



U.S.-China Economic and Security Review Commission

Monthly Analysis of U.S.-China Trade Data

November 04, 2014

Highlights of this month's edition

- **Bilateral trade:** U.S. monthly goods deficit with China is highest ever, reaching \$251.8 billion through September on strength of imports from China; U.S.-China trade surplus in services hits record \$6.81 billion in Q2, as U.S. exports grow and China services sector lags.
- **The Fourth Plenum Decision:** Government promises to improve fairness and accountability in the legal system, but the Party is not loosening grip on power.
- **Bilateral policy issues:** Renminbi "significantly undervalued" but Administration stops short of accusing China of currency cheating; United States requests China submit missing subsidies notifications to WTO.
- **Quarterly review of China's economy:** Slowest GDP growth in over a decade; key indicators underperform (freight, real estate, consumption); exports strong but data unreliable; global investors in limbo as Shanghai-Hong Kong stock trading link missed projected start date amid ongoing protests in Hong Kong.
- **Sector spotlight – Asian Infrastructure Investment Bank:** The AIIB heralded as a much needed addition to address the region's infrastructure funding shortfall; concerns remain on lending standards and its potential challenge to the World Bank and IMF.

Bilateral Goods Trade

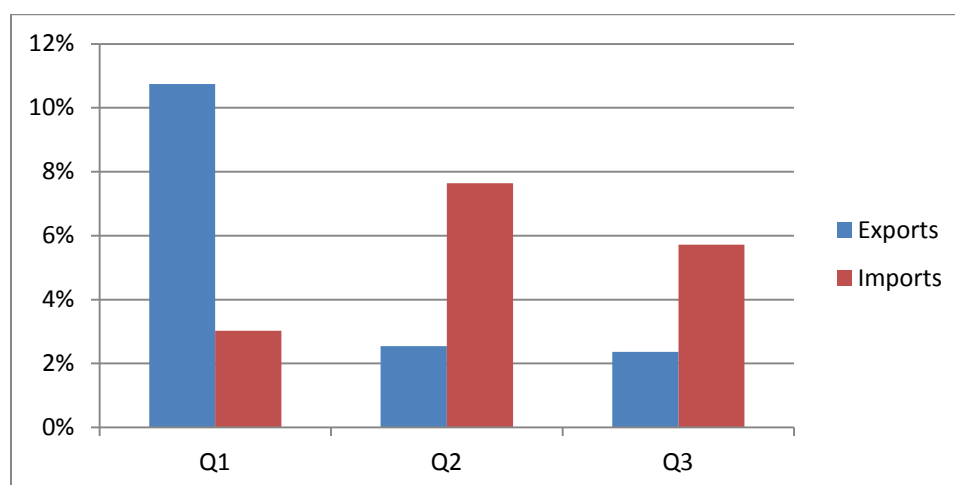
U.S. Goods Trade Deficit with China Hits Monthly Record

Total U.S. goods trade with China increased by 9.1 percent year-on-year in September, the highest monthly rate so far this year. All of this growth, however, was owing to U.S. imports from China, which rose by 11.8 percent year-on-year and 17.8 percent month-on-month. In contrast, U.S. shipments to China declined by 2 percent over last year.

The net result was the United States' highest monthly goods trade deficit with China on record. The 16.1 percent monthly increase in the bilateral deficit, 7 percentage points greater than the growth in bilateral trade. At \$251.8 billion through September, the bilateral deficit is on pace to set another annual record. The deficit has expanded by over \$13 billion so far this year, compared to \$6 billion at this point last year.

Viewed in quarterly terms, the difference between the first quarter of this year and the second and third quarters is notable (see Figure 1). U.S. exports to China jumped in January-March, but failed to keep pace with import growth in the ensuing six months. This trend is disconcerting when considering that the United States already spends about \$4 on Chinese imports for every dollar it earns for export sales to China.

Figure 1: Quarterly Growth of U.S. Trade with China, 2013-2014
(year-on-year, %)



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

Of the \$9.3 billion in U.S. goods exports to China in September, transportation equipment ranked first by far, accounting for 24.4 percent of shipments. For the year to date, transportation equipment makes up a 22.2 percent share, on pace to surpass its share of 19.2 percent in 2013. China also accounts for a disproportionate share of U.S. transportation equipment exports to the world (see Table 1). The U.S. exports ranking behind transportation equipment were computer and electronic products (14.7 percent), chemicals (11.6 percent), agricultural products (7.9 percent), and machinery (7.3 percent).

While exports of computer and electronic products saw strong year-on-year gains of 14.4 percent, agricultural product shipments plummeted by 27.8 percent. Food and related product shipments also dropped by 29.9 percent. This flagging demand for U.S. food could be related to China's weak economy, which reduces domestic demand, pushes down commodity prices, and causes oversupply in China's domestic farm sector, particularly among meat producers.

Table 1: U.S. Exports to World and China through September 2014
(YTD, US\$ billions)

	U.S. exports (US\$ bn)		China share of U.S. exports
	To world	To China	
Transportation eqpt	200.9	19.3	9.6%
Total exports	1,208.8	86.9	7.2%
<i>Transportation eqpt share</i>	<i>16.6%</i>	<i>22.2%</i>	

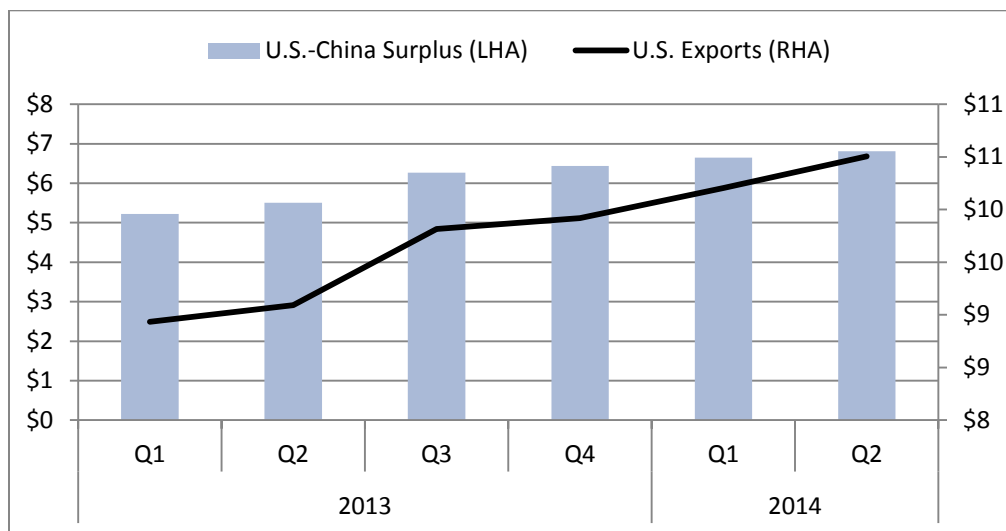
Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, November 2014). http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl.

The surge in imports of Chinese goods in September appeared tied to U.S. consumer goods demand, which has picked up along with the U.S. economy. Imports of computers and electronic products, comprising over one-third of U.S. imports from China, rose by 13.8 percent year-on-year. Apparel and accessories imports grew by 23.8 percent.

U.S.-China Trade in Services

The quarterly U.S.-China trade surplus in services increased by 2.5 percent to a record \$6.81 billion in the second quarter of 2014 (Figure 2). Strong performance by U.S. services exports, which increased 2.9 percent from last quarter, was the primary driver of the higher surplus. The surplus, a bright spot in the U.S.-China trade relationship, increased 23.7 percent year-on-year. U.S. services imports from China rose 3.8 percent in the second quarter, but remain low at only about one-third the value of U.S. services exports to China.

