U.S.-China Economic and Security Review Commission
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Highlights of This Month's Edition

- **Bilateral trade:** In October 2017, U.S. goods trade deficit grew 13.2 percent year-on-year to reach $35.2 billion; year-to-date, the deficit reached $309 billion, up 7 percent year-on-year.
- **Bilateral policy issues:** President Trump traveled to China for a presidential summit with President Xi, which culminated in a series of business agreements worth about $250 billion, but no resolutions on higher-priority issues; citing wide-spread shortcomings in China's economic reform, the U.S. Department of Commerce maintains its classification of China as a nonmarket economy, prompting China to launch a new WTO case against the United States.
- **Policy trends in China's economy:** China announces plans to relax or eliminate caps on foreign ownership in Chinese financial institutions; NDRC launches third wave of mixed-ownership SOE reforms, seeking to introduce increased private capital in the state sector while simultaneously strengthening government's role in the economy; Alibaba's Singles' Day reaches new sales record of $25.3 billion, eclipsing U.S. Black Friday and Cyber Monday sales.
- **Sector focus – Commercial Aviation:** U.S. and Chinese aviation regulations will recognize each other's approvals for aircraft and aviation products, likely increasing U.S. imports of Chinese aircraft and aviation.

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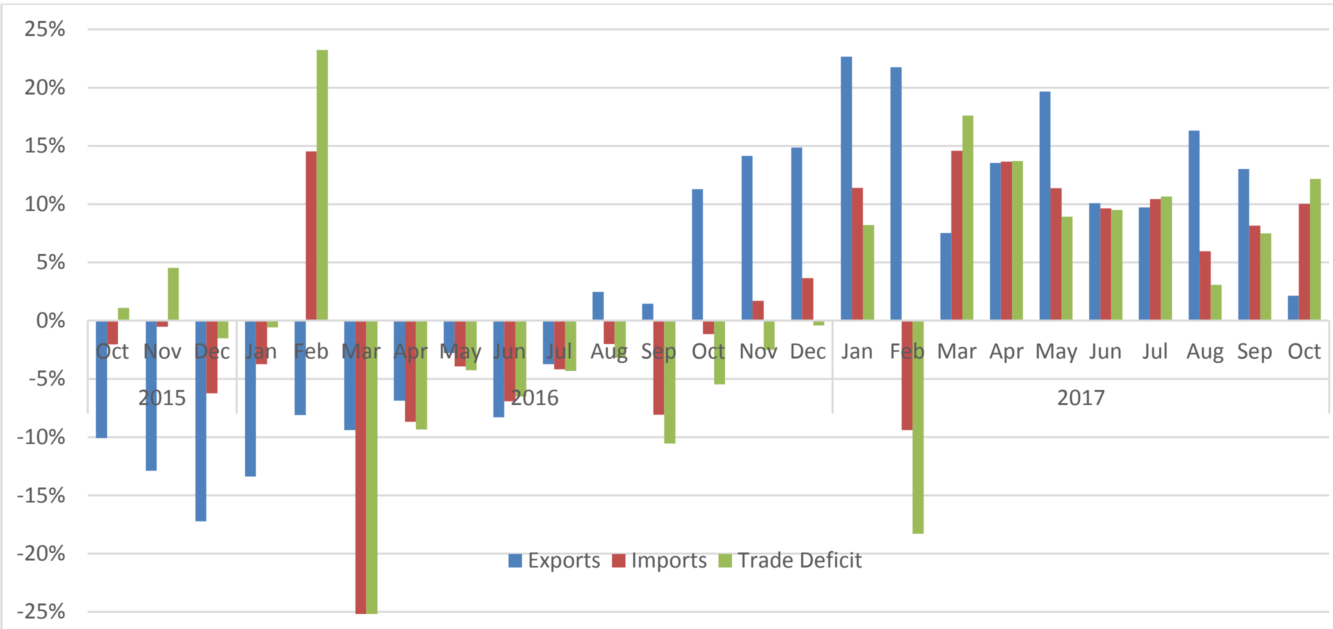
Bilateral Trade

U.S. Goods Deficit with China Expands 13.2 Percent in October 2017

In October 2017, U.S. goods deficit with China reached $35.2 billion, a 13.2 percent increase year-on-year. U.S. goods exports to China grew 2 percent year-on-year to $13 billion, their highest level since December 2013, while imports jumped to $48.2 billion, a 10 percent increase year-on-year (see Figure 1).

Figure 1: U.S. Goods Trade with China, October 2015 – October 2017

(year-on-year)



Source: U.S. Census Bureau, *Trade in Goods with China*, December 5, 2017. *https://www.census.gov/foreign-trade/balance/c5700.html.*

In the first 10 months of 2017, the cumulative deficit was about $309 billion, up 7 percent over the same period in 2016. Cumulative imports were up 8.4 percent year-on-year, while exports grew 13 percent. After a protracted downward trend from late 2015 to mid-2016, U.S. exports to China showed a steady recovery since August 2016. Imports from China have similarly trended upward, and the deficit in 2017 is on track to exceed its 2016 level.

Bilateral Policy Issues

President Trump on State Visit to China

As part of his first trip to Asia, President Donald Trump traveled to China on November 8 for a state visit with Chinese President and General Secretary of the Chinese Communist Party Xi Jinping. The visit marked one of several stops before the East Asia Summit in Manila on November 14.[1] The visit was described by China's foreign ministry as a "state visit plus," with special ceremonies to fete President Trump's arrival: President Xi treated President Trump to a private tour of the Forbidden City, followed by a state banquet with performances the next evening.[2] Though amicable, the visit concluded without concrete actions on deficit reduction, forced technology transfers, or any other problems raised by the U.S. business community.

