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U.S.-China Economic and Security Review Commission

Monthly Analysis of U.S.-China Trade Data **October 3, 2014**

Highlights of this month's edition

- **Bilateral trade:** Monthly U.S. trade deficit with China declines 2.2 percent but year-to-date deficit up 4.1 percent; U.S. exports to China continue to rise, while imports slow.
- **Bilateral policy issues:** Inflows and outflows of FDI in China decline amid anticorruption and antimonopoly crackdowns.
- **Policy trends in China's economy:** The People's Bank of China, the central bank, is injecting RMB 500 billion into China's five largest banks on concerns over economic slowdown; the State Council introduced new measures to boost small companies.
- **Sector spotlight – China-India-U.S. Economic Relations:** In mid-September, President Xi Jinping made his inaugural visit to New Delhi as China's head of state. Two weeks later, India's Prime Minister Narendra Modi traveled to Washington for the first time since taking office in May. The two visits mark an important step in the development of the triangular relationship between the United States, China and India.

Bilateral Goods Trade

The U.S. trade deficit in goods with China registered $30.2 billion in August, a 2.2 percent decline from July. August was the first time in the past four months that the U.S. trade deficit with China decreased, though the pattern appears to be seasonal. The reduction was due primarily to strong performance of U.S. exports to China which increased 3.7 percent month-on-month and 3 percent year-on-year in August.

Table 1: U.S. Trade in Goods with China, January-August 2014
(US$ billions; growth %)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
US$ billions								
Exports	10.4	9.9	10.8	9.0	9.2	9.4	9.3	9.6
Imports	38.2	30.7	31.2	36.3	38.0	39.4	40.2	39.8
Balance	(27.8)	(20.9)	(20.4)	(27.3)	(28.8)	(30.1)	(30.9)	(30.2)
Total	48.6	40.6	42.1	45.3	47.2	48.8	49.4	49.5
Balance YTD (US$ billions)								
2013	(27.8)	(51.4)	(69.2)	(93.4)	(121.2)	(147.9)	(178.0)	(207.8)
2014	(27.8)	(48.7)	(69.1)	(96.4)	(125.2)	(155.2)	(186.1)	(216.3)
yoy growth %								
Exports	10.4%	8.2%	13.6%	0.9%	5.4%	1.5%	6.5%	3.0%
Imports	2.7%	-6.1%	14.4%	9.6%	3.7%	9.8%	3.5%	1.7%

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, October 2014). *http://www.census.gov/foreign-trade/balance/c5700.html.*

Slowing rates of Chinese imports also contributed to the lower monthly deficit; imports remained unchanged from July and increased only 1.7 percent year-on-year, the lowest rate of increase in 2014 besides the seasonal February drop related to the Chinese New Year holidays. Overall, however, the trade deficit continues to grow, with the August year-to-date balance showing a 4.1 percent increase year-on-year.

Transportation equipment continued to lead U.S. exports to China in August with a total value of $2.49 billion, an increase of 20 percent year-on-year. Electrical equipment, appliances, and components rose in the export rankings with a 37 percent increase year-on-year. Meanwhile, U.S. agricultural exports continued to decline with a 30 percent year-on-year decrease.

Table 2A: Top U.S. Goods Exports to China in October, 2013-2014
(US$ millions)

	Value (US$mn)		yoy growth
	2014	2013	(%)
Transportation Equipment	2,489.9	2,071.3	20%
Computer and Electronic Products	1,521.0	1,427.2	7%
Chemicals	1,172.4	1,133.3	3%
Machinery, Except Electrical	766.4	896.7	-15%
Waste and Scrap	682.3	787.9	-13%
Food and Kindred Products	327.4	423.9	-23%
Electrical Equipment, Appliances, and Component	267.4	195.5	37%
Agricultural Products	267.3	381.8	-30%

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

The top U.S. import categories from China remained largely unchanged from July. The top category, computer and electronic products, continued to decline slightly; while electrical equipment, appliances, and components as well as machinery (except electrical) continued to increase at double-digit rates, year-on-year.

Table 2B: Top U.S. Goods Imports from China in October, 2013-2014
(US$ millions)

	Value (US$mn)		
	2014	2013	yoy growth (%)
Computer and Electronic Products	12,745.3	12,974.0	-2%
Electrical Equipment, Appliances, and Component	3,666.0	3,276.4	12%
Apparel and Accessories	3,657.7	3,752.6	-3%
Miscellaneous Manufactured Commodities	3,586.4	3,558.3	1%
Machinery, Except Electrical	2,419.0	2,054.4	18%
Leather and Allied Products	2,239.1	2,429.0	-8%
Fabricated Metal Products, Nesoi	1,739.6	1,687.3	3%

Note: Nesoi = not elsewhere specified or included.
Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, October 2014). *http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl.*

Bilateral Policy Issues

Chinese FDI Inflows and Outflows at a Four-Year Low amid Anticorruption and Antimonopoly Investigations

Inflows of foreign direct investment (FDI) in China fell to a four-year low in August 2014, according to data released by China's Ministry of Commerce. China attracted $7.2 billion in FDI in August, a 14 percent decline year on year. In July, the country attracted $7.8 billion in FDI, which was a 17 percent decline from the previous year.

