January 8, 2018

Highlights of This Month’s Edition

- **Bilateral trade:** The U.S. trade deficit in goods with China totaled $35.4 billion in November 2017, its highest monthly level in the past two years and a 16.2 percent increase year-on-year.

- **Bilateral policy issues:** President Trump issues National Security Strategy calling for more assertive policies to combat Chinese influence campaigns and economic coercion; the U.S. government is pursuing multilateral and bilateral approaches to confront China’s market-distorting support for sectors such as steel and aluminum.

- **Policy trends in China’s economy:** At the Central Economic Work Conference, Chinese leaders maintain last year’s focus on financial risks and supply-side structural reform but place less emphasis on deleveraging; IMF cites China’s credit growth, regulation, and implicit credit guarantees from banks and government actors as top concerns in its most recent financial system stability report.

- **Sector focus – Consumer Goods:** U.S. consumer goods exports to China experience consistent growth from 2003 to 2016 despite accounting for a small portion of U.S. exports to China; on December 1, the Chinese government cut tariffs on several products, including top U.S. consumer good exports.

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**Bilateral Trade**

**U.S. Goods Deficit with China Expands 16.2 Percent in November 2017**

The U.S. trade deficit in goods with China totaled $35.4 billion in November 2017, its highest monthly level in the past two years and a 16.2 percent increase year-on-year (see Figure 1).\(^1\) U.S. exports to China continued to increase, growing 4.9 percent year-on-year to $12.7 billion.\(^2\) U.S. imports from China grew 13 percent year-on-year to $48.1 billion.\(^3\) Month-on-month, U.S. exports fell 1.9 percent mostly due to a decrease in soybeans and crude oil while U.S. imports from China declined 0.1 percent due to a decrease in toys, games, sporting goods, and apparel.\(^4\)

The cumulative U.S. goods trade deficit with China in the first 11 months of 2017 is $344.4 billion, up 7.9 percent over the same period in 2016.

![Figure 1: U.S. Exports, Imports, and the Trade Deficit with China, January 2016–November 2017](https://www.census.gov/foreign-trade/balance/c5700.html)

**Bilateral Policy Issues**

**2017 National Security Strategy Warns of Increased Economic Threats from China**

On December 18, 2017, President Donald Trump unveiled his Administration’s first National Security Strategy (NSS), laying out the White House’s strategic vision for handling pressing challenges in U.S. national security. Overall, the strategy document is outlined in four main pillars: protecting the homeland, promoting American prosperity, preserving peace through strength, and advancing American influence. The NSS also includes a section devoted to the United States’ strategy in the Indo-Pacific, and warns against China’s use of “economic inducements and penalties, influence operations, and implied military threats to persuade other states to heed its political and security agenda.”\(^5\) The document lays out several economic threats presented by China, the most notable of which include:

- **Theft of intellectual property**: The NSS cites that each year, “competitors such as China steal U.S. intellectual property valued at hundreds of billions of dollars.”\(^6\) The report goes on to warn that this theft has robbed the United States of its technological edge as China and other foreign competitors unfairly tap
into U.S. innovation and threaten to erode the United States’ long-term competitive advantage in key industries.7

- **Increased foreign investment**: The document names China and Russia as countries that use their foreign investments not for economic purposes, but rather to “expand influence and gain competitive advantages against the United States.”8 Partially in response to these Chinese investment efforts, the strategy states that the United States will pursue freer, fairer, and more reciprocal economic relationships.9 The Administration also promises to “work with the Congress to strengthen the Committee on Foreign Investment in the United States (CFIUS) to ensure it addresses current and future national security risks,” while “maintaining an investor-friendly climate.”10

- **Influence operations abroad**: The NSS outlines the threats posed by competitors who “weaponized information to attack the values and institutions that underpin free societies … [and] exploit marketing techniques to target individuals based upon their activities, interests, opinions, and values.”11 China is specifically cited for its use of data and artificial intelligence to influence the behaviors of its citizens. The document calls for the U.S. private sector to support and amplify voices of tolerance, openness, and freedom around the world.12

- **Increasing presence abroad**: The document cites the Chinese government’s efforts to expand its influence in Africa, Latin America, and Asia, where it seeks to undermine development efforts, support corrupt and authoritarian governments, and promote unfair trade systems. In response, the strategy calls for the United States to help foreign governments become more integrated in the world economy, improve political stability, and reduce vulnerability to extremists.13

