the electronic payment case, China agreed to implement the WTO decision by July 2013, but has not yet done so.<sup>ii</sup>

### **WTO Hands Down Decisions in Cases Challenging China's Rare Earths Export Restrictions and U.S. Application of Trade Remedy Law**

Rare Earths: In a March 26, 2014 decision, the WTO Dispute Settlement Panel ruled that China's export restrictions of rare earths, tungsten and molybdenum violated its WTO obligations.<sup>5</sup> China was widely expected to lose the case after an earlier successful U.S. challenge of China's export restraints on raw materials used in the steel, aluminum, and chemicals industries (bauxite, coke, fluorspar, magnesium, manganese, silicon carbide, silicon metal, yellow phosphorous and zinc).<sup>6</sup>

The *Rare Earths* case was initiated in 2012 by the United States, the European Union, and Japan in response to China's restrictions on the exports of rare earths,<sup>7</sup> Tensions between the nations have been escalating since China announced plans to limit its rare earths exports, justifying such action on environmental protection grounds. Rare earths are crucial to many U.S. industries, especially clean energy and advanced electronics. The restrictions in question are both published and unpublished and consist primarily of export restrictions in the forms of duties, quotas, minimum price requirements, and licensing.

The United States and other plaintiffs argued that these restrictions are part of industrial policy aimed at providing competitive advantages for Chinese manufacturers. Because of China's position as a leading global producer of these materials, its export restraint measures give China the ability to manipulate global supply and pricing. These measures also can create substantial pressure on foreign producers to move their operations, jobs, and technologies to China.<sup>8</sup>

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<sup>ii</sup> As recently as March 2014, the United States has continued to express "serious concerns" over China's failure to take needed steps to authorize foreign suppliers' access to its electronic payments market. According to the 2013 USTR report on China's WTO compliance, the United States is "actively pressing China to comply with the WTO's rulings and also is considering its further options at the WTO." Office of the U.S. Trade Representative, *2013 Report to Congress on China's WTO Compliance* (Washington, DC: December 2013), p. 11. <http://www.ustr.gov/sites/default/files/2013-Report-to-Congress-China-WTO-Compliance.pdf>.

The WTO Panel found that China failed to justify its restrictions as legitimate conservation or environmental protection measures, saying the export quotas were “designed to achieve industrial policy goals rather than conservation.” The Panel further explained that China did not pair the export quotas with domestic restrictions on the use of rare earths; rather, the Panel concluded that “that the overall effect of the foreign and domestic restrictions is to encourage domestic extraction and secure preferential use of those materials by Chinese manufacturers.”<sup>9</sup>

So far, the response from the Chinese government has been muted. The Ministry of Commerce said China was reviewing the decision and considering its options. China is likely to appeal the decision and delay compliance.<sup>10</sup> The U.S. government has celebrated the decision, but it is far from clear that China’s policy changes, if and when they come, would have a substantial positive effect on U.S. economy. Following China’s drastic reduction of the rare earth export quota by 40 percent in 2010, the price shocks sent heavy users of rare earths scrambling for alternatives. This has worked to some extent—China’s share of the global production of rare earths has fallen from 95 percent in 2010 to 80 percent now as other countries ramped up their own production or found replacements—but China is still expected to dominate the industry for years to come. Moreover, even if the WTO decision stands, China had ample time to reap the rewards of its strategy: Foreign companies using rare earths to make their products (mostly electronics) have shifted production to China, while Chinese industries relying on rare earths, such as wind turbines, have thrived.<sup>11</sup>

Trade Remedy Law: While the WTO was unequivocal in its rejection of China’s rare earth restrictions, the decision in the Chinese case challenging U.S. application of countervailing (CVD) and antidumping (AD) duties was mixed.<sup>12</sup> The Dispute Settlement Panel report upheld the applicability of U.S. CVD law to nonmarket economies like China, but supported China’s claim that U.S. Department of Commerce failed to investigate whether the concurrent application of AD and CVD duties on Chinese imports in 25 cases may have resulted in a double remedy. The latter finding mirrors a similar WTO Appellate Body finding in another Chinese case challenging use of U.S. trade law against China.<sup>13</sup>

Initiated in 2012, China’s claims relate to the imposition of duties in connection with investigations initiated between November 20, 2006, and March 13, 2012. The case focused on whether the United States acted consistently with its WTO obligations when it passed Public Law 112-99, “An act to apply the countervailing duty provisions of the U.S. Tariff Act of 1930 to nonmarket economy countries, and for other purposes” (the so-called *GPX legislation*). The *GPX legislation*, enacted by Congress in March 2012, confirmed the ability of U.S. Department of Commerce to apply CVD to imports from nonmarket economies, after a 2011 decision by the Court of Appeals of the Federal Circuit held that Commerce did not have that authority. The *GPX legislation* was “made effective” on November 6, 2006 (thus covering all existing CVD orders against nonmarket economies).<sup>14</sup>