The slowdown in inbound FDI is particularly marked in the industrial sector. A recent report by the National Bureau of Statistics found industrial production in August grew at the slowest pace since the global financial crisis.[1] The drop in inbound FDI also reflects growing concern and caution among foreign investors. A member survey released in September by the American Chamber of Commerce in China found 60 percent of companies feel less welcome in China than before, an increase from 41 percent in 2013.[2] Although China insists that the increase of antimonopoly and anticorruption investigations is not specifically targeting foreign companies, many U.S. businesses see things differently.[i] In September, U.S. Treasury Secretary Jacob Lew warned in a letter to Vice Premier Wang Yang that China's stepped-up antimonopoly investigations seemingly targeting foreign companies could damage bilateral relations.[3]

The anticorruption campaign is also impacting domestic firms in some sectors, dampening outbound Chinese investment, since overseas investment "beyond the reach of the Chinese authorities [has] been a favorite vehicle for corruption and money-laundering in recent years," according to some accounts.[4] According to the Heritage Foundation, Chinese overseas investment through June of 2014 totaled $39 billion, down from $46 billion the previous year. And according to the Rhodium Group, which also closely tracks Chinese overseas investment, scrutiny from anticorruption investigators has reduced Chinese energy companies' appetite for risky overseas deals this year, which is "a big drag on the total outbound investment number."[5] In a bid to boost overseas investment, China's Ministry of Commerce published revised rules in September that ease restrictions on domestic firms seeking to invest overseas.[6]

Policy Trends in China's Economy

The Government Introduces New Measures to Shore Up Growth

On September 17, 2014, the People's Bank of China (PBoC) provided RMB 500 billion ($81 billion) to China's five largest state-owned banks (Industrial & Commercial Bank of China, China Construction Bank, Agricultural Bank of China, Bank of China, and Bank of Communications). PBoC will inject RMB 100 billion into each state-owned bank via standard lending facility, a liquidity support tool, in the form of three-month loans. The move comes amid weakening economic indicators: China's gross domestic product (GDP) grew by 7.4 percent in the first quarter of 2014, and 7.5 percent in the second quarter; meanwhile, FDI inflows, fixed asset investment, and retail sales slowed.

Unlike the more open-ended measures the Chinese government used to stimulate the economy in the past (e.g., cutting interest rates or the reserve requirement ratio), the loan of RMB 500 billion is temporary and must be repaid. The government has been reluctant to issue broader stimulus measures for fear of worsening China's debt problems and undermining the prospect of economic reforms. In a comment published by Xinhua, China's official news agency, an adviser to PBoC said the country has not yet reached a point where

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[i] For more on China's antimonopoly crackdown, see the USCC September Trade Bulletin. http://www.uscc.gov/trade-bulletin/september-2014-trade-bulletin.

cutting interest rates is necessary, and should stick instead to "prudent monetary policy."[7] This echoes Chinese Premier Li Keqiang's earlier statement that the government cannot rely on monetary stimulus to boost economic growth. Still, the decision to inject liquidity points to rising concerns over the slowing economy.

PBoC is expected to guide the big banks to channel credit into areas the government has deemed important to the economy, such as public housing and small business.[8] Beijing followed the liquidity injection with another policy announcement aimed at boosting small enterprises. The State Council announced on September 18 that any company with monthly revenues under RMB 30,000 ($4,886) will be exempted from the value-added tax (VAT) and business tax from October 1, 2014, to the end of 2015.[9] This is the latest in a series of steps taken by the State Council to shore up small businesses as growth slows and regulators crack down on shadow banking, which is traditionally a substantial source of financing for small companies. Previously, the State Council granted a tax exemption for businesses with revenues under RMB 20,000. And in April, the State Council announced that companies with annual taxable income under RMB 100,000 will have their business income taxes halved from January 2014 until the end of 2016.