Figure 2: U.S.-China Trade Surplus in Services
(US\$ billions)



Source: U.S. Department of Commerce, Bureau of Economic Analysis.

China's global trade deficit in services, which registered at \$30 billion in the second quarter of 2014, has more than doubled since 2011 (Figure 3). Growing domestic demand for services, coupled with an underdeveloped domestic services industry, is the primary driver for China's services imports. On average, U.S. services exports to China in 2014 constitute nearly 20 percent of China's total services imports.

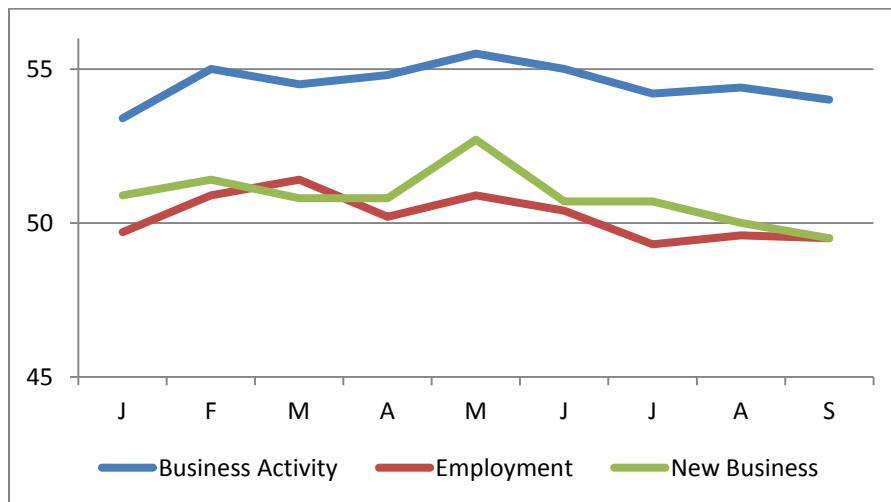
Slowing expansion and even signs of contraction in China's domestic services sector could explain China's poor performance in services exports. As shown in Figure 4, China's purchasing managers' index (PMI) of nonmanufacturing business activity, which is a proxy for expansion of the services sector, has been steadily declining since May—although the index continues to register well above 50, indicating overall expansion of China's services sector. However, sub-indices for nonmanufacturing employment and new nonmanufacturing business have already dropped below 50, suggesting contraction.

Figure 3: China's Global Trade in Services
(US\$ billions)



Source: China State Administration of Foreign Exchange, via CEIC.

Figure 4: China's 2014 Nonmanufacturing PMI
(> 50 = expansion; < 50 = contraction)



Source: China National Bureau of Statistics, via CEIC.

The Fourth Plenum Decision: Rule of Law with Chinese Characteristics

The Chinese Communist Party's (CCP) 18th Central Committee held its Fourth Plenum in October 2014. At the conclusion of the meetings, the Party leadership adopted the "Decision on Several Major Issues Concerning Comprehensively Pushing Forward Governing the Country in Accordance with the Law" (the "Decision"). The Decision—much anticipated after the ambitious economic reform agenda announced at the Third Plenum last year—comes at a time when instances of abuse by the country's law enforcement apparatus are on the rise, from censorship to illegal detention of human rights activists in the wake of the 25th anniversary of the Tiananmen Square massacre.

The Decision also reflects the government's fears about rising social unrest prompted by public anger over corruption, land seizures, and worsening air pollution. Some of this unrest has resulted in violent clashes with police.ⁱ The government is well aware of the need to maintain the public's trust in the system; the Decision acknowledges "many issues of inadaptability and inconformity" exist in the legal system "compared with the expectation of the people."¹ There are no signs, however, the government will loosen its censorship of social media, an important outlet for public discontent. On the contrary, the Decision calls for tougher legislation regarding the Internet, and for regulation of "online behavior according to law."²

The Decision is light on specifics, and does not provide details on deadlines or implementation priorities. However, buried among platitudes about perfecting the socialist order are several statements that could have a profound impact on the way the law is administered and applied in China. These are highlighted below:

- ***The Party comes first, the law last.*** Like the Third Plenum economic reforms, the Decision on rule of law is driven by the government's need to maintain social stability, which ensures the CCP stays in power. Although it promises change in six major areas, the Decision does not propose to alter the status quo, where the Party essentially remains above the law. Section 1 of the Decision starts by stating that "governing the country according to law is essential" for effective governance and for ensuring "the people's happiness, peace and health" and "the long-term stability of the Party and the country."³ It then goes on to list the key principles necessary for achieving this goal, first among them upholding the Party leadership. The theme of the Party's preeminence is repeated in other sections. For example, judges should be "loyal to the Party, the nation, the people, and the law," in that order, while "supporting the leadership of the [Party]" should be the basic requirement for lawyers.⁴
- ***Professionalization of judges.*** In China's authoritarian system, officials often shunt aside constitutional protections in favor of government priorities. Consequently, the country's judges do not have a free hand in interpreting the law. Outside large urban centers, many judges are not well qualified; some have no legal training at all.⁵ To remedy this situation, the Decision calls for the creation of a "standardized, professional, job-focused team specialized in the rule of law," and proposes a system for selecting judges and procuratorsⁱⁱ from lower courts for promotion to the higher level courts. If conducted on the basis of merit, and without political interference, such a promotion system may result in a new class of competent, professional judges. Despite these promising proposals, the Decision also calls for "the channels allowing the retiring military cadres to join the team specialized in the rule of law."⁶ Such a move seems to run contrary to the goal of professionalization, as evidenced by the fact that since 1981, when 57,000 demobilized soldiers were reassigned to work in the legal system on Deng Xiaoping's orders, many retired military officers became judges without ever studying the law.⁷
- ***Increased judicial independence, up to a point.*** The Decision calls judicial partiality "fatal and destructive to social fairness," and advances several proposals to improve judicial independence. For example, the Decision promises to punish those who interfere or meddle in cases, even if such interventions come at the "request of Party and government organs [or] leading cadres." It proposes a system for

ⁱ See the testimony from the U.S.-China Commission hearing on domestic stability in China for some recent examples. <http://www.uscc.gov/Hearings/hearing-stability-china-lessons-tiananmen-and-implications-united-states-webcast>.

ⁱⁱ Under Chinese legal system, a procurator is a government officer charged with both investigation and prosecution of crimes.

“recording, reporting, and responsibly tracking” officials who inappropriately interfere in cases.⁸ The Decision fails to specify who would mete out punishments for such interference, or how such a tracking system would be administered, but the announcement may send an important signal. The Decision further says the Supreme People’s Court will set up circuit courts to hear major administrative and civil cases that span administrative regions. This proposal may help curtail local protectionism, whereby local officials or businesses exert leverage over a court’s decisions.⁹

As is the case with all policy pronouncements from the Chinese government, implementation will be the true test of the legal reforms announced in the Decision. While President Xi Jinping’s anticorruption campaign is expected to get a boost from the proposed changes, the impact on the lives of ordinary Chinese citizens remains to be seen, especially when it comes to protections of human rights and free speech.¹⁰ Section 4 of the Decision promises to prevent “extorting a confession by torture” and to have “zero tolerance of corruption in the judicial realm,” but carrying out these changes in practice would be a significant challenge in China’s huge, decentralized legal bureaucracy, which is often beholden to local leaders.