The trip's biggest takeaway was a series of business agreements valued at an estimated $250 billion.[3] To affirm these agreements, a business delegation of more than two dozen corporate executives accompanied President Trump to China.[4] Major agreements focused primarily on the energy sector, though other sectors were also represented:

- *Energy:* Alaska Gasline Development Corp. signed a development agreement to fund a liquid natural gas pipeline with China Petroleum Group (Sinopec), the Bank of China, and the China Investment Corporation (CIC), China's sovereign wealth fund, valued at $43 billion. West Virginia and China Energy Investment Corp. agreed to invest $83.7 billion in shale gas and chemical projects.[5] Delfin Midstream "sealed a preliminary 15-year sales agreement" with natural gas distributor China Gas Holdings.[6] Apart from the official delegation, Westinghouse Electric Company and State Nuclear Power Technology Company signed agreements for the construction of six nuclear reactors in China.[7]
- *Agriculture:* The U.S. Soybean Export Council signed a letter of intent with the China Chamber of Commerce for Import and Export of Foodstuffs, Native Produce and Animal By-Products, for eight million metric tons of imports.[8] COFCO International signed a memorandum of understanding for the import of additional soy products from Archer Daniels Midland Company.[9]
- *Aircraft:* China Aviation Supplies Holding Company sealed a pact to purchase 300 aircraft from Boeing.[10] GE Aviation agreed to sell Juneyao Airlines GEnx-1B engines for ten of their aircraft.[11]
- *Chemicals:* American Ethane Co. signed a binding 20-year contract to supply ethane to Nanshan Group, a producer of ethylene.[12] Air Products (APD) and Yankuang Group Co., Ltd. reached an agreement to fund a coal-to-syngas production site in Shaanxi Province worth $3.5 billion.[13]
- *Mobile phone technology:* Qualcomm signed memoranda of understanding with Xiaomi, Oppo, and Vivo, which will purchase components over three years.[14]
- *Financial services:* Goldman Sachs Group Inc. announced the establishment of a $5 billion fund to invest in U.S. manufacturing, with initial investment from CIC.[15]

Despite the agreements associated with President Trump's visit, observers noted the deals' limited gains. Many agreements had either been previously negotiated or simply represented memoranda of understanding, in lieu of binding commitments.[16] The Boeing jet purchase, for example, had been confirmed possibly as early as 2013 as part of a broader supply commitment, and Sinopec has characterized its interest in the Alaska pipeline agreement as a "possibility."[17] The agreements' final valuation is also uncertain, as some companies were silent regarding the products' value, and the total figure was not broken out by line item.[18]

Some analysts had expected more progress on continuing sources of friction to emerge from the meeting. In an editorial ahead of the event, China observer Orville Schell expressed hope for increased pressure on halting U.S. technology transfers, enforcing greater intellectual property protection, and opening economic sectors currently closed to U.S. businesses.[19] Similarly, William Zarit, the chairman of the American Chamber of Commerce in China, urged the discussions not to lose sight of broader "structural issues."[20] Following the meeting, business organizations renewed calls for a "cohesive U.S. government strategy" to boost leadership and competitiveness in Asia.[21] Similarly, there has been no progress on issues of strategic interest to the United States. On the question of North Korean nuclear development, for example, President Trump reportedly requested China halt all oil shipments, freeze bank accounts, and expel North Korean migrant workers. President Xi responded that trade sanctions would require time to take effect.[22] No further definitive strategy was agreed upon.

United States Deems China a Nonmarket Economy, Prompting a WTO Challenge

On October 26, 2017, citing continued lack of liberalization in China's market, the U.S. Department of Commerce (DOC) reaffirmed China's status as a nonmarket economy (NME). This decision, made as part of the DOC's determination of antidumping (AD) duties on Chinese aluminum foil imports to the United States, provoked an angry response from Beijing.[23] Under U.S. AD procedures, when assessing AD duties on goods from NME countries, the DOC can use prices from third-party countries to adjust for systemic market distortions in NMEs that artificially lower prices (the so-called "surrogate country" approach). This process usually results in higher margins for dumped goods from the NME country.[24] In conjunction with the determination of China as an NME, the DOC imposed preliminary AD duties of 96.8 to 162.2 percent on imports of Chinese aluminum foil.[25]

The DOC's determination was part of a review of China's economy begun in March 2017.[26] Under U.S. law, the DOC bases its determination of a country's status as a market economy on six statutory factors, including the convertibility of the country's currency; free bargaining for wages; the acceptance of joint ventures and foreign investment; government ownership and control over the means of production; government control over the allocation of resources, prices, and output levels; and other criteria as appropriate.[27] The DOC found serious shortcomings in China's economy[*] with respect to all six factors used to evaluate its classification as a market economy:

- *Currency convertibility:* The DOC noted that while China's currency is convertible into foreign currencies for trade transactions, the Chinese government continues to maintain capital controls, including approval requirements for large capital account transactions.[28] China also regularly intervenes in capital markets to reduce price divergence between onshore and offshore exchange rates for the renminbi (RMB).[†]
- *Free bargaining for wages:* The DOC identified several institutional obstacles to free bargaining in China, including the prohibition of independent trade unions, the lack of a legal right for workers to strike, and the appropriation of all negotiations on behalf of workers by the All-China Federation of Trade Unions—an entity created and controlled by the Chinese Communist Party (CCP).[29] China's residency permit system, the *hukou*, which ties Chinese citizens' social benefits to geographical locations, was also cited by the DOC as a barrier to free movement of labor and a source of labor market distortions.[30]
- *Joint ventures and foreign investment:* China's foreign investment regime is "particularly restrictive relative to that of other major economies," according to the DOC.[31] China continues to impose barriers such as equity limits, local partner requirements, technology transfer and localization requirements, and nontransparent approval procedures.[32] The DOC noted "it is the Chinese government's foreign investment regime, not the market primarily, that channels foreign investment in those sectors the Chinese government determines to support, while limiting foreign investment in those sectors that the Chinese government finds strategically import to maintain under its control alone."[33]
- *Government ownership and control over the means of production:* The DOC found the Chinese government has "significant ownership over the means of production" largely through the prevalence of state-invested enterprises and the Chinese government's control over land.[34] According to the DOC, the "economic weight" of state-invested enterprises is substantial compared to other economies; moreover, because the Chinese government uses state-invested enterprises as a significantly important tool to fulfill government objectives, they often do not act in accordance with market-based behavior.[35] With respect to land, the DOC found the government's sole ownership of Chinese land makes it the "final arbiter" of who uses land for what purpose.[36]
- *Government control over resource allocation, prices, and output levels:* According to the DOC, the Chinese government continues to control China's economy through industrial policies, including subsidies, investment guidance catalogues, allocation of credit, mandatory industrial restructuring, and investment approvals.[37] The DOC also highlighted the government's control over prices of inputs such as electricity, which the government regularly alters to achieve policy objectives.[38]
- *Other criteria:* The DOC faulted China's legal system as an instrument through which the government can achieve desired economic goals. According to the DOC, China's courts are "structured to respond to" the CCP's direction and do not provide an adequate venue for "individuals and firms that seek to act independently of government or CCP direction."[39]