China challenged the *GPX legislation* on the grounds that it was retroactive and therefore violated transparency provisions contained in Article X of the 1994 General Agreement on Tariffs and Trade (GATT). The Panel found, however, that the *GPX legislation* was not in violation because it did not retroactively raise duty rates or impose “new” or “more burdensome” requirement or restriction on imports.<sup>15</sup>

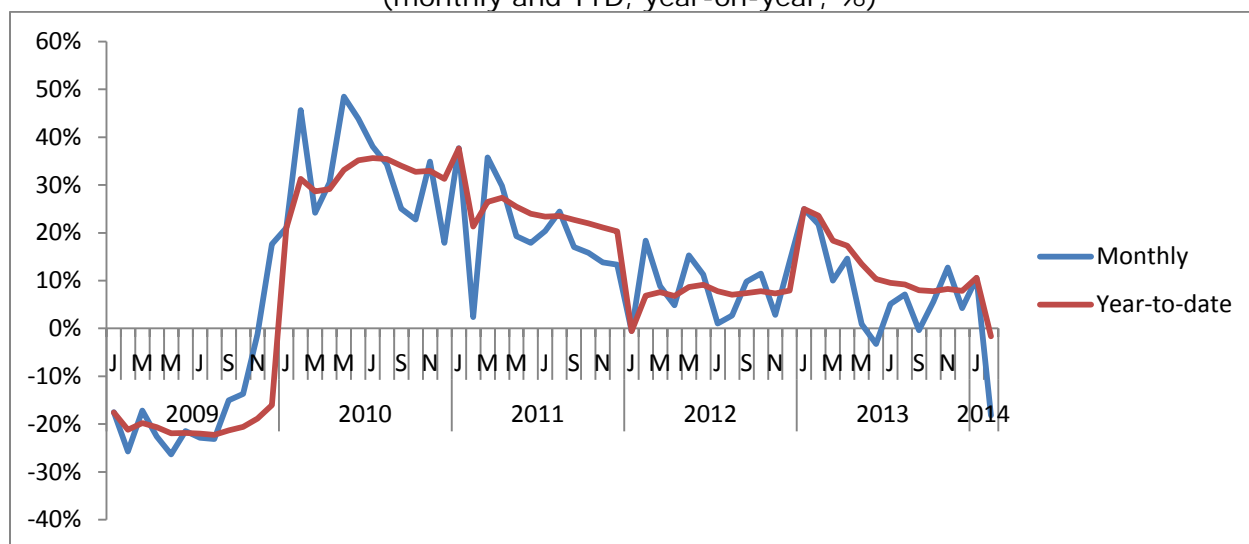
Regarding the Panel’s siding with China over the allegation of double remedies, U.S. Trade Representative Michael Froman said the U.S. was “disappointed.” But he noted that the Panel’s “concerns relate to certain past determinations, and U.S. law now directs the Department of Commerce to investigate any possible overlap.”<sup>16</sup> Both sides have 60 days to appeal the decision.

## China's Economy

In his March 5 address to the National People's Congress (NPC), Premier Li Keqiang offered a sanguine year-in-review of China's economy, downplaying the debt burden, weak exports and other risks. The government's annual work report set a 7.5 percent growth target for 2014, while moving ahead with the reforms laid out by the leadership last year.<sup>iii</sup> In the ensuing weeks, negative economic data, spanning manufacturing, exports, consumption, and investment, have painted a gloomier picture. A median estimate of economists surveyed by Bloomberg in mid-March projected only 7.4 percent GDP growth for the first quarter of 2014, down from an earlier forecast of 7.6 percent.<sup>17</sup> A snap AFP poll of economists saw a median forecast of 7.4 percent growth for 2014.<sup>18</sup> Speaking in China's northeastern rustbelt on March 26, Premier Li sought to reassure anxious markets. He acknowledged "downward pressure" on the economy, but also maintained that conditions were "stable" and that his government had the tools to avert a hard landing.<sup>19</sup>

Headlining China's lackluster indicators were exports, which dropped by 18 percent year-on-year in February (see figure 2). That was the worst monthly drop since August 2009, at the peak of the global financial crisis. Imports stayed strong, mainly because Chinese companies took advantage of low global prices to build stockpiles of crude oil, iron ore, and other commodities.<sup>20</sup> The result was a monthly trade *deficit* of \$23 billion, a rarity in China's export-oriented economy. Some economists, though, cautioned against over-interpreting these numbers. China's trade balance always takes a dive in February, due to economic inactivity during the spring festival season. Exports may have looked particularly weak because customs data a year ago was inflated by over-invoicing of export receipts—a practice used by companies to skirt foreign exchange controls to bring foreign currency onshore. The government has since clamped down on this practice.<sup>21</sup>

Figure 2: Growth of China's Exports  
(monthly and YTD, year-on-year, %)



Source: China General Administration of Customs, via CEIC data.