### Continued State Support Exacerbates Global Excess Capacity

China’s state-led economic model14 finances the rapid expansion of capacity and production in government-selected industries such as steel,15 aluminum, and solar.16 Frustrated by the market distortions these policies create, the United States, the EU, and Japan made a joint statement on December 12, 2017, at the World Trade Organization’s (WTO) Eleventh Ministerial Conference. Although largely directed at China, the statement does not mention China by name:

> We shared the view that severe excess capacity in key sectors exacerbated by government-financed and supported capacity expansion, unfair competitive conditions caused by large market-distorting subsidies and state owned enterprises, forced technology transfer, and local content requirements and preferences are serious concerns for the proper functioning of international trade, the creation of innovative technologies and the sustainable growth of the global economy. We, to address this critical concern, agreed to enhance trilateral cooperation in the WTO and in other forums, as appropriate, to eliminate these and other unfair market distorting and protectionist practices by third countries.17

In steel, China’s subsidization and other state support generated roughly three-quarters of the world’s expansion in steel capacity from 2000 to 2014, contributing to massive global excess capacity and production.18 China has made incremental steps in the last two years to rein in its excess capacity, but the state continues to step in and bail out loss-making steel firms—reinforcing the very same drivers that exacerbated the global excess capacity and production crises.19 In 2016, global excess steel capacity reached 737 million metric tons—its highest historical

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level—just as the annual growth of long-term steel demand slowed to 1 percent. This severe imbalance has lowered global prices, reduced industry profitability, and destabilized global steel trade.

Given the depth of the crisis, the G20 and the more than ten other steel-producing countries—accounting for 90 percent of global steel production—established the Global Forum on Steel Excess Capacity in December 2016. While the Global Forum successfully compiled an extensive database on capacity developments over the last year, it did not lead to any new, meaningful policy commitments in November 2017.

The United States is also stepping up its efforts to address China’s dumping of its subsidized excess production in the U.S. market. On November 28, 2017, the U.S. Department of Commerce (DOC) self-initiated an antidumping (AD) and countervailing duty (CVD) case into U.S. imports of Chinese aluminum sheets—the first self-initiated trade case in over 25 years. While the DOC traditionally waits for U.S. firms to bring AD and CVD petitions, it found evidence that suggested Chinese aluminum sheets were sold below market value and China’s aluminum industry benefited from subsidies. If the subsequent investigation finds these allegations are true, the DOC will release final determinations in April 2018 for CVD and July 2018 for AD.

Policy Trends in China’s Economy

Central Economic Work Conference Keeps Focus on Containing Financial Risks

At the Central Economic Work Conference, an annual three-day meeting on national economic priorities for 2018 held December 18–20, 2017, Chinese leaders maintained last year’s focus on financial risks and supply-side structural reform but placed less emphasis on deleveraging. The statement issued at the conclusion of the conference noted that economic policies would be guided by “Xi Jinping Thought on Socialist Economy with Chinese Characteristics for a New Era,” cementing Chinese President and General Secretary of the Chinese Communist Party Xi Jinping’s control over economic policymaking. The statement emphasized quality over speed of growth and identified three major “battles” for the next three years: preventing and resolving financial risks, reducing poverty, and curbing pollution.

To curb financial risks, Beijing will “promote a virtuous circle between finance and the real economy, between finance and the property sector, and within the financial system” as well as crack down on “illegal and irregular” financial activities, the statement said. Chinese leaders also pledged to set up a long-term mechanism to ensure housing supply and keep property prices in check. Beijing’s top economic priority for 2017 was managing financial risk, and to that end, Chinese financial regulators strengthened industry supervision and enforcement in what commentators have described as a “regulatory storm.” In particular, Chinese regulators have targeted the shadow banking industry, increasing checks on banks’ off-balance sheet wealth management products—a key component of shadow banking credit—and issuing new draft rules to govern the asset management industry in November 2017.

Chinese authorities have also tightened regulation of the internet finance sector, which has flourished by providing credit to large segments of Chinese consumers underserved by traditional banks, but has been plagued by high-profile cases of fraud. “The meeting set a signal that regulations on the financial industry will further tighten [in 2018] as a healthy and stable financial market is key for China’s sustainable development,” said Yang Zhiyong, a researcher with the Chinese Academy of Social Sciences.