China's Ministry of Commerce rebuffed the DOC's determination, claiming the United States has "ignored China's achievements in building a market economy and the conclusion was a serious distortion of the real situation."[40] Beijing has frequently asserted that the United States does not accurately portray the government's role in China's

[*] For more on China's status as an NME, see U.S.-China Economic and Security Review Commission, *Evaluation of China's Nonmarket Economy Status*, April 18, 2017. *https://www.uscc.gov/sites/default/files/Research/Non%20Market%20Economy%20Issue%20Brief.pdf.*

[†] In addition to China's onshore RMB market, which manages RMB within a band of exchange rates set by Chinese regulators, there are offshore markets in Hong Kong, London, Singapore, and Taiwan where RMB-denominated assets are traded at exchange rates that float freely according to market forces. Subsequently, offshore and onshore markets often have different exchange rates for the RMB. Mamta Badkar, "An Introduction to How China's Offshore Renminbi Market Works," *Business Insider*, February 21, 2014. *http://www.businessinsider.com/onshore-and-offshore-renminbi-2014-2*. U.S. Department of Commerce, *China's Status as a Non-Market Economy*, October 26, 2017. *https://enforcement.trade.gov/download/prc-nme-status/prc-nme-review-final-103017.pdf*.

economy. However, to win market economy status (MES) Beijing has often relied on strategies and arguments that are independent of actual market conditions in China. For example, as part of its 2001 World Trade Organization (WTO) accession protocol, China agreed to a provision that allowed WTO countries to automatically treat it as an NME for 15 years.[41] Since the expiration of this provision in December 2016, China has argued that it is automatically entitled to MES from all WTO members, including the United States.[42] Additionally, China has made recognition as a market economy a prerequisite for free trade agreement negotiations, effectively leveraging access to its large domestic market in exchange for MES.[*]

In response to the DOC's decision, China filed a new case against the United States at the WTO, arguing that the United States is bound to recognize China as a market economy following the expiration of China's accession protocol provision.[43] China opened similar cases against the United States and the EU in December 2016.[44] However, while China advanced its case against the EU to the next procedural step by requesting a WTO panel in March 2016, it failed to do so for its case against the United States, indicating China may believe it will have an easier time challenging EU AD procedures than those of the United States.[45] In October 2017, the EU introduced legislation altering how it calculates AD margins, a move seen as an attempt to preempt challenges from China in the WTO.[†]

On November 30, the United States laid out its legal defense to the WTO against China's claim that other countries must automatically grant it MES. Joining as a third party in the case brought by China against the EU, the United States argued China's accession protocol does not strip WTO countries of their right to correct for NMEs under General Agreement on Tariffs and Trade (GATT) rules.[‡] The United States highlighted a 70 year history of GATT countries adjusting for prices in nonmarket economies, particularly drawing on precedents from the cold war economies of Poland, Hungary, and Romania which at the time did not operate according to market principles.[46] The United States argued the termination of China's accession protocol clause only required WTO countries to provide evidence that China does not function as a market economy to adjust for price distortions.[47] The U.S. delegation suggested the DOC's analysis of China's economic conditions could serve as sufficient evidence to show that China functions as an NME.[48]

In the event the EU or the United States ultimately loses its WTO case with China, their AD methodologies would have to be changed to accord with the WTO ruling or risk facing retaliatory measures from China.[§] Although the outcome of each case is far from clear, a worst-case ruling would require the EU and United States to alter their AD methodologies in such a way that would prevent them from accounting for market-wide distortions in China's economy.

Policy Trends in China's Economy

China Announces Plans to Ease Limits on Foreign Ownership in Financial Firms

On November 10, the Chinese government announced plans to relax or eliminate caps on foreign ownership in Chinese financial institutions.[**] [49] China's Vice Minister of Finance Zhu Guangyao said at a press briefing that China will lift the cap on foreign equity stakes in securities, fund management, and futures companies to 51 percent from the current cap of 49 percent, but did not provide a timeline. Restrictions will be completely lifted three years after the new limit takes effect.[50] China will also remove the 20 percent cap on ownership of Chinese commercial

[*] For more on China's free trade agreement objectives, see Nargiza Salidjanova, "China's Trade Ambitions: Strategy and Objectives behind China's Pursuit of Free Trade Agreements," *U.S.-China Economic and Security Review Commission*, May 28, 2015. *https://www.uscc.gov/sites/default/files/Research/China's%20Trade%20Ambitions%20-%2005.28%2015.pdf*.

[†] For more on changes to the EU's AD methodology, see U.S. China Economic and Security Review Commission, *Economics and Trade Bulletin*, November 3, 2017. *https://www.uscc.gov/sites/default/files/Research/November%202017%20Trade%20Bulletin.pdf*.

[‡] The GATT was the precursor to the WTO. Many rules agreed to under the GATT have been carried over into the WTO. Jack Caporal, "USTR: GATT provides the basis for treating China as a non-market economy," *Inside U.S. Trade*, December 1, 2017. *https://insidetrade.com/daily-news/ustr-gatt-provides-basis-treating-china-non-market-economy*.

[§] Retaliatory measures may include compensation or temporary suspension of WTO obligations. World Trade Organization, "The Process—Stages in a Typical WTO Dispute Settlement Case." *https://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c6s8p1_e.htm*.