Several of the changes outlined in the Decision, such as the creation of circuit courts, are steps toward centralizing judicial power, which may undermine the ability of local officials to interfere in the application of the law. Concentration of all power in the hands of the central government—an approach President Xi has adopted in the economic and political realms—may leave the law better administered. And yet, it is unlikely to curtail the power of the Party, which is increasingly intolerant of attempts to challenge its authority.

Bilateral Policy Issues

Administration: China Does Not Manipulate Its Currency

In its latest semi-annual report on international exchange rates, the Treasury Department finds that the Chinese renminbi (RMB) “remains significantly undervalued.”¹¹ But as in each of its past reports, the Administration’s October 15 version stops short of accusing Beijing of “manipulating” its currency to boost exports. A 1988 law requires the Treasury Department to identify countries that deliberately devalue their currencies in order to create an artificial price advantage for their exports. Therefore, an explicit accusation of currency manipulation would require the Administration to open talks with China directly addressing its monetary policies. The last time an administration cited China for manipulating its currency was in 1994, when Bill Clinton was in the White House.

Currency manipulation has been identified by economists as a major contributor to job loss in the United States. The Peterson Institute for International Economics in Washington estimated in 2012 that currency manipulation by 20 countries—China chief among them—caused an increase in the annual trade deficit of between \$200 billion and \$500 billion and resulted in the loss of between 1 million and 5 million jobs. “Half or more of excess U.S. unemployment—the extent to which current joblessness exceeds the full employment level—is attributable to currency manipulation by foreign governments,” the report said.¹² The solution? “Eliminate or at least sharply reduce [the] trade deficit to accelerate growth and restore full employment ... [by insisting] that other countries stop manipulating their currencies and permit the dollar to regain a competitive level.”

The last time China was cited for currency manipulation, manufacturing employment in the United States stood at 17.2 million at the end of 1994. Twenty years later, manufacturing employment in September 2014 had fallen to 12.1 million, for a decline of 5.1 million jobs.¹³

An artificially low valued currency also discourages consumers from purchasing imported goods, whose prices rise as the value of the home currency falls.

The most recent Treasury report notes that the RMB depreciated by 1.4 percent against the dollar during the first nine months of 2014 as the People's Bank of China intervened in the international currency markets to drive down the value of the RMB (by buying dollars and selling RMB). The central bank accumulated an additional \$135 billion in foreign exchange, according to the Treasury report. Nevertheless, the October report notes only that "China has not yet reached a situation in which the RMB exchange rate can be said to be market-determined."

By second quarter of 2014, China reported its holdings of foreign exchange at \$3.9 trillion, the largest in the world.¹⁴ China does not reveal how much of its foreign exchange is held in dollars, but according to the International Monetary Fund, 62 percent of global foreign exchange reserves are denominated in dollars.¹⁵

United States Pressures China on Missing WTO Notifications

In an October 15, 2014, complaint to the World Trade Organization (WTO), the United States said China failed to comply with WTO subsidy notification requirements. The United States identified 110 central and sub-central government-level subsidies that "appeared as if they should have been [revealed] by China."¹⁶ The list spans industries including iron and steel, software, textiles, and agriculture, and identifies stimulus plan and investment subsidies. In addition, the United States submitted specific questions to China regarding the status, name, duration, and criteria of subsidies in the following six programs:

- Government assistance to Semiconductor Manufacturing International Corporation (SMIC) for research and development and plant construction;
- Local government subsidies to newly established industrial projects in Zhongshan's industrial zones;
- Priority support rendered by the Chinese National Textile and Apparel Industry Council and Hangzhou Municipal Government to selected local textile industries;
- Subsidies including tax exemptions and rebates to enterprises located in the Lianyungang Economic-Technological Development Area;
- Income tax exemptions for companies located in Chongqing Chemical Industrial Park;
- Local government assistance to companies in Northeast Socks Industrial Park located in Liaoyuan City of Jilin Province.¹⁷

These moves are the latest in a series of requests by the United States that China adhere to its transparency obligations under the WTO. In 2011, the United States listed nearly 200 subsidy measures that China failed to register with the WTO.¹⁸ A year later, the United States referred to the WTO Agreement on Subsidies and Countervailing Measures to request information on China's numerous subsidy programs at the central and sub-central levels.¹⁹ In July of this year, the United States accused China of violating transparency requirements by consistently failing to notify the WTO in advance of newly enacted trade policies.²⁰ China's response to these requests has been mixed. While it did not contest the 2011 request, China has not "substantially" responded to the 2012 request by providing answers to U.S. inquiries "as quickly as possible and in a comprehensive manner," according to the U.S. complaint.²¹ Other WTO member countries expressing concern over China's incomplete and overdue subsidies notifications include Canada, Japan, the European Union, Turkey, Australia, New Zealand, and Norway.²²

In 13 years of WTO membership, China has submitted only two subsidy notifications: (1) a 2006 notification that covered the period from 2001 to 2004, and (2) a 2011 notification

that covered the period from 2005 to 2008.²³ China has not submitted any subsidy notifications for periods after 2008, nor has it notified the WTO of subsidy measures at the sub-central government level.²⁴ According to the WTO's July 2014 Trade Policy Review (TPR) of China, "Updated notifications appear to be necessary in the area of subsidies" because the application of such measures is "not always transparent" and the "extent to which China supports ... different sectors of the economy is not clear."²⁵

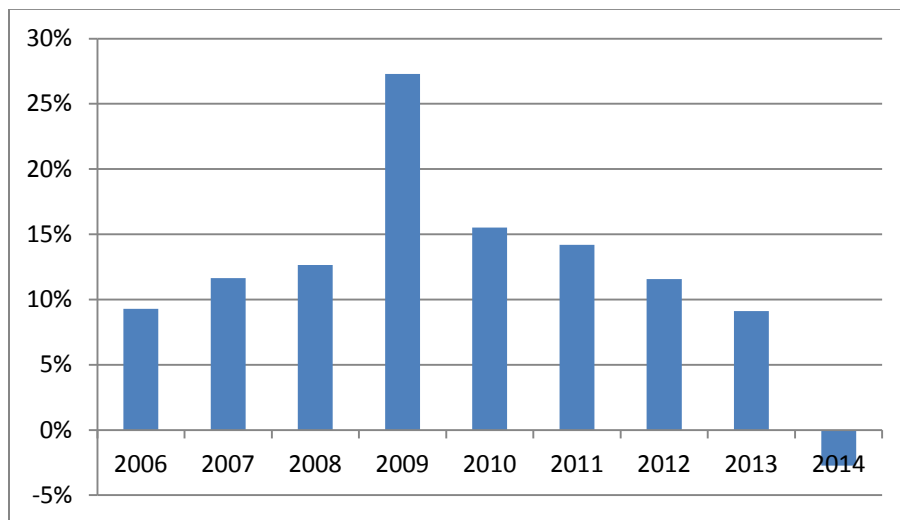
Quarterly Review of China's Economy

Major Slowdown in Third Quarter

According to China's National Bureau of Statistics, China's gross domestic product (GDP) in the third quarter (July–September) grew by 7.3 percent over the last year. The announcement surprised many analysts who had expected worse (e.g., a Reuters consensus forecast was 7.2 percent). Nonetheless, it was the worst reading since the height of the financial crisis in the first quarter of 2009, and 0.2 percentage points below the government's 2014 growth target.²⁶