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1 In the Chinese context, supply-side reform has been a catchall term for structural reforms. First announced at the December 2015 Central Economic Work Conference, key elements of the policy include cutting excess industrial capacity and housing inventories, deleveraging, and reducing business costs. For more on China’s supply-side structural reforms, see U.S.-China Economic and Security Review Commission, Chapter 1 Section 1, “Year in Review: Economics and Trade,” in 2016 Annual Report to Congress, November 2016, 40–41. https://www.uscc.gov/sites/default/files/Annual_Report/Chapter/Chapter%201%20U.S.-China%20Economic%20%20Trade%20Relations_0.pdf.


On deleveraging—a key policy objective over the past two years—the statement called for local governments to rein in their borrowing. However, according to Yao Wei, chief China economist at Societe Generale SA, “The statement doesn’t mention corporate deleveraging, suggesting financial de-risking takes priority for the moment.” The statement noted “credit and social financing should see reasonable growth” in 2018, an indication that Beijing may be willing to tolerate more debt to maintain growth.

China’s efforts to reduce its debt levels have been met with mixed results. The most recent data from the Bank of International Settlements show China’s debt-to-gross domestic product (GDP) ratio rose slightly from 255.1 percent in the fourth quarter of 2016 to 255.9 percent in the second quarter of 2017. While corporate debt has moderated from 166.3 percent in the fourth quarter of 2016 to 163.4 percent in the second quarter of 2017, this reduction came mostly from private companies. State-owned enterprises, which account for the bulk of corporate debt, continued to borrow heavily. Meanwhile, household debt has picked up. Bloomberg Intelligence economists Fielding Chen and Tom Orlik estimate China’s total debt-to-GDP ratio will reach 327 percent by 2022, double the level in 2008.

China’s key economic targets for 2018 will be unveiled during the annual parliamentary session in March 2018 as part of the government work report. Economists have raised their economic growth forecasts for full-year 2017 to 6.8 percent (well above the government’s target growth rate of “around 6.5 percent”), which would be the first full-year acceleration in seven years. China needs a 6.3 percent annual real GDP growth rate to achieve Beijing’s goal of doubling GDP in 2020 from a decade ago, according to UBS economist Wang Tao.

The International Monetary Fund Financial System Stability Report Confronts China’s “Gray Rhinos”

On December 6, the International Monetary Fund (IMF) released its latest financial stability report detailing concerns and recommendations for the Chinese financial system. It cited three primary concerns: China’s monetary and fiscal policy has led to a large credit expansion; this expansion is difficult to regulate given the financial system’s innovation and complexity; and credit has come with implicit guarantees that downplay its risk. To observers, these concerns form a common refrain. All three were voiced in the IMF’s previous evaluation of China’s financial stability, published in 2011, and have been acknowledged by regulatory authorities in China. As longstanding challenges, credit expansion, regulatory oversight, and implicit guarantees are a few of the “gray rhinos” (or high-impact, visible, but overlooked risks) China continues to face in its economy.

- **Credit expansion**: The IMF estimates China’s credit-to-GDP ratio at about 25 percent above its long-term trend, with increased borrowing at both the corporate and household levels. The productivity of this credit is questionable: the credit necessary to boost growth has increased most in regions with industries plagued by excess capacity, including real estate, steel, solar panels, and utilities. As these industries continue to receive financing, the IMF highlighted that effective supervision requires authorities’ willingness to restructure overindebted sectors. Those authorities are often local governments—indirect recipients of local bank lending that may prioritize growth and employment targets above market-determined allocation.

  - **IMF recommendation**: To lower local government intervention, the IMF recommended “de-emphasizing” national-level GDP targets that create pressure for credit growth at the local level. The policy shift would assist local governments in confronting struggling state-owned enterprises (SOEs). The IMF said lending supervision can only succeed with “political willingness to restructure overindebted sectors,” and stated that “a policy choice must also be made to allow non-viable SOEs to fail.”