[**] For more on U.S. access to China's financial services market, see U.S.-China Economic and Security Review Commission, Chapter 1, Section 3, "U.S. Access to China's Consumer Market," in *2017 Annual Report to Congress*, November 2017, 128–140.

banks and asset management companies by a single foreign investor and the 25 percent cap on total foreign ownership of such companies.[51] The opening in insurance is the only one with a concrete timeline: foreign stakes in life insurance joint ventures will be raised to 51 percent in three years, from 50 percent currently for most foreign companies, and removed entirely in five years.[52]

A White House spokesperson said the announcement, which came a day after President Trump concluded his visit to China, was "welcome but long overdue," adding it is "one of a plethora of problems China needs to address in order to provide fair and reciprocal access to its market."[53] According to the *Wall Street Journal*, China proposed to jointly unveil the announcement during President Trump's visit, but the White House had declined; the article quoted a U.S. official as saying, "The overall approach now is not to negotiate over crumbs, not celebrate small deals that will have limited impact."[54] When China joined the WTO in 2001, it committed to rapidly open up its financial markets to foreign competition, but liberalization has been slow. U.S. and other foreign financial institutions remain marginal players in China due to formal and informal market access barriers.[55]

Industry analysts warn it will take time for Beijing's commitments to be implemented by China's central bank and banking, securities, and insurance regulators. "We're cautioning clients that it will take time to go from rhetoric to action. Directionally speaking, it's very clear where China is heading but it's going to be a slow, methodical process rather than a Big Bang approach," said Peter Alexander, managing director of Shanghai-based consultancy Z-Ben Advisors.[56]

China stands to benefit from greater foreign participation in its financial markets. People's Bank of China Governor Zhou Xiaochuan said in June that a lack of outside competition had made domestic financial institutions "lazy."[57] Increased outside competition could push Chinese financial institutions to be more efficient and help the sector adopt better governance and risk management practices.[58]

For many foreign firms, however, this opening is too little, too late. The European Chamber of Commerce said in a statement, "This opening-up comes at a late stage in development. It is now difficult for foreign firms to capitalize on these changes as domestic Chinese firms have stronger positions in their respective industry."[59] The combination of entrenched local players and an opaque regulatory regime means foreign financial companies may have limited appetites for taking advantage of widened access.[60]

Moreover, despite the size of China's financial services market, it is no longer as profitable as it was a decade ago. According to Chinese financial data provider Wind Information, the average return on assets for Chinese listed financial firms was just 0.9 percent in the first half of 2017, compared to above 4 percent for Chinese listed firms in the telecommunications and healthcare sectors.[61] Traditional financial intuitions in China are facing intense competition and disruption from domestic financial technology players such as Alibaba's Ant Financial and Ping An Insurance Group's Lufax.[62] In addition, amid concerns over China's rising debt levels, Beijing is cracking down on more profitable but risky financial products, like wealth management products.[*] Finally, many U.S. and European banks have shed their minority stakes in Chinese commercial banks in the years following the global financial crisis[†] as regulators tightened capital standards and foreign banks discovered their investments had failed to help expand their China footprint. These conditions likely will continue to dampen foreign financial institutions' interest.[63]

Third Wave of Mixed-Ownership Reforms Signals Continued Efforts to Increase Private Equity in State-Owned Enterprises

To combat increasing levels of debt and inefficiency in its state sector, the Chinese government is attempting to bring private sector investment and management into state-owned enterprises (SOEs). In November 2017, the

[*] For more on Beijing's recent moves to tighten rules on wealth management products, see U.S.-China Economic and Security Review Commission, *Economics and Trade Bulletin*, June 2, 2017, 6–8. *https://www.uscc.gov/sites/default/files/Research/June%202017%20Trade%20Bulletin.pdf*.

[†] Examples include Goldman Sachs, UBS, Citigroup, and Bank of America. HSBC is one of the few global banks to still hold a substantial stake in a Chinese bank; it holds a 20 percent stake in Chinese state-owned lender Bank of Communications. Gabriel Wildau and Hudson Lockett, "China Pledges to Open Finance Sector to More Foreign Ownership," *Financial Times*, November 10, 2017. *https://www.ft.com/content/d4a85422-c5d5-11e7-b2bb-322b2cb39656*.

National Development and Reform Commission (NDRC), China's main economic planning agency, announced a third round of pilot mixed-ownership reforms, bringing the total number of SOEs (both central and local[*]) participating in the program to 50.[64] Rather than signaling an increased effort toward privatizing key sectors of the economy, mixed-ownership reforms seek to make SOE operations more efficient and less reliant on government support while strengthening the government's central role in the economy.[65]

SOEs remain an important part of China's economy, but they are struggling due to inefficient operations and increasing debt.[66] According to the Beijing-based financial research firm Gavekal Dragonomics, all SOEs account for more than one-third of total investment and receive nearly 30 percent of all bank loans in China, yet they generate less than 10 percent of China's total gross domestic product.[67] Faced with years of declining returns, SOEs have become increasingly reliant on loans from state banks: from 2008 to 2015, SOEs increased their loans relative to assets from 53 percent to 64 percent—nearing the United States' 70 percent debt-to-asset ratio before the 2008–2009 financial crisis—while private companies' loans relative to assets declined over the same period.[68]

In 2014, the Chinese government announced its first plans for mixed-ownership reforms, which would bring private-sector investment and management into local and central SOEs.[69] Under the program guidelines, each participating company chooses a unit of the business, which then sells around a 30 to 45 percent stake to the private sector.[70] According to China's Caixin news service, the funds raised through the sale typically total more than $1 billion for central SOEs.[71] These funds are then reinvested in new projects between the SOE and its new private investors. After the sale, the central government remains the firm's largest shareholder, generally retaining at least 50 percent ownership and continuing to dictate the company's management and strategic planning.[72]

In the first two rounds, China's State Council selected 19 SOEs (primarily central SOEs)—in industries ranging from electrical services to civil aviation—to proceed with the pilot reforms.[73] Notable firms that have participated in the pilot program to date include China Eastern Air Holding Company and China Southern Power Grid.[74] According to NDRC spokesperson Meng Wei, these early mixed-ownership programs have been implemented successfully, with SOEs involved in the first two rounds "gradually implementing their restructuring programs and more than a third of them [completing] most of their reforms, including introducing new investors, boosting corporate governance and setting up new internal incentive mechanisms."[75]