Sector Spotlight: China-India-U.S. Economic Relations

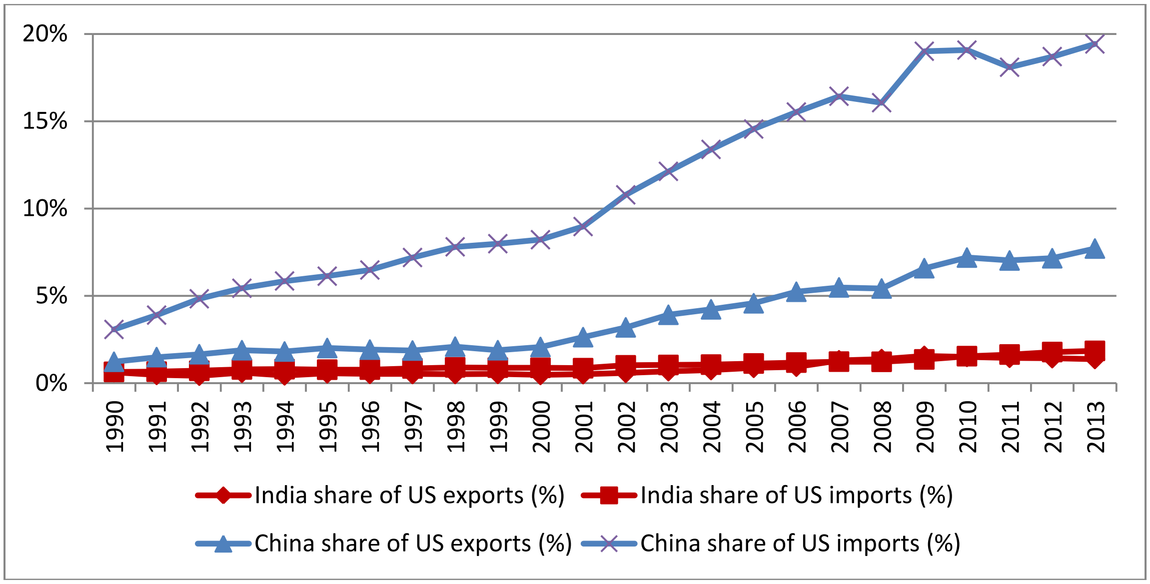
In mid-September, President Xi Jinping made his inaugural visit to New Delhi as China's head of state. Two weeks later, India's newly elected Prime Minister Narendra Modi traveled to Washington for the first time since taking office in May. The two visits marked an important stage in triangular relations between China, India, and the United States. Together, these countries account for 41 percent of the world's population and 37 percent of the global economy (nominal GDP).

India and the United States both contend with China's rise. China's economy, which in 1970 was only seven-tenths the size of India's, is now over three times as large, and, should the growth trends continue, is poised to eventually overtake that of the United States.[ii] Total U.S. goods trade with China expanded five-fold between 2000 and 2013, to $562 billion; over the same period, India's goods trade with China grew 33-fold, from $2 billion to $66 billion.[10] This increase in trade has primarily benefited Chinese exporters: China last year accounted for one-quarter of India's trade deficit with the world, and for nearly half of the U.S. trade deficit. Meanwhile, trade with China has become far more important to the U.S. economy than trade with India (see Figure 1). Although U.S. companies outsource services to India, this activity is dwarfed by U.S. capital flows to China. India has a balance of payments deficit, while China holds $1.26 trillion in U.S. treasuries.[iii]

[ii] Historical comparisons of Indian and Chinese GDP are measured in 2005 U.S. dollars. In terms of purchasing power parity GDP, which takes into account differences in prices across countries, China's economy is already nearly the size of the United States'. Data from World Bank.

[iii] These are the official registered numbers. China's purchases of Treasuries on the secondary markets are not officially registered and are through to be at least as large as the official purchases. China's total foreign exchange reserves are about $4 trillion, the largest in the world.

Figure 1: China and India Share of U.S. Goods Trade, 1990–2013
(share, %)



Source: U.S. International Trade Commission.

The Obama-Modi summit presented an opportunity to strengthen ties between the world's oldest and largest democracies. As The Brookings Institution fellow Tanvi Madan noted, U.S.-India relations have improved markedly since 1998, when the Clinton Administration imposed sanctions in response to India's nuclear program.[11] The frank discussions at the White House contrasted with the Xi-Modi meeting, which was overshadowed by a tense standoff between Chinese and Indian troops along the border in the Ladakh region of northern India. The United States shares India's concern about China's growing military assertiveness in Asia. Secretary of State John F. Kerry and Defense Secretary Chuck Hagel have traveled to India in recent months to meet with top officials.[12]

With respect to economic cooperation, however, Washington and New Delhi have made less headway. Brookings economist Eswar Prasad sees potential for bilateral financial market integration, as well as an increase in high-tech goods trade.[13] The United States is a growing destination for Indian goods, particularly pharmaceuticals.[14] And yet the Obama Administration omitted trade issues from the list of major deliverables expected from the Modi visit. The economic discussions that did take place dealt with U.S. complaints about India's economic policy.