- **Innovation and complexity**: The report welcomed the China Banking Regulatory Commission’s (CBRC) moves to implement the Basel III framework and strengthen resilience at the individual bank level. Bank-specific regulation has created opportunity for innovations that skirt regulation: as bank balance sheets receive more oversight, risk is shifted to less regulated, off-balance-sheet products and nonbank financial institutions. These similar products are subject to different supervision, enabling them to fund sectors restricted by traditional credit

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Yet they still affect the banking system: small- and medium-sized banks rely on a larger share of off-balance-sheet products, and their capitalization levels may not be sufficient. Though China’s largest four banks hold the necessary capital to weather a crisis, other banks do not: 27 of 33 Chinese banks in IMF stress tests were undercapitalized by the IMF’s standards.

- **IMF recommendation:** The report acknowledged China’s reserve cushion—over $3 trillion in assets—but recommended an increase in bank capital nonetheless. It cautioned that regulatory focus must remain on crisis prevention, rather than mitigation. In this vein, current regulations target specific investment types but not banks’ and other actors’ demand to issue higher-return investments. This demand can be addressed by lifting lending restrictions to overcapacity sectors once implicit guarantees (described below) are removed, and focusing regulation on banks’ “credit and risk management policies and practices” and regulatory compliance, instead of loan performance.

**Implicit guarantees:** The government’s involvement in loan decisions and stake in banks themselves lead to “the perception of de facto public guarantees” securing this credit, whereby issuing banks backed by government entities will insure against investor losses regardless of legal obligation. As noted in the report, “much of the financial system, from local government and SOE debt to bank-issued investment vehicles, is seen by investors as being ultimately guaranteed by the central government.” Such assurances range from bank compensation for principal invested in wealth management products (WMPs), to the high (AAA) ratings placed on SOE bonds and government investments, to actions taken in mid-2015 and early 2016 to support stock prices. These assurances present two problems: 1) an enormous potential public expense, and 2) the inability to accurately evaluate and price risk, lowering overall returns and complicating credit allocation.

- **IMF recommendation:** To tackle implicit guarantees, the report suggested coupling consistent disclosure requirements and loan classification with bank capital increases, followed by lengthened funding time horizons and then clarification of government backing for SOEs. Such reforms aim to incrementally remove implicit guarantees by increasing investor awareness about risk and producing the conditions to deny or raise the cost of credit where warranted.

To secure China’s financial markets more broadly against systemic risk, the IMF developed additional recommendations for increased oversight and crisis prevention. They fall into four categories:

- **Establishment of an advisory body with the sole task of ensuring financial stability:** This body would report to the Financial Stability and Development Committee (FSDC) and the Security Council.

- **In conjunction with this advisory body, greater coordination across regulatory agencies:** The People’s Bank of China (PBOC) should coordinate with regulatory agencies to conduct systemic risk analysis across all sectors. Coordination should prioritize crisis prevention through data sharing and risk assessment.

- **Greater regulatory independence and resources:** Ensure supervisory decisions are not overturned, staff cannot be dismissed arbitrarily, and financial stability takes priority over other policy considerations. Agencies should be allotted budgetary discretion within reason, allowing them to hire more personnel, as headcount has not increased in a decade.

- **Improved data reporting:** The report recognizes that authorities are building an interagency information-sharing platform, but called for enhanced data availability and quality for regulators and financial actors.

The PBOC responded to the Financial System Stability Assessment, acknowledging the IMF’s “professional and valuable” evaluation and stating it would draw on the report’s recommendations when implementing policies determined at the 19th Party Congress. The PBOC said its own conclusions diverged from the report in a few respects: the PBOC believed the report’s assessment of the stress tests did not fully describe the outcomes, which were stronger than implied by the report; SOE profitability had improved in 2017 since the report research was undertaken; and this improved position, coupled with more recent banking write-offs and loan resolution, indicated that the current share of nonperforming loans is a reasonable estimate.
Sector Focus: Consumer Goods

U.S. exports of consumer goods to China (defined by the DOC as most goods purchased by consumers excluding food and beverages)* are a small but growing component of U.S. exports to China. In 2016, the United States exported $7 billion worth of consumer goods to China, or only 6 percent of total U.S. goods exports to China (Figure 2). However, from 2010 to 2016, consumer goods exports to China grew 90 percent and their share of U.S. goods exports to China increased from 4 percent to 6 percent (Figure 3). Consumer goods registered the second-highest growth rate of all goods exports from 2011 to 2016 after automotive exports, and are the only category of U.S. goods exports to China that have increased every year since 2003 (Table 1). In the first three quarters of 2017, U.S. consumer goods exports to China totaled $5.4 billion, an increase of 3 percent year-on-year.