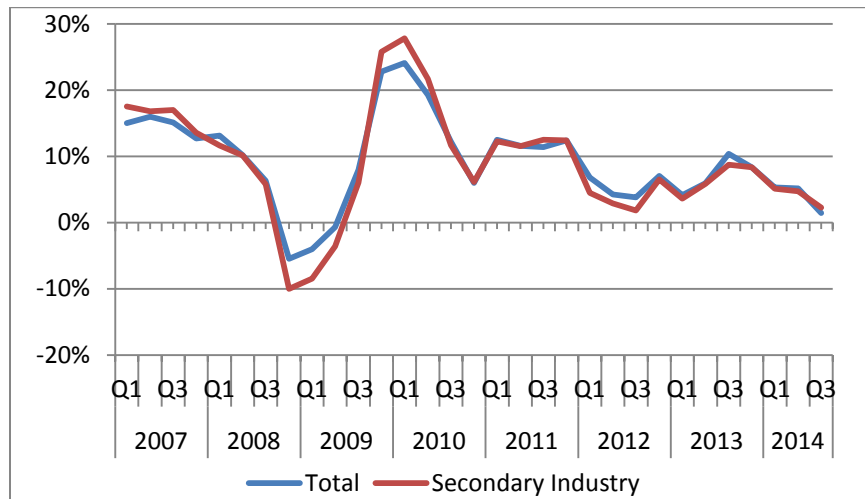
On most indicators, China's economy is decelerating. Freight traffic, a reliable proxy of economic activity in China's industry-heavy economy, contracted through the first nine months of the year, continuing the slowdown that began in 2009 (see Figure 5). Quarterly growth in electricity consumption also recorded its lowest rate since the global financial crisis in 2009 (see Figure 6).

Figure 5: Cumulative Growth in China's Freight Traffic through September (YTD, year-on-year, %)



Source: China National Bureau of Statistics, via CEIC.

Figure 6: Quarterly Growth in China's Power Consumption: Total and Secondary Industry (quarterly, year-on-year, %)



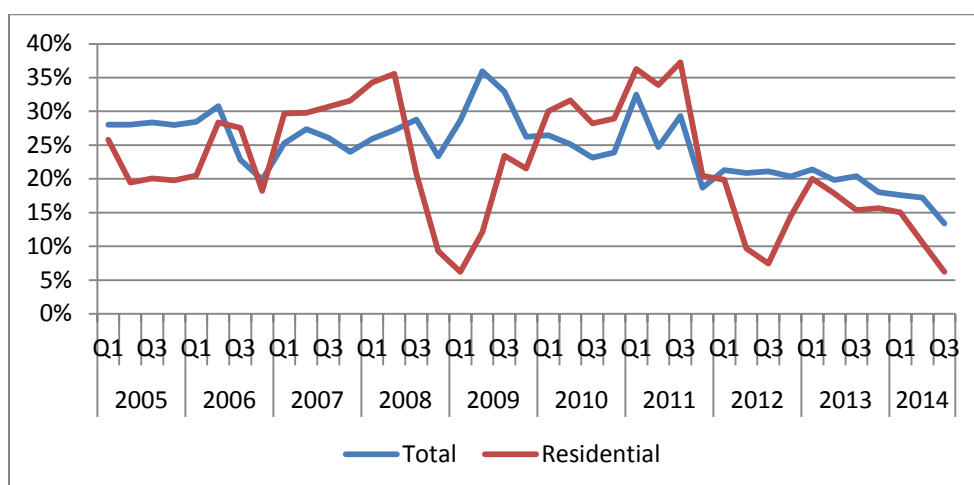
Source: China Electricity Council, via CEIC.

At the same time, China's retail coal prices hit multiyear lows, the result of excess inventories and a lack of electricity demand (coal accounts for four-fifths of the country's power generation). International oil prices, too, hit a four-year low in September, partly due to weak demand in China, now the world's largest net oil importer. Flagging energy prices contributed to China's lowest consumer inflation rate in two years.

China's low inflation rate leaves households with more disposable income. But in September, year-on-year growth in retail sales—the best gauge available for consumption—was only 11.6 percent. In nominal terms, it marked the lowest monthly year-on-year growth in China's consumption since November 2003 (excluding national holiday periods each February). The consumption slowdown recorded at individual companies was worse. According to the *Financial Times*, "consumer goods manufacturers Unilever, Nestlé, and Colgate-Palmolive all reported declines in China sales in the third quarter to the end of September, with Unilever's China sales down 20 per cent in value terms." Consumer research group Kantar Worldpanel predicts growth in fast-moving consumer goods like soft drinks and toiletries will slow to 5.5 percent in China this year, down from 15 percent three years ago. For foreign companies, slowing consumer demand is compounded by the loss of market share to domestic Chinese companies.²⁷

Weak consumption may be tied to a slump in China's housing market. At 13.4 percent, fixed investment registered the lowest quarterly growth in over a decade (see Figure 7). Fixed investment in residential buildings expanded at less than half the rate of total fixed investment. Real estate investment in September increased at its slowest rate since July 2009, coupled with weak property values.²⁸ Since real estate leads to consumption of furniture and other household goods and bolsters consumer confidence, of, decoupling consumption from the housing sector remains a challenge to China's rebalancing efforts.

Figure 7: Growth in China's Fixed Investment: Total and Residential Buildings (quarterly, year-on-year, %)



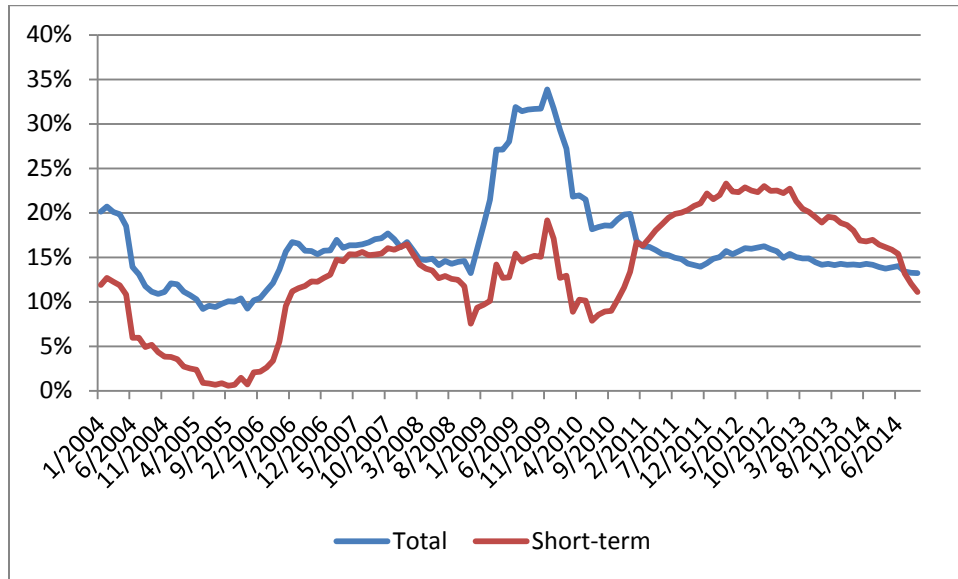
Source: China National Bureau of Statistics, via CEIC.

Caution in the Financial Sector

So far this year, China's financial sector has not contributed significantly to economic activity. During the first nine months of 2014, monthly lending growth averaged 13.8 percent, the slowest pace since 2005. In September, monthly lending growth fell to its lowest level since November 2008, just before the central government unleashed its RMB 4 trillion stimulus plan.²⁹ As things stand, another large-scale stimulus seems a distant prospect. The government has resorted instead to "mini-stimulus" measures. In late October, China's official news agency, Xinhua, reported the government will try to boost consumption in housing, education, and tourism, though the report did not provide details on the measures.³⁰ At the same time, the central bank is tightening the screws on risky borrowers. July marked a subtle turning point, as short-term credit growth trailed total credit growth for the first time since January 2011 (see Figure 8).