<sup>iii</sup> For more information on this year's NPC meetings, see Nargiza Salidjanova and Iacob Koch-Weser, "China's 2014 Government Work Report: Taking Stock of Reforms" (Washington, DC: U.S.-China Economic and Security Review Commission, April 1, 2014).

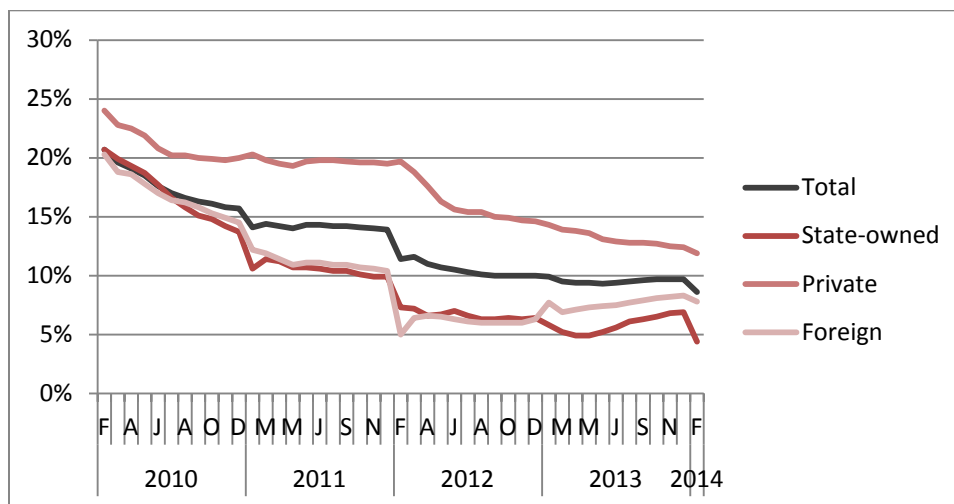
[http://origin.www.uscc.gov/sites/default/files/Research/USCC%20Backgrounder\\_NPC%20scorecard.pdf](http://origin.www.uscc.gov/sites/default/files/Research/USCC%20Backgrounder_NPC%20scorecard.pdf).

For more information on last November's Third Plenum, see Nargiza Salidjanova and Iacob Koch-Weser, "Third Plenum Economic Reform Proposals: A Scorecard" (Washington, DC: U.S.-China Economic and Security Review Commission, November 19, 2013).

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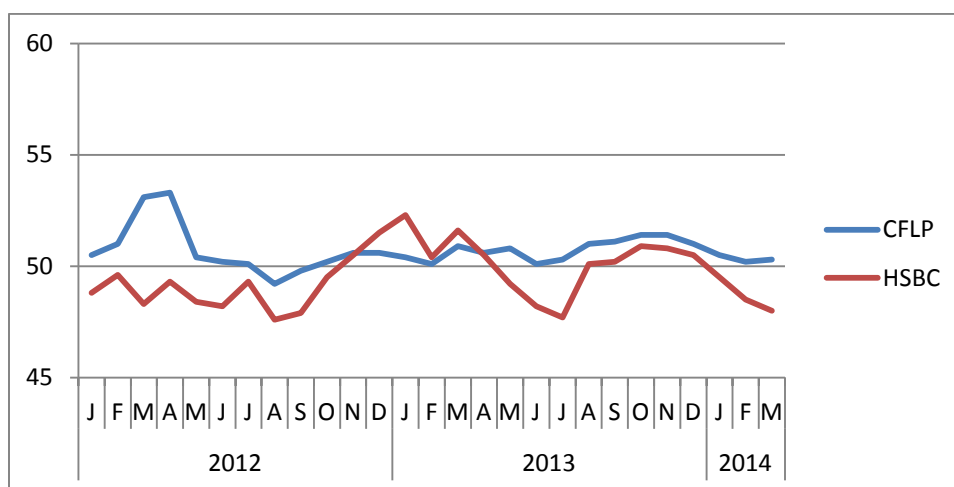
While there is room to question the export data, the poor state of the economy has been confirmed by other figures. Industrial output growth in February fell to its lowest since 2009. Private companies, registering stronger output gains than state-owned enterprises (SOEs), have not been immune to the slowdown (see figure 3). The HSBC's Purchasing Managers' Index (PMI), a survey of manufacturers that focuses on private companies, fell in March for the sixth month. It has been below 50 since January, a sign of declining output (see figure 4). The Chinese government's PMI (published by the China Federation of Logistics and Purchasing), which surveys more SOEs, fared slightly better.