![Pie chart showing U.S. Goods Exports to China, 2016](https://www.bea.gov/iTable/iTable.cfm?ReqID=62&step=1#reqid=62&step=7&isuri=1&6210=1&6200=3&6211=28)

**Figure 2: U.S. Goods Exports to China, 2016**

U.S. consumer goods exports to China have likely increased due to rising Chinese income levels. According to the World Bank, China’s GDP per capita almost doubled in 2010–2016 from $4,560 to $8,123. Only three countries registered higher income growth over this time period. This increase in income has led analysts to predict growth in the size of China’s middle class, possibly facilitating more U.S. consumer goods sales to China. According to the Economist Intelligence Unit, as of 2015 roughly 10 percent of China’s population qualified as high or upper middle class (earning more than $10,000 per year), the segment of Chinese society most able to afford imported consumer goods. By 2030, the Economist Intelligence Unit predicts 35 percent of China’s population will be high or upper middle class. Some foreign consumer goods are preferred in China due to a reputation for quality or safety.

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Table 1: U.S. Goods Exports to China, 2011–2016

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</tr>
</thead>
<tbody>
<tr>
<td>Consumer goods</td>
<td>$4,506</td>
<td>$4,788</td>
<td>$5,783</td>
<td>$6,080</td>
<td>$6,716</td>
<td>$6,998</td>
<td>55%</td>
<td>9%</td>
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<tr>
<td>Automotive Vehicles, Parts, and Engines</td>
<td>$6,867</td>
<td>$7,407</td>
<td>$10,896</td>
<td>$13,771</td>
<td>$11,582</td>
<td>$11,772</td>
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<td>11%</td>
</tr>
<tr>
<td>Foods, Feeds, and Beverages</td>
<td>$15,468</td>
<td>$21,152</td>
<td>$20,849</td>
<td>$21,031</td>
<td>$17,023</td>
<td>$19,979</td>
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<td>5%</td>
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<tr>
<td>Industrial Supplies and Materials</td>
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<td>$42,746</td>
<td>$42,498</td>
<td>$38,711</td>
<td>$34,588</td>
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<td>-6%</td>
</tr>
<tr>
<td>Capital Goods Except Automotive</td>
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<td>$34,940</td>
<td>$41,299</td>
<td>$43,807</td>
<td>$45,664</td>
<td>$43,711</td>
<td>30%</td>
<td>5%</td>
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Figure 3: U.S. Consumer Goods Exports to China, 2010–2016


https://www.bea.gov/iTable/iTable.cfm?ReqID=62&step=1#reqid=62&step=7&isuri=1&6210=1&6200=3&6211=28.

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* From 2010 to 2016, the GDP per capita of Ethiopia, Laos, and Bangladesh grew at 107 percent, 106 percent, and 79 percent, respectively. China’s GDP per capita grew 78 percent over the same period. World Bank, “GDP Per Capita (Current US$).” https://data.worldbank.org/indicator/NY.GDP.PCAP.CD.
U.S. exports of consumer goods to China consist mostly of cell phones and other household goods, pharmaceutical preparations, toiletries and cosmetics, and jewelry, which accounted for 35 percent, 31 percent, 5 percent, and 3 percent of all U.S. consumer goods exports to China in 2016, respectively (Figure 4). \(^7\)

**Figure 4: U.S. Consumer Goods Exports to China, 2016**

![Pie chart showing distribution of U.S. consumer goods exports to China in 2016]

Cell phones and other household goods account for the largest share of U.S. consumer goods exports to China. While the “cell phones and other household goods” category includes a broad array of different products such as clothing pins, household tools, hat racks, photo frames, and weighing machines, since 2011 cell phones have made up the majority of this category’s exports to China. \(^8\) In 2016, cell phones accounted for 64 percent of all U.S. exports to China under the “cell phones and other household goods” classification. \(^9\) Exports of cell phones and other household goods have increased both by value and as a share of U.S. consumer goods exports to China. From 2011 to 2016, exports of cell phones and other household goods to China climbed 161 percent from $930 million to $2.4 billion (Figure 5). \(^10\) Exports of cell phones accounted for most of this increase. From 2011 to 2016, U.S. cell phone exports to China expanded from $484 million to $1.6 billion. \(^11\) This growth in cell phone exports alone was equal to 72 percent of the total increase of all exports under the “cell phones and other household products” category during this timeframe (Figure 6). \(^12\)