The tendency toward caution is also apparent in the broader financial market. Aggregate financing—a measure that comprises all forms of financing, including bank loans, bonds, and riskier instruments in the "shadow banking" sector—declined by 39 percent year-on-year in the third quarter. Most of this decline appears to be in shadow banking instruments. Ordinary bank loans, comprising just 57 percent of aggregate financing since 2009, accounted for 84 percent in the third quarter this year, as China's large banks reverted to their traditional role of controlling credit growth.³¹

Figure 8: Monthly Growth in China's Bank Lending: Total Loans and Short-Term Loans (monthly, year-on-year, %)

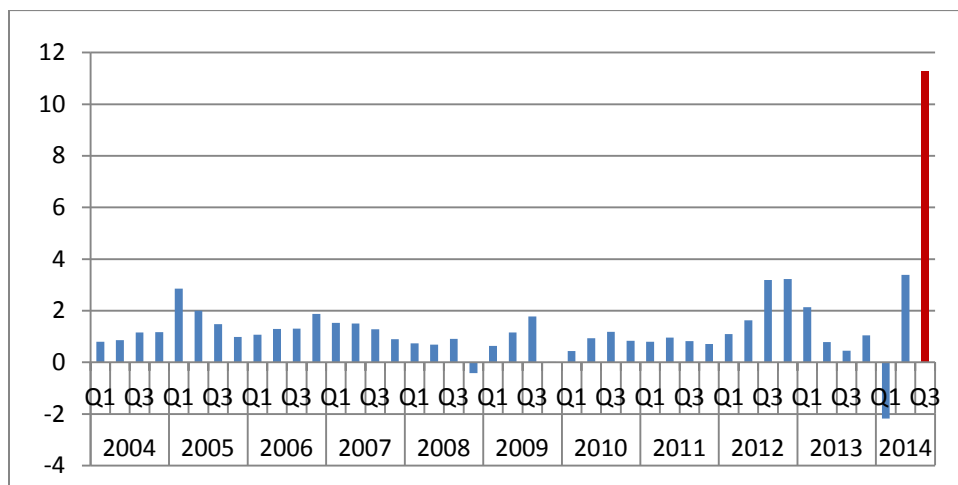


Source: The People's Bank of China, via CEIC.

Puzzling Trade Numbers

International trade proved a puzzling segment of the Chinese economy in the third quarter. China's General Administration of Customs recorded the highest quarterly trade surplus with the world in over a decade (\$152 billion). Exports expanded at their fastest pace since the first quarter of 2013. Oddly, trends in exports and imports diverged: exports jumped by 13 percent year-on-year, whereas imports remained almost unchanged at 1.2 percent. The resultant growth elasticity between exports and imports was unusually high (see Figure 9). Normally, imports rise along with exports, since China uses imported raw materials and components to manufacture goods for export. It is unclear why this did not happen in the third quarter.

Figure 9: Elasticity between China's Export and Import Growth (Ratio of export growth to import growth)



Source: China General Administration of Customs, via CEIC.

Adding to the puzzle is the fact that growth in industry value added in August (6.9 percent) and September (8 percent) was the worst since the global financial crisis in early 2009, suggesting a lack of factory activity.³² The HSBC purchasing managers' index, a survey of manufacturers, remained just above 50 in August and September; the index signals expansion, but not to the extent one would expect given the strong exports.³³

Also unusual is the fact China recorded a decline in its foreign exchange reserves in the third quarter, despite its large trade surplus. The State Administration of Foreign Exchange's preliminary data showed a \$100 million outflow of foreign exchange, counter to the \$148 billion inflow during the first half of the year. This implies large capital outflows from China. An element that weakened the balance of payments was foreign direct investment, which fell by 9.8 percent year-on-year in the third quarter.³⁴ The causes for this drop are debatable, but it does appear foreign investors are wary of China's economic health.

Lack of data reliability continues to frustrate analysts of China's economy. The current focus is on China's export data, since the surge in exports boosted GDP growth in the third quarter. Many economists suspect Chinese companies are deliberately invoicing export receipts incorrectly, overstating actual goods shipments in order to evade China's strict capital controls. Further adding to suspicions, a Bloomberg report showed the Mainland's exports to Hong Kong in September were \$13.5 billion higher than Hong Kong's recorded imports from the Mainland. The Chinese government has acknowledged the problem, though it claims fake export invoices totaled only \$10 billion since last April. A Ministry of Commerce spokesman said the ministry will step up its scrutiny. Such reassurances have been issued repeatedly in recent years, to no avail.³⁵

Lack of Clarity and Delays Hinder China-Hong Kong Stock Trading

Originally slated to launch on October 27, 2014, a landmark cross-border trading arrangement designed to allow global investors freer access to China's capital markets has experienced a series of delays, causing confusion among investors. First announced by the Hong Kong and Chinese governments in April, the so-called Shanghai-Hong Kong Stock Connect was met with apprehension by members of the Asia Securities Industry & Financial Markets Association (ASIFMA), who wrote a letter requesting the launch be delayed. The members cited uncertainty surrounding technical issues and a lack of clarity over taxation of capital gains, dividends, and other corporate profits.³⁶ ASIFMA's October 17 letter requested participants be given a month's notice before the scheme is launched, in order to prepare trading systems and documentation processes.³⁷

Silence from Beijing over the Stock Connect's launch has generated uncertainty among participants. After the Stock Connect missed its projected October 27 start date, Hong Kong Exchanges & Clearing (HKEx), the southern bourse, declined 4.7 percent; some Chinese brokerages, including First Shanghai Investments Ltd., lost upward of 5 percent.³⁸ Charles Li, chief executive of the HKEx, suggested pro-democracy protests in Hong Kong's Central business district might have been a factor in the delayed launch.³⁹ Other participants say Chinese brokerages may not be able to handle the scheme's expected trading volume.⁴⁰

Regulators have not set a timetable for launching the Stock Connect, but say the link is only waiting on "relevant approvals" to start.⁴¹ On October 30, China Securities Regulatory Commission Deputy Chairman Yao Gang indicated the launch is in its "final stage," and the exchanges had resumed testing of trading systems on November 1 after a pause over the previous weekend.⁴² David Cui, head of China equity strategy at Bank of American Merrill Lynch Global Research, expects the link to launch by the end of the year.⁴³

Sector Focus – The Asian Infrastructure Investment Bank

On October 24, 2014, China and 20 other countries signed a memorandum of understanding (MOU) for the creation of the Asian Infrastructure Investment Bank (AIIB) to provide loans for construction projects in Asia.⁴⁴ The founding AIIB members are Bangladesh, Brunei, Cambodia, China, India, Kazakhstan, Kuwait, Laos, Malaysia, Mongolia, Burma (Myanmar), Nepal, Oman, Pakistan, the Philippines, Qatar, Singapore, Sri Lanka, Thailand, Uzbekistan, and Vietnam.⁴⁵ Noticeably absent are Australia, Indonesia, Japan, and South Korea, in part due to pressure from the United States not to join.⁴⁶

According to Chinese Finance Minister Lou Jiwei, the AIIB will be headquartered in Beijing, with initial capital of \$50 billion and an authorized capital of \$100 billion.⁴⁷ Share allocation will be based on GDP, with China as the largest shareholder. China has offered to provide up to half the initial capital, with the remaining funds provided by member countries.⁴⁸ The rules and processes of the AIIB are in negotiations, which are expected to conclude by the end of 2015.⁴⁹