Figure 3: Growth in China's Industry Value-Added, by Enterprise Type (YTD, year-on-year, %)



Source: China National Bureau of Statistics, via CEIC data.

Figure 4: China's Purchasing Managers' Index, HSBC vs. CFLP



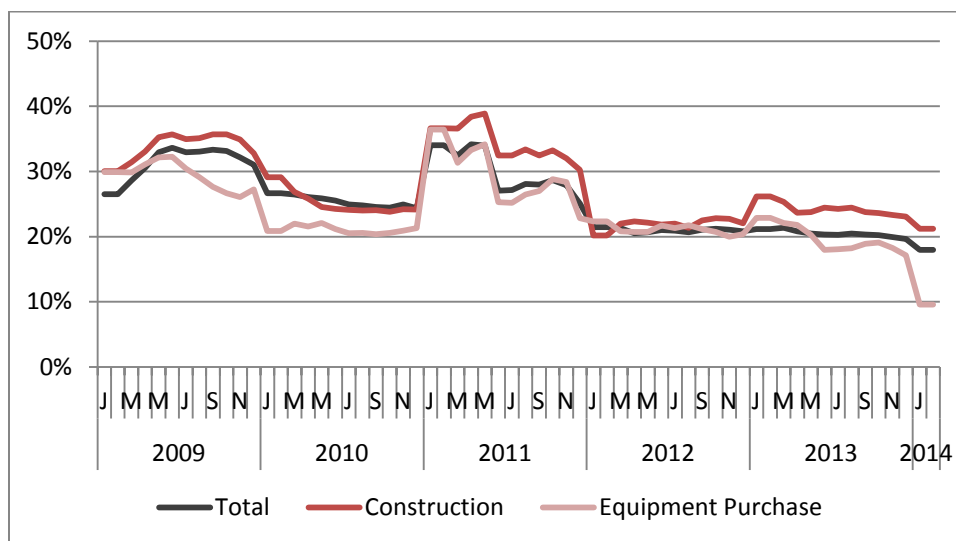
Source: China's National Bureau of Statistics, via CEIC data; HSBC Purchasing Managers' Index. <http://www.hsbc.com/1/2/emerging-markets/em-index/purchasing-managers-index>.

Equally striking was the letdown in consumption and investment, the alternative drivers of growth. Fixed investment in February increased by 17.9 percent year-to-date, the slowest since 2003. Investment in construction (primarily real estate), which accounts for 70.9

percent of fixed investment, remained strong; the real decline was in capital equipment purchases, a sign that factories are putting less money into productive assets (figure 5).

Retail sales, which serve as a barometer of China’s rebalancing toward a consumer-driven economy, rose by only 11.8 percent, much lower than investment growth, and the worst showing since April 2004. Even adjusting for China’s low consumer inflation (2 percent in February), the slump is undeniable.

Figure 5: China’s Fixed Investment Growth by Sector (YTD, year-on-year, %)



Source: China National Bureau of Statistics, via CEIC data.

### Tolerance for Defaults and a Subtle Stimulus

For China’s policymakers, the current downturn poses a familiar conundrum: How to sustain growth while also addressing such systemic risks as debt and overcapacity. The officials have avoided using the word “stimulus,” but the past month they revealed some measures to boost growth. Finance Minister Lou Jiwei and Premier Li also affirmed that below-target growth would be acceptable as long as new jobs are created.<sup>22</sup>

A more tangible change has been the tolerance for corporate failure. Back in January, the government decided to bail out a trust company that had lent billions to a collapsed coal miner. Yet in early March, it stood back as China’s RMB 8.5 trillion domestic bond market experienced its first default. The company, Shanghai Chaori Solar Energy Science and Technology Company, is a maker of solar cells and panels, and as such, is representative of the excess capacity, flagging exports, and plummeting prices that have hit China’s clean-tech industries over the past two years.<sup>iv</sup> The Chaori default—on a RMB 1 billion bond (\$161 million)—was followed by news on March 18 that Zhejiang Xingrun Real Estate Co., a developer with RMB 3.5 billion (\$563 million) of debt, would collapse as well. Two of China’s largest commercial banks, China Construction Bank and Agricultural Bank of China, were among Xingrun’s biggest creditors.<sup>23</sup>

<sup>iv</sup> For a closer look at the problems facing China’s clean-tech industry, see the June 2013 edition of the USCC Monthly Trade Bulletin. [http://origin.www.uscc.gov/sites/default/files/trade\\_bulletins/June%202013%20Trade%20Bulletin\\_6%207%2013.pdf](http://origin.www.uscc.gov/sites/default/files/trade_bulletins/June%202013%20Trade%20Bulletin_6%207%2013.pdf).