India has delayed implementation of the World Trade Organization (WTO) Trade Facilitation Agreement (TFA), an "early harvest" outcome of the Doha Round that was agreed to last December in Bali. While China supports the TFA, India refuses to do so until food stockholding programs are exempted from agricultural subsidies commitments in the WTO. Food stockholding is central to India's efforts to combat food price inflation and guarantee food security. But Washington is concerned that the TFA—a broader issue that requires unanimous approval from WTO members—is being held hostage by India's agenda.[15]

Furthermore, U.S. businesses have pressured the Obama Administration to get tough with India on intellectual property issues. Pharmaceutical companies are upset that India permits generic production of patented products if the patentee does not attempt to sell and distribute the product in India. U.S. companies further complain India's Supreme Court has invalidated foreign patents that do not meet the Court's definition of a new invention.[16] Rod

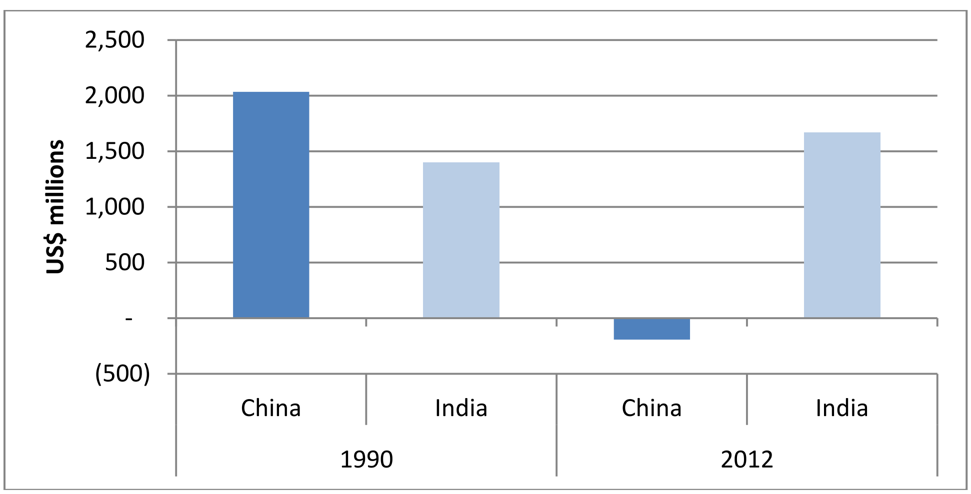
Hunter, senior vice president for international affairs at PhRMA, a pharmaceutical advocacy group, told the U.S.-China Economic Security and Review Commission in April:

> *We've seen in the case of India over the past two years either the disallowance or the attack in one form or another on the patents on some 15 products of which there are only 45 patented products in the market … So there's been a pretty consistent industrial policy of promoting generics, and so that's quite different from the Chinese context where first off the legislation is pretty consistent with international practice.*[17]

In remarks at the Council on Foreign Relations, held in New York on September 29, Prime Minister Modi asserted that whether the 21st century "belongs to India or China is something people are debating."[18] To be sure, India has structural advantages. The median age of its population is a decade lower than China's, and there are millions more children in primary school in India, most of whom will one day join the labor force. India has also been more effective at integrating gas and renewable energy into its energy mix, while China scrambles to offset the effects of excessive coal and oil consumption.[19]

A glance at World Bank figures, however, illustrates that China has outcompeted India on numerous indicators over the past two decades. Over half of China's population now lives in cities, compared to one-third of India's population. Average Chinese income is three times more per capita than an average Indian income, and fewer Chinese farmers live at the poverty line. On other measures of a modern economy, such as vehicle ownership, air travel, maritime shipping, and internet use, China has surpassed India by a large margin. Particularly striking is that China, which at one time received more official development assistance than India, is now a net donor (see Figure 2).

Figure 2: Net Flows of Official Development Assistance, 1990 vs. 2012
(US$ millions)



Source: World Bank.

Last year, China's top exports to India were machinery and nuclear-related technologies. India's top goods exports to China comprised cotton, copper, ores, and mineral fuels.[20] Although services constitute a small share of China's total exports, China is beginning to rival India in communications and information technology (IT) services.[21]

The outcomes of President Xi's visit to India punctuated the bilateral power imbalance. China pledged to invest $20 billion in two industrial parks in the western states of Gujarat and Maharashtra.[22] China will also help India upgrade its rail system to high-speed trains, an extension of China's extensive rail-building projects on the Mainland and in Central Asia.

Rather than competing with domestic Indian firms, China's rail builders are vying with Japan for contracts from the Indian government.[23] Attracting Chinese capital and technology appears to be a greater priority for New Delhi than improving market access for Indian companies in China.

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