Proponents argue the AIIB is a welcome new addition, providing long overdue competition to international financial institutions and filling the as-yet-unmet demand for infrastructure investment. David Dollar, a senior fellow at The Brookings Institution, attributes the creation of the AIIB to China's frustration "with the lack of governance reform, slow pace of project implementation, and reluctance to expand lending on the part of the existing development banks."⁵⁰ Despite promises sought by China to restructure the governance procedures at the International Monetary Fund and World Bank, increases in the voting shares for China and other emerging economies have not materialized.⁵¹ Dr. Dollar notes the AIIB "will provide some healthy competition" for the International Monetary Fund and World Bank, and hopes this pressure will lead to needed reform, so China will "buy fully into the existing institutions."⁵²

The Asian Development Bank, World Bank, and International Monetary Fund all publically support the creation of the AIIB, and have expressed an interest in partnering with the AIIB.⁵³ Jim Yong Kim, president of the World Bank, stated in July the AIIB "should be a very welcome addition to the current situation, which is a woeful lack of financing for infrastructure."⁵⁴ In 2010, the Asian Development Bank estimated that infrastructure investment in Asia will require roughly \$800 billion per year in financing to meet demand between 2010 and 2020.⁵⁵ Multilateral development banks and private investors have contributed \$205 billion, representing just a fraction of the demand.⁵⁶

Critics argue the AIIB lacks fair governance arrangements, risks weakening international lending requirements such as environmental and social standards, and challenges the existing international and regional lenders, namely the World Bank and the Asian Development Bank.⁵⁷ In private conversations over the past year with South Korean, Australian, and other government officials in the region, U.S. officials have vigorously lobbied their allies not to join the AIIB.⁵⁸ According to senior South Korean and Australian officials, the U.S. Treasury believes the AIIB will weaken existing U.S.-dominated international financial institutions and be a political tool for China to extend its economic and political influence among its neighbors.⁵⁹

U.S. dominance in international institutions such as the World Bank has provided the United States significant political and economic influence in shaping lending practices and developing international lending norms. All twelve World Bank presidents have hailed from the United States.⁶⁰ Therefore, the creation of the AIIB and other similar organizations could erode U.S. leadership and its established international economic institutions and policies. A new report by German-based think tank Mercator Institute for China Studies (MERICS), argues the creation of the AIIB is part of a broader Chinese policy to "[construct]

supplementary—in part complementary, in part competitive—channels for shaping the international order beyond Western claims to leadership.”⁶¹ The AIIB and the New Development Bank (the so-called BRICS [Brazil, Russia, India, China, and South Africa] bank), among other institutions, reflect China’s strategy of “targeting gaps within established intergovernmental organizations” to push “towards a realignment of the international order” (see Figure 10).⁶²

Figure 10: International Parallel and Alternative Structures Promoted by China



Note: On October 29, the Chinese government announced it will begin accepting applications by Visa, MasterCard, and other competitors for access to China’s payment market, potentially ending China Union Pay Company’s monopoly.⁶³

Source: Sebastian Heilmann, Moritz Rudolf, and Mikko Huotari, *China’s Shadow Foreign Policy: Parallel Structures Challenge the Established International Order* (China Monitor, October 28, 2014). p. 2.

Moreover, both the U.S. Treasury and the Japanese finance ministry have raised transparency and governance objections on the AIIB’s proposed lending practices.⁶⁴ China continues to rank as the least transparent donor nation or institution. As one U.S. official asked, “How would the Asian Infrastructure Investment Bank be structured so that it doesn’t undercut the standards with a race to the bottom?”⁶⁵ Consequently, the Asian Development Bank urged the AIIB to “adopt international best practices in procurement and environmental and social safeguard standards on its projects and programs.”⁶⁶ If the bank complies, the stricter rules may attract additional AIIB members. Despite not signing the original memorandum, Australian Prime Minister Tony Abbott promised that with enhanced transparency and governance, “Not only will Australia be happy to join, but I imagine that Korea and Japan and the United States would also be happy to join.”⁶⁷

For inquiries, please contact a member of our economics and trade team (Jacob Koch-Weser, ikoch-weser@uscc.gov; Nargiza Salidjanova, nsalidjanova@uscc.gov; Kevin Rosier, krosier@uscc.gov; Katherine Koleski, kkoleski@uscc.gov; or Lauren Gloudeman, lgloudeman@uscc.gov).

This edition of the monthly trade bulletin, originally released November 4, was revised on November 5 to highlight the United States' record monthly goods deficit with China. The original version included an inaccurate subheading, which stated that the deficit was up but growing more slowly.

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 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.

¹ Xinhua (English edition), "Decision of the CPC Central Committee on Several Major Issues Concerning Comprehensively Pushing Forward Governing the Country in Accordance with the Law," October 29, 2014. Open Source Center translation. ID: Cho2014102921410254.

² Xinhua (English edition), "Decision of the CPC Central Committee on Several Major Issues Concerning Comprehensively Pushing Forward Governing the Country in Accordance with the Law," October 29, 2014. Open Source Center translation. ID: Cho2014102921410254.

³ Xinhua (English edition), "Decision of the CPC Central Committee on Several Major Issues Concerning Comprehensively Pushing Forward Governing the Country in Accordance with the Law," October 29, 2014. Open Source Center translation. ID: Cho2014102921410254.

⁴ Xinhua (English edition), "Decision of the CPC Central Committee on Several Major Issues Concerning Comprehensively Pushing Forward Governing the Country in Accordance with the Law," October 29, 2014. Open Source Center translation. ID: Cho2014102921410254.

⁵ Wang Chenguang, *Administering Justice for People (sifa weimin)—China's Judicial Reform Efforts and their Limitations* (Carnegie Endowment for the International Peace, April 18, 2005). http://carnegieendowment.org/files/panel2_summary.pdf; Carl F. Minzner, "The Rise and Fall of Chinese Legal Education," *Fordham International Law Journal* 36:2 (August 2012): 344, 368-369. <http://ssrn.com/abstract=2128151>.

⁶ Xinhua (English edition), "Decision of the CPC Central Committee on Several Major Issues Concerning Comprehensively Pushing Forward Governing the Country in Accordance with the Law," October 29, 2014. Open Source Center translation. ID: Cho2014102921410254.

⁷ Richard McGregor, *The Party: The Secret World of China's Communist Rulers* (New York, NY: Harper Perennial, 2012), p. 114.

⁸ Xinhua (English edition), "Decision of the CPC Central Committee on Several Major Issues Concerning Comprehensively Pushing Forward Governing the Country in Accordance with the Law," October 29, 2014. Open Source Center translation. ID: Cho2014102921410254.

⁹ Stanley Lubman, "Key Points in China's Flood of Legal Reform Rhetoric," *China Realtime Report* (Wall Street Journal blog), October 30, 2014. <http://blogs.wsj.com/chinarealtime/2014/10/30/key-points-in-chinas-flood-of-legal-reform-rhetoric/>.

¹⁰ "China with Legal Characteristics," *Economist*, November 1, 2014. <http://www.economist.com/news/leaders/21629383-xi-jinping-invoking-rule-law-thats-risky-him-and-good-china-china-legal>.

¹¹ U.S. Department of the Treasury, "Report to Congress on International Economic and Exchange Rate Policies," Washington, DC, October 15, 2014, p. 4.

¹² C. Fred Bergsten and Joseph E. Gagnon, "Currency Manipulation, the U.S. Economy, and the Global Economic Order," December, 2012, <http://www.iie.com/publications/pb/pb12-25.pdf>.