In tandem with high-profile defaults, however, it appears that stimulus measures are on the way. In a statement released on March 19, China's cabinet stated that the nation will "seize the moment to roll out already-determined measures in expanding domestic demand and stabilizing growth" and will "accelerate preliminary work and construction on key investment projects with timely assignment of budgeted funds."<sup>24</sup> A central focus of infrastructure investment is the rail sector, which has the added benefit of addressing infrastructure bottlenecks and air pollution from vehicles. The government in early March approved five railway projects projected to cost a total of RMB 142 billion (\$22.8 billion).<sup>25</sup> The government's mini-stimulus program also includes extending tax breaks for SMEs until 2016, and shantytown redevelopment.<sup>26</sup>

Other analysts have discerned stimulus measures in China's monetary policy. The value of the RMB, which is traded according to a daily trading band and a daily trading rate set by the central bank, has depreciated sharply this year.<sup>v</sup> The central bank may have done so to ward off speculative currency inflows, but the devalued currency has also provided a much-needed boost to China's export sector, which is struggling with cheaper competition from Vietnam and Indonesia. Central bank intervention in the currency market also brings down domestic interest rates as more cash is injected into the financial system, resulting in lower interest rates.<sup>27</sup> Whether China will continue to weaken the currency, however, is unclear. On March 24, the RMB climbed the most in more than two years as the central bank raised the exchange rate for the first time in five days. Chinese Vice Finance Minister Zhu Guangyao stated that depreciation of the RMB is "not big." His colleague at the central bank, PBOC Vice Governor Yi Gang, asserted that two-way movement of the currency will be the norm and that the central bank's role in the exchange rate will weaken.<sup>28</sup>

Although Beijing's currency policy is hard to discern, its lending policy is certainly loosening. Companies have been permitted to raise capital by selling preferred stock—a hybrid between equity and debt. Two property developers have been allowed to raise capital on the stock market, reopening a channel that had been closed since 2010 as the government sought to temper a building boom.<sup>29</sup> Moreover, risky practices related to China's opaque financial sector continue. *The Wall Street Journal* recently reported that state-owned Zoomlion, a leading maker of construction machinery, has been selling more equipment to customers who cannot afford to pay for it. Zoomlion has resold these "accounts receivable" to local banks, which are incurring the risk that Zoomlion's customers will default on their debts.<sup>30</sup>

### **Sector Focus: China's Imports of Bulk and Consumer Agriculture Goods**

Food and agriculture was the top U.S. export to China in February. That continues a trend—U.S. food shipments to China have risen fivefold over the past decade, to \$25.8 billion last year. During a period when U.S. food producers have grown more reliant on foreign markets, China has become their number-one destination. With China buying 17.7 percent of their goods, the U.S. farm sector is considerably more reliant on China than other U.S. exporters, which sell only 6.7 percent of their goods there.

The standard explanation for these trends is that China's emerging economy is lifting per capita food consumption to levels that cannot be satisfied by China's farmers alone, particularly as urban consumers adopt protein-based diets. The United States, with its comparative advantage in resources and productivity, is well-positioned to step in. The reality, however, is more complex—U.S. food shipments are actually underperforming.

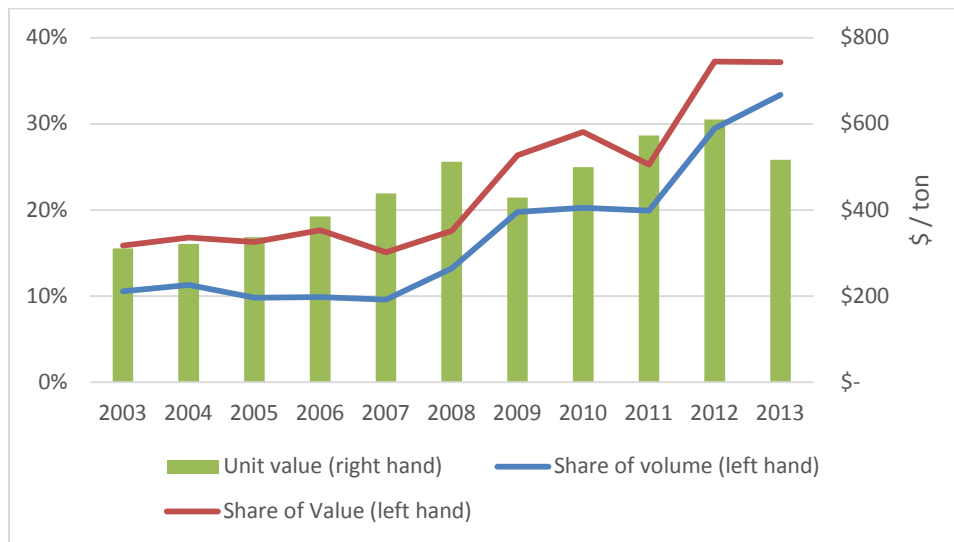
A striking feature of U.S. food shipments to China is their stop-and-go pattern. In dollar terms, exports vaulted in 2010 and 2012, only to tail off in 2011 and 2013. Much of this