The third round of reforms will involve 31 additional SOEs, including both centrally and locally administered firms that have applied for the program and been approved by the State Council.[76] In the first half of 2018, the NDRC plans to establish a $15 billion fund (made up of contributions from large central SOEs, other state investors, and private capital) to assist with implementing further mixed-ownership reforms.[77] Several smaller funds on both the national and local levels have also been created to assist with SOE restructuring, including the Beijing China Structural Mixed Ownership Reform Investment Fund, which seeks to facilitate local mixed-ownership reforms in Shenzhen, Shanghai, and Xi'an.[78]

Although mixed-ownership reforms seek to increase private capital in public firms, Chinese policymakers have stated the reforms will not lead to the full privatization of state assets.[79] Instead, these deals are structured primarily as capital injections for indebted SOEs while allowing the government to maintain its controlling stake in the firm. The case of Jiangxi Salt illustrates this trend. Jiangxi Salt has a legal monopoly in China's salt market, and was previously owned by the Jiangxi provincial State-Owned Assets Supervision and Administration Commission (SASAC).[80] After a deal in September 2015 to open Jiangxi Salt to foreign investors, the government's direct ownership of the company dropped from 100 to 47 percent, with four outside investors collectively holding a 47 percent stake and Jiangxi Salt's management buying a 6 percent stake.[81] However, the four new investors all had direct ties to the Chinese government: three were SOEs administered by SASAC, while the fourth was 83 percent owned by the Ministry of Finance.[82]

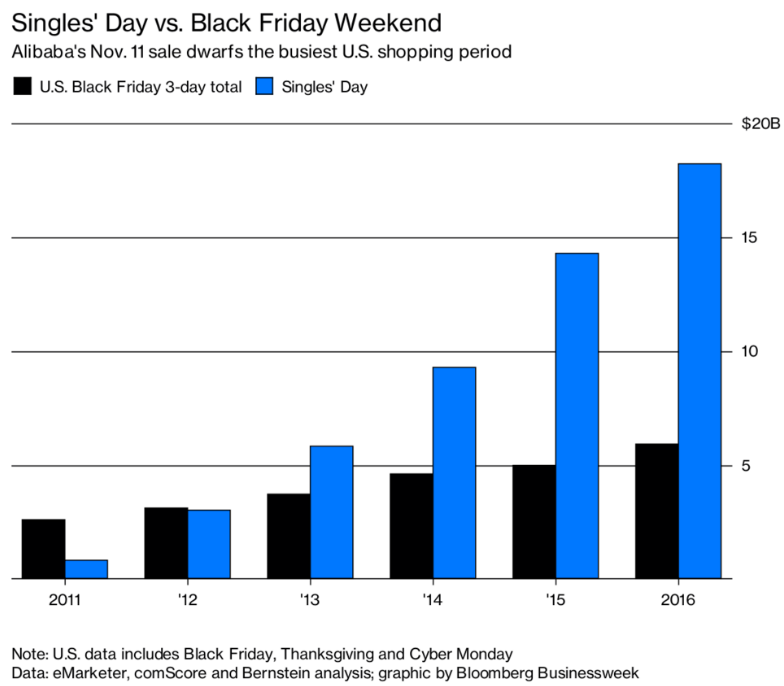
[*] China has two broad classes of SOEs: central and local. Central SOEs are directly owned by the central government and tend to be the biggest and most profitable companies; they are administered by the State-Owned Assets Supervision and Administration Commission (SASAC). There are currently 98 central SOEs. There are significantly more local SOEs, which are owned by provincial and municipal governments. Local SOEs tend to be small and less efficient, though many play important roles in their local economies; they are administered by local SASACs.

Alibaba's Singles' Day Reaches New Sales Record of $25.3 Billion

Within 24 hours on November 11, 2017, Alibaba Group, China's e-commerce giant, reached a new Singles' Day sales record of $25.3 billion (RMB 168.2 billion) in gross merchandise value (GMV),* 39 percent higher than in 2016.[83] Alibaba's previous Singles' Day sales records were $17.8 billion (2016), $14.3 billion (2015), $9.3 billion (2014), $5.8 billion (2013), and $3.06 billion (2012).[84]

These sales figures dwarf reported revenues from biggest U.S. shopping events (see Figure 2). For example, Amazon's Prime Day in July 2017 generated an estimated $1 billion in revenue during its 30-hour sales window.[85] In 2016, total sales across all merchants on Black Friday and Cyber Monday were $6.79 billion, and the combined total sales for four days after Thanksgiving in the United States were $12.8 billion.[86] According to Adobe Insights, in 2017 online sales were $5.03 billion on Black Friday and $6.59 billion on Cyber Monday.[87]

Figure 2: Alibaba's Singles' Day vs. U.S. Thanksgiving Holiday Sales Revenue, 2011–2016



Source: Lulu Yilun Chen, "Black Friday's Got Nothing on Alibaba's Singles' Day Sale," Bloomberg, November 9, 2017. *https://www.bloomberg.com/news/articles/2017-11-09/black-friday-s-got-nothing-on-alibaba-s-singles-day-sale.*

Singles' Day started as a noncommercial idea among male college students in China in 1993 to organize activities to celebrate their bachelorhood in protest of Valentine's Day.[88] In 2009, Alibaba transformed this annual celebration into an online shopping event and trademarked the name "Double Eleven" in 2012.[89] Today, November 11 has been rebranded by Alibaba as the Double Eleven Global Shopping Festival for all e-commerce consumers.[90]

In addition to Alibaba's online retail platforms (e.g., Tmall.com, Taobao Marketplace, and Juhuasuan), retail competitors (e.g., JD.com, Amazon China, and Suning) partnered with China's media and technological giants (e.g., Baidu and Tencent's WeChat) to offer bargains to shoppers on Singles' Day.[91] Retailers offered significant discounts on Singles' Day—often under pressure from e-commerce sellers such as Alibaba—in exchange for promotion on their shopping websites.[92]

Here are the highlights of the 2017 Singles' Day shopping festival for Alibaba Group alone:

* Gross merchandise value (GMV) is the total value of merchandise sold over a given period of time through a customer exchange site. It is a measure of growth of the business, or use of the site to sell merchandise owned by others. Investopedia, "Gross Merchandise Value," 2017. *https://www.investopedia.com/terms/g/gross-merchandise-value.asp.*

- Alibaba carried 140,000 brands in this festival, up 40 percent from 2016.[93] For the first time, Alibaba's Tmall.com carried 100 indigenous brands available to overseas consumers and 60,000 international brands available to consumers in China.[94]
- Alibaba's platforms listed a total of 15 million products.[95] While the top-selling products were in health and wellness, and baby products categories, Alibaba kept its Singles' Day sales dominance in the apparel and cosmetics categories.[96] The most popular foreign products were from Japan, the United States, Australia, Germany, and South Korea.[97]
- Alibaba processed a total of 812 million orders, and Alipay, an electronic payment arm owned by Alibaba, processed 1.48 billion payment transactions.[98] Mobile transactions[*] accounted for 90 percent of total sales in 2017, surpassing 82 percent in 2016 and 69 percent in 2015.[99]

Founder and CEO of Alibaba Group Jack Ma applied an omni-channel retail strategy on Singles' Day to achieve his vision[†] of "New Retail," a new concept of merging entertainment and consumption.[100] Alibaba's strategy is to use advanced technologies (e.g., big data, cloud computing, and artificial intelligence) to integrate the entire shopping experience (e.g., browsing, payment, and logistics) throughout all devices online and offline.[101] This allows consumers to receive intelligent purchasing recommendations and to fully engage with live entertainment (e.g., Alibaba's Singles' Day kickoff gala) in real time using interactive apps with virtual reality (VR) and augmented reality (AR) functions to create personalized shopping experiences.[102]

In preparation for Singles' Day, Alibaba helped 600,000 mom-and-pop stores and 1,000 brands upgrade their computer systems, advised stores on what items to procure and how to display their merchandise, and converted retailers in prime city locations into delivery and storage centers.[103] Alibaba used an app called Ling Shou Tong (Connect Retail) to connect 10 percent of China's six million convenience stores to the internet.[104] Alibaba also converted nearly 100,000 retail outlets in China into "smart stores," enabling people to peruse products sold online and in physical stores, track availability in different store locations, and make purchases on Alibaba's platforms using Alibaba's cloud computing, payments, and delivery services.[105] These smart stores also had VR and AR features and facial recognition payment functions.[106]

To ensure logistics keep up with orders, Alibaba offered $226 million (RMB 1.5 billion) in subsidies and JD.com offered $316 million (RMB 2.1 billion) in subsidies to assist merchants and logistics partners to build more warehouses and improve delivery efficiency ahead of the shopping holiday.[107] Although both firms used "smart logistics" (e.g., artificial intelligence, big data, and warehouse robotics) to increase logistics efficiency, the last mile deliveries still required human couriers,[108] prompting e-commerce platforms and third-party courier companies to expand their delivery teams to cope with holiday demand.[109] International brands on T-mall Global, Alibaba's cross-border e-commerce platform, also stocked up on inventories at various free trade zones in China in advance to facilitate customs clearance and shipments.[110]

Since early November, e-commerce platforms and some Chinese peer-to-peer (P2P) lenders offered alternative ways for consumers to pay for the upcoming shopping spree.[111] Alipay, the most preferred payment option during Singles' Day, offered its credit loan product, Huabei, which works as a virtual credit card, enabling consumers to pay for online and offline purchases within a certain credit limit. [112] Alipay began raising the credit limit for nearly 80 percent of its users before Singles' Day and introduced a new function on Huabei after Singles' Day to allow users to send requests to their Alipay friends to ask for help to pay their shopping bill. [113] Moreover, Alipay's Huabei and JD.com's Baitiao offered deferred interest-free payment options for certain periods or installment payment

[*] 2015 was the first time both Alibaba and JD.com made most of their sales via mobile transactions. In comparison, according to Adobe Insights, mobile sales accounted for $2 billion of sales revenue on 2017 Cyber Monday in the United States for the first time. *Financial Times*, "China's Singles Day Sets Spending Record," November 11, 2015. *https://www.ft.com/content/a8bbaaee-881a-11e5-9f8c-a8d619fa707c*; Lauren Thomas, "Cyber Monday Becomes Largest Online Shopping Day in US History," CNBC, November 28, 2017. *https://www.cnbc.com/2017/11/28/a-record-6-point-59-billion-spent-online-on-cyber-monday-making-us-history.html*.

[†] Jack Ma's vision for future retail is to use Alibaba's entire ecosystem (commerce, cloud, logistics, entertainment, and brick-and-mortar) to support its "Five New" strategy to empower individuals and companies of all sizes to do business globally. The "Five New" strategy comprises New Retail, New Finance, New Manufacturing, New Technology, and New Energy. Michael Zakkour, "Singles' Day 2017: Alibaba's Vision for the Future of Retail," *Forbes*, October 31, 2017. *https://www.forbes.com/sites/michaelzakkour/2017/10/31/singles-day-alibabas-vision-for-the-future-of-retail/#2a78510d68e0*.

options with additional fees if consumers fail to pay full at maturity.[114] Finally, Chinese P2P firms boosted loans before Singles' Day because some e-commerce platforms already started accepting deposits for certain purchases.[115]

The Singles' Day sales figures cited by Alibaba have raised some flags with U.S. regulators. In 2016, the U.S. Securities and Exchange Commission launched an ongoing investigation into Alibaba's accounting practices, including Singles' Day GMV data reporting.[116] Experts had voiced concerns over the notoriously opaque calculation methods for GMV.[117] Since Alibaba does not disclose canceled or returned orders as a percentage of total sales, previous Singles' Day figures have not been later revised to reflect orders that fell through.[118] Paul Gillis, Professor of Practice and Co-Director of the IMBA program at Guanghua School of Management at Peking University, noted, "A major problem is that GMV is not a defined accounting term and the numbers are unaudited. Alibaba does not report GMV as sales revenue. Instead Alibaba reports the transaction fees it charges to sellers. In the absence of accounting rules, Alibaba is allowed to define GMV as it chooses."[119]