¹³ U.S. Department of Labor, Bureau of Labor Statistics, Current Employment Statistics survey, November 4, 2014 <http://data.bls.gov/pdq/SurveyOutputServlet>.

¹⁴ Bloomberg, "China Monthly Foreign Exchange Reserves," <http://www.bloomberg.com/quote/CNGFOREX:IND>.

¹⁵ International Monetary Fund, Foreign Exchange Reserves, Appendix I, <http://www.imf.org/external/pubs/ft/ar/2013/eng/pdf/a1.pdf>.

¹⁶ World Trade Organization Committee on Subsidies and Countervailing Measures, *Subsidies—Request from the United States to China Pursuant to Article 25.10 of the Agreement*, G/SCM/Q2/CHN/51, October 21, 2014.

https://docs.wto.org/dol2fe/Pages/FE_Search/DDFDocuments/127947/q/G/SCMQ2/CHN51.pdf.

¹⁷ World Trade Organization Committee on Subsidies and Countervailing Measures, *Subsidies—Request from the United States to China Pursuant to Article 25.10 of the Agreement (Supplement)*, G/SCM/Q2/CHN/46/Suppl.1, October 21, 2014.

¹⁸ World Trade Organization Committee on Subsidies and Countervailing Measures, *Subsidies—Request from the United States to China Pursuant to Article 25.10 of the Agreement*, G/SCM/Q2/CHN/51, October 21, 2014.

https://docs.wto.org/dol2fe/Pages/FE_Search/DDFDocuments/127947/q/G/SCMQ2/CHN51.pdf.

¹⁹ World Trade Organization Committee on Subsidies and Countervailing Measures, *Subsidies—Request from the United States to China Pursuant to Article 25.10 of the Agreement*, G/SCM/Q2/CHN/51, October 21, 2014.

https://docs.wto.org/dol2fe/Pages/FE_Search/DDFDocuments/127947/q/G/SCMQ2/CHN51.pdf.

²⁰ U.S.-China Economic and Security Review Commission, *July Trade Bulletin*, July 3, 2014, p. 4. <http://origin.www.uscc.gov/sites/default/files/Research/July%202014%20Trade%20Bulletin.pdf>.

²¹ World Trade Organization Committee on Subsidies and Countervailing Measures, *Subsidies—Request from the United States to China Pursuant to Article 25.10 of the Agreement*, G/SCM/Q2/CHN/51, October 21, 2014.

https://docs.wto.org/dol2fe/Pages/FE_Search/DDFDocuments/127947/q/G/SCMQ2/CHN51.pdf.

²² World Trade Organization Committee on Subsidies and Countervailing Measures, "Subsidies Committee Focuses on Improving Notifications," October 26–27, 2011. http://www.wto.org/english/news_e/news11_e/scm_26oct11_e.htm; World Trade Organization Committee on Subsidies and Countervailing Measures, "Subsidies Committee Continues Focus on Improving Notifications," April 26, 2012.

http://www.wto.org/english/news_e/news12_e/scm_26apr12_e.htm.

²³ World Trade Organization Committee on Subsidies and Countervailing Measures, *Subsidies—Request from the United States to China Pursuant to Article 25.10 of the Agreement*, G/SCM/Q2/CHN/51, October 21, 2014.

²⁴ World Trade Organization Committee on Subsidies and Countervailing Measures, *Subsidies—Request from the United States to China Pursuant to Article 25.10 of the Agreement*, G/SCM/Q2/CHN/51, October 21, 2014.

https://docs.wto.org/dol2fe/Pages/FE_Search/DDFDocuments/127947/q/G/SCMQ2/CHN51.pdf.

²⁵ World Trade Organization, "Fifth Trade Policy Review: China," July 3, 2014.

http://www.wto.org/english/tratop_e/tpr_e/s300_sum_e.pdf.

²⁶ Li Anne Wong, "China GDP Beats, but Growth Slowest since Crisis," MSNBC, October 20, 2014. <http://www.cnbc.com/id/102101000#>.

²⁷ Gabriel Wildau, "China's 'New Normal' for Consumption," *Financial Times*, October 28, 2014. <http://www.ft.com/intl/cms/s/0/ae37dbfa-5e59-11e4-bc04-00144feabdc0.html#axzz3I4FoEtCC>.

²⁸ Data from China National Bureau of Statistics, via CEIC.

²⁹ Data from the People's Bank of China, via CEIC.

³⁰ Xinhua (English edition), "Xinhua Insight: China Moves to Expand, Upgrade Consumption," October 30, 2014. For more information, see previous editions of the USCC monthly trade bulletin.

³¹ Data from the People's Bank of China, via CEIC.

³² Data China National Bureau of Statistics, via CEIC.

³³ Data from HSBC. <http://www.hsbc.com/news-and-insight/emerging-markets-pmi>.

³⁴ China State Administration of Foreign Exchange and China National Bureau of Statistics, via CEIC.

³⁵ Bloomberg, "China Fake Invoice Evidence Mounts as Hong Kong Figures Diverge," October 27, 2014. <http://www.bloomberg.com/news/2014-10-27/china-fake-invoice-evidence-mounts-as-hong-kong-figures-diverge.html>.

³⁶ Michelle Pierce, "Exclusive: Investors Seek Delay to HK-Shanghai Stock Tie-up," Reuters, October 22, 2014. <http://www.reuters.com/article/2014/10/22/us-hongkong-china-stocks-exclusive-idUSKCN0IB0RC20141022>.