On December 1, 2017, the Chinese government enacted a series of tariff cuts that may further boost U.S. sales of consumer goods. \(^13\) Included in this cut are 154 different types of consumer goods, with tariff reductions ranging from 2 to 25 percentage points. \(^14\) Many products constituting top U.S. consumer goods exports to China received tariff cuts, particularly pharmaceutical preparations and cosmetics. For example, average beauty product tariffs fell from 8.3 percent to 3.5 percent following the cut. \(^15\) Similarly, tariffs on antibiotics fell from 6 percent to 2 percent, and tariffs on other pharmaceutical preparations dropped from 5 percent to 2 percent. \(^16\)

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\(^7\) Prior to the cuts, perfume, lipstick, and eye makeup imports were taxed at 10 percent, while manicure/pedicure products and other beauty products were taxed at 15 percent and 6.5 percent, respectively. Following the tariff cuts, perfume, lipstick, eye makeup, and manicure/pedicure products will all be taxed at 5 percent, and other beauty products will receive a 2 percent tariff. China’s Ministry of Finance, *Notice of the Tariff Commission of the State Council on Adjusting the Import Tariffs of Some Consumer Goods*, November 25, 2017. http://gss.mof.gov.cn/zhengwuxinxi/zhengcefabu/201711/t20171125_2755506.html.
Since 2013, China has been the world’s largest smartphone market. China has also accounted for a larger share of U.S. cell phone exports over time (Figure 6). However, while China has become increasingly important for U.S. cell phone exports, U.S. smartphone companies are facing increasing domestic competition. The United States has historically catered to the high end of China’s cell phone market, providing more expensive smartphones with more functions. However, Chinese companies such as Huawei and Vivo have begun to offer their own premium phones and appear to be taking market share from Apple. For example, Apple and Samsung have historically dominated the top ten seller list of premium phones in China. However, in the first quarter of 2017, Chinese phone models accounted for four of the top ten best-selling premium phones in China. In 2016, Apple’s share of China’s

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**Figure 5: U.S. Exports of Cell Phones and Other Household Goods to China, 2011–2016**


**Figure 6: U.S. Cell Phone Exports to China, 2007–2016**


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smartphone market declined from 13.6 percent to 9.6 percent, while domestic companies increased their share from 46 percent to 57 percent.\textsuperscript{89} Apple’s fall 2017 release of the iPhone 8 helped it increase its share of China’s market 7.3 percent year-on-year in the third quarter of 2017, but overall Apple’s market share stands at 7.7 percent, significantly lower than its 2016 and 2015 levels.\textsuperscript{90}

**Pharmaceutical Preparations**

Pharmaceutical preparations are the United States’ second-largest consumer goods export to China. Pharmaceutical preparations are drugs for human or veterinary use in their final, dosed, consumable form, such as painkiller pills or individual insulin shots.\textsuperscript{9} From 2007 to 2016, pharmaceutical preparations have increased at the second-fastest rate of all U.S. consumer good exports to China, expanding from $402 million in 2007 to $2.2 billion in 2016—an increase of 438 percent (see Figure 7).\textsuperscript{1}

**Figure 7: U.S. Pharmaceutical Preparation Exports to China, 2007–2016**


Despite increasing exports, China still accounts for a relatively small amount of U.S. pharmaceutical preparation sales. According to the DOC, in 2016 China was the second-largest pharmaceutical market globally, but only the ninth-largest export market for the United States, accounting for 4 percent of U.S. pharmaceutical preparation exports.\textsuperscript{91} Historically, U.S. pharmaceutical companies have faced market access barriers in China, particularly with respect to approval for new drugs.\textsuperscript{1} China uses an asynchronous review process to approve foreign pharmaceutical products that requires safety trials of foreign drugs to be at an advanced stage in other countries before Chinese regulators begin their own review process.\textsuperscript{92} This significantly slows the introduction of new foreign drugs into China’s market, essentially doubling review times for foreign pharmaceuticals. In some cases, U.S. drugs have been held up by as much as seven years due to Chinese regulatory procedures.\textsuperscript{93} As new drugs are an important source