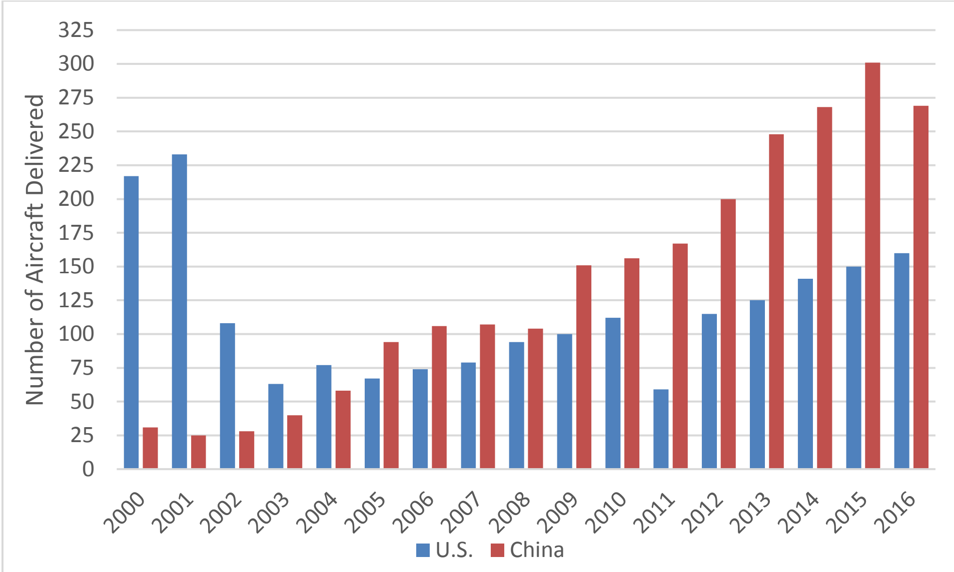
While analysts predict slower sales growth during Singles' Day in the coming years, Alibaba has great ambitions for the future.[120] Joe Tsai, Alibaba's cofounder and vice-chairman, said Alibaba wants to export the Singles' Day 24-hour shopping concept overseas and transform it into a global shopping festival serving two billion consumers worldwide by 2036.[121] Daniel Zhang, Alibaba's chief executive officer, said, "It [Singles' Day] will not only be a shopping festival for Chinese….We want the 'China phenomenon' to spread to the whole world."[122]

Sector Focus: Chinese Aviation Products Gain Access to U.S. Market

On October 27, 2017, after 12 years of consultations, the U.S. Federal Aviation Administration (FAA) and the Civil Aviation Administration of China (CAAC) signed the "Implementation Procedures for Airworthiness" agreement that allows both the FAA and CAAC to recognize each other's approval of aircraft and aviation products' and articles' airworthiness.[123] This agreement will speed up the approval process for commercial aerospace products and parts for U.S. and Chinese firms, but China's domestic aircraft, the C919 and ARJ21, will still require FAA's approval before they begin flying in U.S. airspace.[124] According to Richard Aboulafia, vice president of analysis at Teal Group, "It shows that the U.S. takes China's aviation industry seriously and that it regards their civil aviation officials as reliable partners."[125]

China surpassed the United States as the world's largest consumer of aircraft in 2005, and is expected to account for one-sixth of global jetliner demand over the next two decades.[126] In 2016, China received 269 aircraft compared with the United States at 160 (see Figure 3).[127] U.S. aircraft manufacturer Boeing and its European competitor Airbus supply most of these aircraft, with China accounting for roughly 20 percent of Boeing's aircraft deliveries.[128]

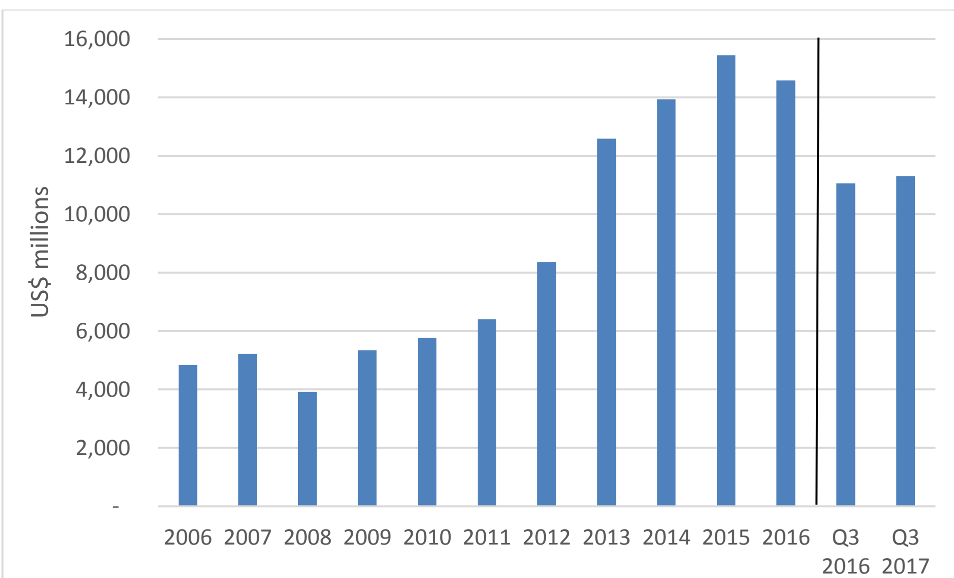
Figure 3: Comparison of Aircraft Deliveries to China and the United States, 2000–2016



Source: Trefor Moss, "China Aircraft Exports Cleared for Takeoff under FAA Deal," *Wall Street Journal*, November 7, 2017. *https://www.wsj.com/articles/china-aircraft-exports-cleared-for-takeoff-under-faa-deal-1509947425*.