-
- ³⁷ Michelle Pierce, "Exclusive: Investors Seek Delay to HK-Shanghai Stock Tie-up," Reuters, October 22, 2014. <http://www.reuters.com/article/2014/10/22/us-hongkong-china-stocks-exclusive-idUSKCN0IB0RC20141022>.
- ³⁸ Kana Nishizawa and Darren Boey, "China's Missing Exchange Link Leaves Traders in Limbo," Bloomberg, October 27, 2014. <http://www.bloomberg.com/news/2014-10-26/china-s-missing-exchange-link-leaves-traders-in-limbo.html>.
- ³⁹ Aaron Back, "Hong Kong's Missed Connection Shows Perils of Betting on Beijing," *Wall Street Journal*, October 27, 2014. http://online.wsj.com/articles/hong-kongs-missed-connection-shows-perils-of-betting-on-beijing-heard-on-the-street-1414411534?tesla=y&mod=rss_about_china&mg=reno64-wsj.
- ⁴⁰ Aaron Back, "Hong Kong's Missed Connection Shows Perils of Betting on Beijing," *Wall Street Journal*, October 27, 2014. http://online.wsj.com/articles/hong-kongs-missed-connection-shows-perils-of-betting-on-beijing-heard-on-the-street-1414411534?tesla=y&mod=rss_about_china&mg=reno64-wsj.
- ⁴¹ Philip Stafford and Josh Noble, "Hong Kong-Shanghai Bourse Venture Delayed," *Financial Times*, October 27, 2014. <http://www.ft.com/intl/cms/s/0/8dba471c-5d16-11e4-873e-00144feabdc0.html?siteedition=intl#axzz3HNLAZyVF>.
- ⁴² Engen Tham and Kaunori Takada, "UPDATE 2-China Market Regulator Says Shanghai-HK Connect in 'Final Stage'-State Media," Reuters, October 30, 2014. <http://www.reuters.com/article/2014/10/30/hongkong-china-stocks-idUSL4NOSP1RI20141030>.
- ⁴³ Aaron Back, "Hong Kong's Missed Connection Shows Perils of Betting on Beijing," *Wall Street Journal*, October 27, 2014. http://online.wsj.com/articles/hong-kongs-missed-connection-shows-perils-of-betting-on-beijing-heard-on-the-street-1414411534?tesla=y&mod=rss_about_china&mg=reno64-wsj.
- ⁴⁴ Wu Jianmin, "Will Asia Bank on China?" *ChinaFile*, October 22, 2014. <http://www.chinafile.com/conversation/will-asia-bank-china#comment-851>.
- ⁴⁵ Xinhua (English edition), "21 Asian Countries Sign MOU on Establishing Asian Infrastructure Investment Bank," October 24, 2014. http://news.xinhuanet.com/english/business/2014-10/24/c_133740149.htm.
- ⁴⁶ Bree Feng, "China Signs Agreement with 20 Other Nations to Establish International Development Bank," *New York Times*, October 24, 2014. <http://www.nytimes.com/2014/10/25/world/asia/china-signs-agreement-with-20-other-nations-to-establish-international-development-bank.html>.
- ⁴⁷ Xinhua (English edition), "21 Asian Countries Sign MOU on Establishing Asian Infrastructure Investment Bank," October 24, 2014. http://news.xinhuanet.com/english/business/2014-10/24/c_133740149.htm.
- ⁴⁸ Xinhua (English edition), "AIIB Authorized Capital Amounts 100 Billion U.S. Dollars," October 24, 2014. <http://english.peopledaily.com.cn/business/n/2014/1024/c90778-8799706.html>; Ely Ratner, "Making Bank," *Foreign Policy*, October 23, 2014. http://www.foreignpolicy.com/articles/2014/10/23/China_Xi_Asian_Infrastructure_Investment_Bank.
- ⁴⁹ Xinhua (English edition), "AIIB Authorized Capital Amounts 100 Billion U.S. Dollars," October 24, 2014. <http://english.peopledaily.com.cn/business/n/2014/1024/c90778-8799706.html>.
- ⁵⁰ David Dollar, "The Creation of the Asian Infrastructure Investment Bank Is the Right Move for the Global Economy," *New York Times*, October 22, 2014. <http://www.nytimes.com/roomfordebate/2014/10/20/a-chinese-rival-to-the-world-bank/the-creation-of-the-asian-infrastructure-investment-bank-is-the-right-move-for-the-global-economy>.
- ⁵¹ David Dollar, "The Creation of the Asian Infrastructure Investment Bank Is the Right Move for the Global Economy," *New York Times*, October 22, 2014. <http://www.nytimes.com/roomfordebate/2014/10/20/a-chinese-rival-to-the-world-bank/the-creation-of-the-asian-infrastructure-investment-bank-is-the-right-move-for-the-global-economy>.
- ⁵² David Dollar, "The Creation of the Asian Infrastructure Investment Bank Is the Right Move for the Global Economy," *New York Times*, October 22, 2014. <http://www.nytimes.com/roomfordebate/2014/10/20/a-chinese-rival-to-the-world-bank/the-creation-of-the-asian-infrastructure-investment-bank-is-the-right-move-for-the-global-economy>.
- ⁵³ Asian Development Bank, "Statement by Asian Development Bank President Takehiko Nakao," ADB Press Release, October 24, 2014. <http://www.adb.org/news/statement-asian-development-bank-president-takehiko-nakao>; World Bank, "Transcript of World Bank Group President Jim Yong Kim's Opening Press Conference, World Bank/IMF Annual Meetings 2014," October 9, 2014. <http://www.worldbank.org/en/news/speech/2014/10/09/transcript-world-bank-group-president-jim-yong-kims-opening-press-conference-world-bank-imf-annual-meetings-2014>; International Monetary Fund, "Transcript of a Press Briefing by Gerry Rice, Director, Communications Department,

International Monetary Fund," October 30, 2014.

<http://www.imf.org/external/np/tr/2014/tr103014.htm>.

⁵⁴ Guy Taylor, "World Bank President, Obama at Odds over China Global Lending Project," *Washington Times*, October 26, 2014. <http://www.washingtontimes.com/news/2014/oct/26/world-bank-president-backs-chinese-counterpart/>.

⁵⁵ Biswa Nath Bhattacharyay, *Estimating Demand for Infrastructure in Energy, Transport, Telecommunications, Water and Sanitation in Asia and the Pacific: 2010–2010* (Asian Development Bank, September 2010). pp. 11-15.

⁵⁶ Guy Taylor, "World Bank President, Obama at Odds over China Global Lending Project," *Washington Times*, October 26, 2014. <http://www.washingtontimes.com/news/2014/oct/26/world-bank-president-backs-chinese-counterpart/>.

⁵⁷ Hugh White, "AIIB: America's Influence in the Balance," *Straits Times*, October 29, 2014. <http://www.straitstimes.com/news/opinion/invitation/story/aiib-americas-influence-the-balance-20141029>.

⁵⁸ Jane Perlez, "U.S. Opposing China's Answer to World Bank," *New York Times*, October 9, 2014. http://www.nytimes.com/2014/10/10/world/asia/chinas-plan-for-regional-development-bank-runs-into-us-opposition.html?_r=0.

⁵⁹ Jane Perlez, "U.S. Opposing China's Answer to World Bank," *New York Times*, October 9, 2014. http://www.nytimes.com/2014/10/10/world/asia/chinas-plan-for-regional-development-bank-runs-into-us-opposition.html?_r=0.

⁶⁰ Asian Development Bank, "Takehiko Nakao," <http://www.adb.org/about/management/takehiko-nakao>; Asian Development Bank, "Past ADB Presidents," <http://www.adb.org/about/management/past-presidents>; and World Bank, "Past Presidents," <http://www.worldbank.org/en/about/archives/history/past-president>.

⁶¹ Sebastian Heilmann, Moritz Rudolf, and Mikko Huotari, *China's Shadow Foreign Policy: Parallel Structures Challenge the Established International Order* (China Monitor, October 28, 2014).

⁶² Sebastian Heilmann, Moritz Rudolf, and Mikko Huotari, *China's Shadow Foreign Policy: Parallel Structures Challenge the Established International Order* (China Monitor, October 28, 2014).

⁶³ Chitra Somayaji, "China to End Back-Card Clearing Monopoly U.S. Opposed," *Bloomberg*, October 29, 2014. <http://www.bloomberg.com/news/2014-10-29/china-to-end-back-card-clearing-monopoly-u-s-opposed.html>.

⁶⁴ Bob Davis and Prasanta Sahu, "China's Plans for Development Bank Fall Short," *Wall Street Journal*, October 23, 2014. <http://online.wsj.com/articles/chinas-plans-for-development-bank-fall-short-1414051724>.

⁶⁵ Jane Perlez, "U.S. Opposing China's Answer to World Bank," *New York Times*, October 9, 2014. http://www.nytimes.com/2014/10/10/world/asia/chinas-plan-for-regional-development-bank-runs-into-us-opposition.html?_r=0.

⁶⁶ Asian Development Bank, "Statement by Asian Development Bank President Takehiko Nakao," ADB Press Release, October 24, 2014. <http://www.adb.org/news/statement-asian-development-bank-president-takehiko-nakao>.

⁶⁷ Jason Scott, "China's Regional Bank Needs To Be More Multilateral, Abbott Says," *Bloomberg*, October 31, 2014. http://www.bloomberg.com/news/2014-10-31/china-s-regional-bank-needs-to-be-more-multilateral-abbott-says.html?utm_source=The+Sinocism+China+Newsletter&utm_campaign=8ec28800a9-Sinocism10_31_1410_31_2014&utm_medium=email&utm_term=0_171f237867-8ec28800a9-29648477&mc_cid=8ec28800a9&mc_eid=3c28e3d015.