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<sup>v</sup> For more on the RMB's decline, see the March 2014 edition of the USCC Monthly Trade Bulletin. [http://origin.www.uscc.gov/sites/default/files/trade\\_bulletins/March%202014%20Trade%20Bulletin.pdf](http://origin.www.uscc.gov/sites/default/files/trade_bulletins/March%202014%20Trade%20Bulletin.pdf).

volatility is attributable to the uneven composition of the exports. Some three-quarters of U.S. food shipments to China last year were bulk items, predominately soybeans. Over one-third of U.S. bulk commodity exports went to China, versus only 5 percent of U.S. consumer foods. Because bulk items are undifferentiated products, they are very susceptible to price swings. A drought in the United States caused commodity prices to spike in 2012, before a recovery in output, combined with a weak global economy, caused prices in 2013 to fall again. These trends directly impacted U.S. trade with China. Measured in tons, China actually increased its share of U.S. bulk item purchases last year; measured in dollars, it did not (see figure 6).

*Figure 6: U.S. Exports of Bulk Agricultural Goods to China: Unit Value and China's Share of Total U.S. Bulk Shipments*

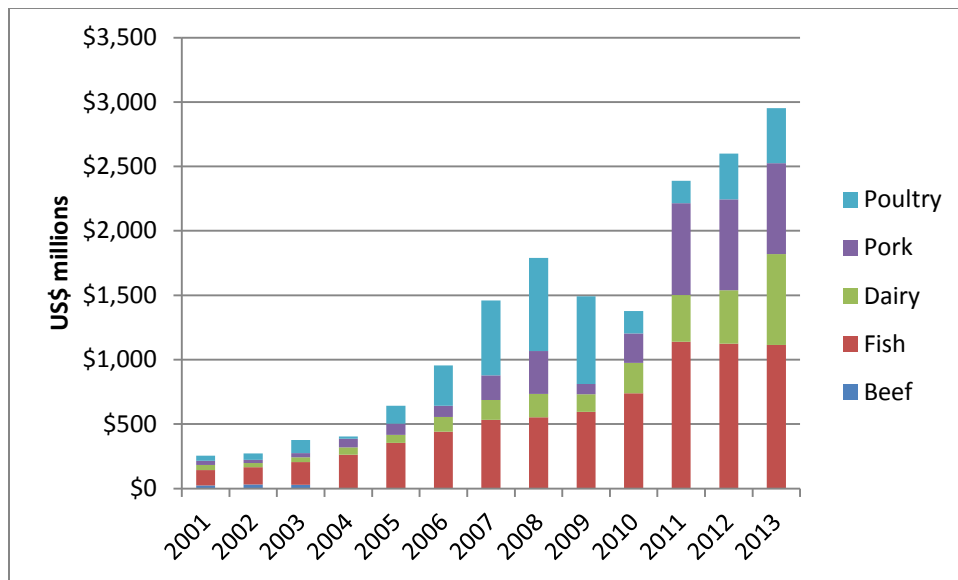


Source: USDA GATS.

China's under-consumption of consumer foods is directly related to its preference for bulk items. Soybeans and corn are used to feed China's outsized population of pigs, chickens, and farm-raised fish (see figure 7). Conversely, China purchased less than \$3 billion worth of U.S. meat, dairy, and fish products last year, even though these goods are worth about four times as much per ton shipped, and have seen more stable price increases. The dearth of purchases has less to do with a lack of appetite for U.S. meat in China, and more to do with Chinese state interference. U.S. beef is banned in China under the pretext that it is unsafe. China's Ministry of Commerce levied antidumping duties on U.S. broiler chickens in 2009, causing poultry exports to decline ever since. U.S. pork is permitted into China but competes with China's heavily subsidized pork industry, which accounts for half of the world's pork output. The only U.S. animal product making any progress in China is dairy, which is benefitting from a scandal that has compelled Chinese consumers to switch from tainted domestic milk to imports (see figure 7).