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\textsuperscript{1} From 2007 to 2016, the fastest-growing U.S. consumer good export to China was jewelry, which increased 456 percent (from $42 million to $233 million). U.S. Census Bureau, U.S. Exports to China by 5-Digit End-Use Code 2007 – 2016, January 2, 2016. https://www.census.gov/foreign-trade/statistics/product/enduse/exports/c5700.html.

of revenue for U.S. pharmaceutical companies, the inability to introduce them in China in a timely fashion has harmed U.S. companies. In October 2017, China’s Communist Party announced a potential workaround to this problem, allowing foreign drugs to forgo Chinese trials if data show the drug is safe for “Eastern” people, likely requiring foreign trials with an Asian population. The efficacy of this change will depend on implementation. Additionally, Chinese drug regulators have historically been understaffed, contributing to a large backlog of approval applications. According to the DOC, from 2011 to 2014 the China Food and Drug Administration received between 7,000 and 9,000 approval applications annually, but concluded only 5,000 applications per year. As of 2016, China has an estimated backlog of 17,000 drug approval applications.

The DOC has also identified intellectual property rights protection shortcomings in China’s pharmaceutical sector. Under Chinese law, a company cannot bring a patent infringement case against a patent violator until the violator has launched its product on the market. As a result, a U.S. drug company must allow a patent violator to enter the market before it can take action. The DOC notes that while injunctions to prevent patent abuse during litigation are allowed, they are “rarely, if ever granted in pharmaceutical cases.” Additionally, according to the DOC, damages awarded by Chinese patent courts are insufficient to recover lost revenue in the pharmaceutical sector or to prevent infringement.

Despite these challenges, China’s pharmaceutical market has many opportunities. China’s population is aging, with an estimated 170 million people over the age of 65 by 2020, increasing Chinese demand for pharmaceutical products. China also faces several chronic health risks that will require constant medication. At least 110 million Chinese are diabetic, and in 2015 China accounted for 20 percent of worldwide new cancer cases (4.3 million cases). Chinese consumers may prefer U.S. pharmaceutical products due to concerns over the quality of domestic drugs. China has been a prolific source of counterfeit and defective medicine. In 2012, Chinese authorities seized 77 million domestically produced gel capsules that were created from industrial waste and contained excessive levels of cadmium. China has been a key producer of counterfeit drugs for more than a decade. According to the Office of the United States Trade Representative, in 2016, 90 percent of all counterfeit pharmaceuticals seized at the U.S. border were from China, Hong Kong, India, or Singapore. While quality concerns may boost U.S. pharmaceutical sales to China, the inability of Chinese regulators to restrict counterfeit medicine risks the health of U.S. consumers.

Toiletries and Cosmetics

Toiletries and cosmetics are the United States’ third-largest consumer goods export to China, accounting for 5 percent of all U.S. consumer goods exports to China in 2016. From 2007 to 2016, U.S. exports of cosmetics and toiletries increased 181 percent from $130 million to $366 million (Figure 8). As of 2016, China was the United States’ ninth-largest toiletries and cosmetics export market, accounting for just over 3 percent of U.S. toiletry and cosmetic exports.

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Unlike in many other sectors, the United States’ chief competitors in China’s toiletries and cosmetics market appear to be other foreign firms. Nine of the top ten personal care companies in China were foreign companies in 2016, with the top three consisting of Procter and Gamble (headquartered in the United States), L’Oreal (headquartered in France), and Shiseido (headquartered in Japan). According to the DOC, 80 percent of all cosmetic and personal care products produced in China is from foreign-owned businesses or foreign joint ventures. Since 2013, the United States has been the fifth-largest exporter of cosmetic and personal care products to China, accounting for roughly 6 percent of Chinese imports in 2016 (Figure 9).

China’s cosmetic and toiletry sector appears to have the potential for significant growth. Per capita spending on cosmetics and personal care in China remains low at $24 per year in 2014, significantly behind regional countries.
such as South Korea and Japan, which spent $223 and $174 per person per year, respectively, in 2014.\textsuperscript{110} According to the DOC, China’s market is anticipated to become the world’s largest between 2021 and 2026.\textsuperscript{111}

\begin{disclaimer}

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