At 8.3 percent, commercial aerospace products and parts accounted for the largest share of U.S. global exports in 2016.[129] Due to its growing demand, China is the largest export market for U.S. aerospace firms.[130] U.S. exports of aerospace products and parts to China increased three-fold from $4.8 billion in 2006 to $14.6 billion in 2016, lifting China's share of U.S. exports from 6.3 percent in 2006 to around 10.7 percent in 2016 (see Figure 4).[131] In the first three quarters of 2017, U.S. exports grew 2.2 percent year-on-year.[132] While all U.S. aviation products are eligible for use in China's market, this new agreement is likely to boost U.S. exports to China through faster regulatory approvals for new products.[133]

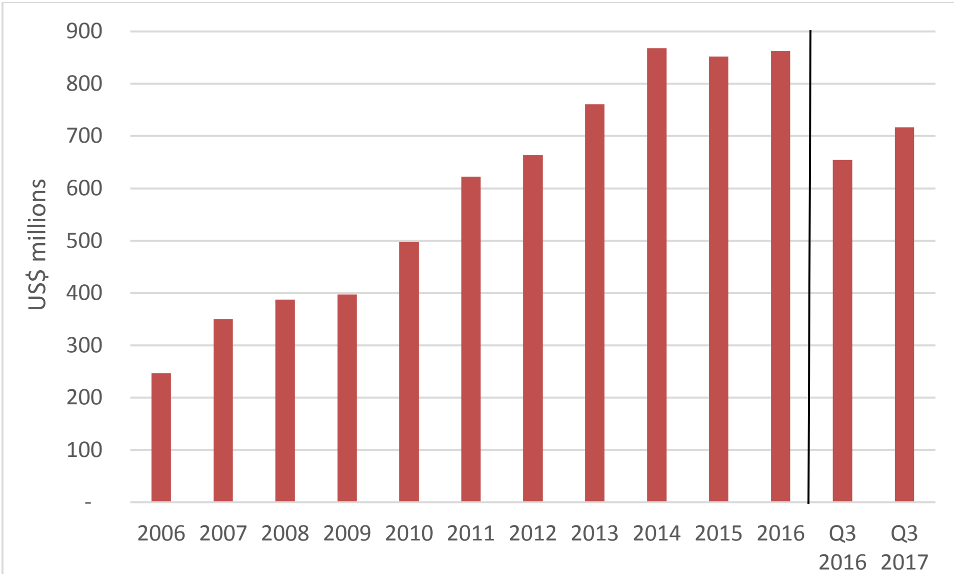
Figure 4: U.S. Exports of Aerospace Products and Parts to China, 2006–Q3 2017



Source: U.S. Census Bureau, *USA Trade Online*, November 28, 2017. *https://usatrade.census.gov/*.

U.S. imports of Chinese aerospace products and parts have grown more than three-fold from $246 million in 2006 to $862 million in 2016 (see Figure 5).[134] In the first three quarters of 2017, U.S. imports grew 9.5 percent year-on-year.[135] Since only a small number of Chinese aviation products, such as rudders and doors for Boeing planes, were eligible for use in the U.S. market, China accounted for just 2 percent of total U.S. aerospace imports in the first three quarters of 2017.[136] By comparison, the five largest U.S. aerospace suppliers (France, Canada, Japan, Germany, and the United Kingdom) together accounted for roughly a third of the total U.S. aerospace market in the first three quarters of 2017.[137] The new FAA-CAAC agreement expands the number of Chinese aerospace suppliers eligible to export to the U.S. market, increasing competition for U.S. and other foreign aviation firms.[138]

Figure 5: U.S. Imports of Aerospace Products and Parts to China, 2006–Q3 2017



Source: U.S. Census Bureau, USA Trade Online, November 28, 2017. *https://usatrade.census.gov/*.

Chinese suppliers have benefited from decades of preferential government subsidies and policies that seek to create a globally competitive Chinese aircraft.* The Chinese government requires foreign competitors to form joint ventures as a price of market entry and uses the promise of sales to state-owned airlines to shift foreign manufacturers' sourcing and assembly operations to China.[139] While complying with these requirements ensures access to the world's largest aviation market, foreign firms have created their own competitors and improved China's aerospace manufacturing capacity and quality.†

For example, in September 2017, Boeing formed a joint venture with its emerging competitor, Commercial Aircraft Corporation of China, Ltd. (COMAC), to build its first overseas completion and delivery center.[140] Boeing will provide $33 million for a 60 percent stake, and COMAC will provide $22 million for a 40 percent stake.[141] COMAC is in the process of getting domestic and international certification for its C919 aircraft, which will compete with Boeing's 737 and Airbus A320.[142] While the C919 is not expected to enter into service until 2020, similar policies in high-speed rail‡ created a globally competitive firm that unseated existing market leaders.[143] Despite these achievements, China's success in the global aviation market is not guaranteed. In a 2017 report prepared for the Commission, RAND Corporation found "U.S. competitiveness is unlikely to be threatened in the near term because production of China's large commercial aircraft—the C919—may be further delayed and operate less efficiently than current Western narrow-body aircraft on the international market."[144]

* For in-depth analysis of China's commercial aerospace industry, see Keith Crane et al., "The Effectiveness of China's Industrial Policies in Commercial Aviation Manufacturing," *RAND Corporation,* April 2014. *http://www.rand.org/content/dam/rand/pubs/research_reports/RR200/RR245/RAND_RR245.pdf*; Roger Cliff, Chad J.R. Ohlandt, and David Yang, "Ready for Takeoff: China's Advancing Aerospace Industry," prepared for the U.S.-China Economic and Security Review Commission, March 1, 2011. *http://www.uscc.gov/Research/ready-takeoff-china%E2%80%99s-advancing-aerospace-industry*.

† For analysis on the impact of China's industrial policies on U.S. commercial aviation industries, see U.S.-China Economic and Security Review Commission, Chapter 1, Section 3, "China's 13th Five-Year Plan," in *2016 Annual Report to Congress*, November 2016, 151–161.

‡ For more information on China's high-speed rail development, see Michelle Ker, "China's High-Speed Rail Diplomacy," *U.S.-China Economic and Security Review Commission*, February 21, 2017. *https://www.uscc.gov/sites/default/files/Research/China%27s%20High%20Speed%20Rail%20Diplomacy.pdf*.

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