China takes these measures to protect the livelihoods of domestic farmers on the one hand, and on the other, to advance a broad definition of "food security," which now includes not only basic grains but also meat products. China is now facing pressure from the United States to abandon these policies. At the 2013 JCCT talks, China promised to reopen its market to U.S. beef by July of this year. A ruling last fall also found the AD duties on U.S. broiler chickens to be a violation of WTO commitments.

*Figure 7: U.S. Exports of Meat, Fish, and Dairy Products to China, 2001-2013*

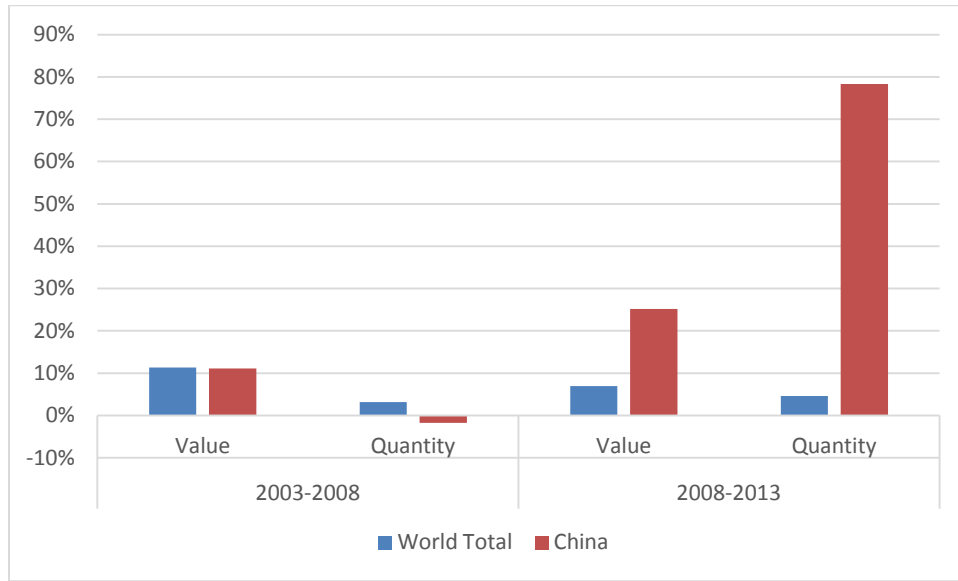


Source: USDA GATS.

Peeling back another layer, the U.S. farm sector faces additional disadvantages unique to China’s agriculture policy. One is the volatility China’s food prices. China’s core inflation of food and energy products was very high in the mid-2000s but has been low over the past two years. That is good for Chinese consumers but bad for China’s fragmented pork sector, which tends to overproduce during upswings and incur heavy losses when the price drops. Downswings thus reduce demand for feedstock, prompting commodity traders to buy up cheap corn and soy in the expectation of profits when prices rebound.

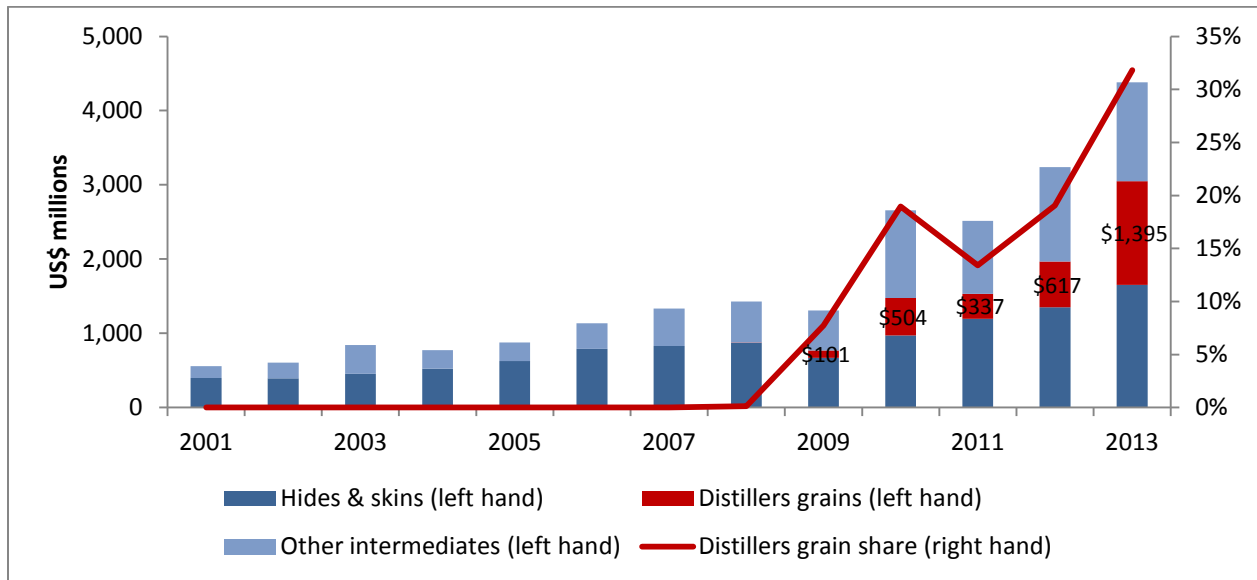
Another issue is China’s ambivalence toward importing corn, a less protein-rich but more abundant source of livestock feed than soybeans. While China opened the floodgates to soy imports in the late 1990s, corn is still a strategic item subject to 90 percent self-sufficiency mandate. To get around import barriers for corn, Chinese importers have resorted in recent years to purchasing dried distillers grains (ddgs), a feed byproduct of corn-based ethanol production that is classified as an “intermediate good” by the U.S. Department of Agriculture (see figure 8). China’s imports of ddgs over the past year alone more than doubled (see figure 9). U.S. efforts to ramp up ethanol production have made ddgs more widely available. Ddgs are also more protein-rich per ton than ordinary corn, a key consideration given the cost of shipping bulk goods across the Pacific. An added advantage for China’s importers is that, unlike corn, ddgs are exempt from value-added tax and the stringent import licensing and quotas of corn.<sup>31</sup>

Figure 8: Growth in U.S. Exports of Intermediate Agricultural Goods, China vs. World (compound annual growth, %)



Source: USDA GATS.

Figure 9: U.S. Exports of Intermediate Agricultural Products to China



Source: USDA GATS.

Eventually, China will need to import more corn, and it has already begun to tacitly abandon its self-sufficiency policy. China's refusals of U.S. corn shipments in recent months, though, suggest that corn will not enjoy smooth entry into China. In addition to general import barriers, a tough barrier is China's treatment of genetically modified grains. In November to December of last year, China's quarantine agency refused some 180,000 tons of U.S. corn under the pretext that the insect-resistant MR162 strain, developed by the Swiss company Syngenta, has not been approved for marketing in China.<sup>32</sup> In late December, China went a step further, rejecting 2,000 tons of ddgs because they were found to contain MR162.<sup>33</sup> Data for January and February of this year suggests that the problem has not been

resolved—only 85,742 tons of corn were shipped to China, compared to 670,649 tons during the same period in 2013.<sup>34</sup>

Like Japan and Europe, China may appear wary about the safety of GMOs. But in reality, China already markets GMO soy and plants GMO cotton. Rather, GMO-based refusals serve as a convenient market barrier to support domestic industry. China adheres to a policy of “asynchronous approvals,” by which it allows application for a biosafety certificate only after it gets fully approved in the exporting country.<sup>35</sup> The specific biotech corn variety at the center of the recent refusals, Syngenta’s MR162, was already approved for cultivation in the United States in 2010, and since then by most major economies. Moreover, MR162 was likely in earlier U.S. corn shipments to China—China only recently decided to step up testing of inbound cargoes.<sup>36</sup> As with slow approvals for patented goods like pharmaceuticals, China can use these redundant approval processes to reduce the patent life of the foreign good when it is marketed in China. It also advantages China’s nascent GMO research industry, which hopes to compete with Western firms in the medium term.

*NOTE: An updated version of this bulletin was published on April 8, 2014, after initial publication on April 4. Key correction: “U.S. exports to China declined by 4.6 percent year-on-year” changed to “U.S. exports to China declined by 4.6 percent month-on-month.”*

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*The U.S.-China Economic and Security Review Commission was created by Congress to report on the national security implications of the bilateral trade and economic relationship between the United States and the People’s Republic of China. For more information, visit [www.uscc.gov](http://www.uscc.gov) or [join the Commission on Facebook!](#)*

*This report is the product of professional research performed by the staff of the U.S.-China Economic and Security Review Commission, and was prepared at the request of the Commission to support its deliberations. Posting of the report to the Commission’s website is intended to promote greater public understanding of the issues addressed by the Commission in its ongoing assessment of U.S.-China economic relations and their implications for U.S. security, as mandated by Public Law 106-398 and Public Law 108-7. However, it does not necessarily imply an endorsement by the Commission, any individual Commissioner, or the Commission’s other professional staff, of the views or conclusions expressed in this staff research report.*

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