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U.S.-China Economic and Security Review Commission

Monthly Summary of U.S.-China Trade Data **August 6, 2013**

Highlights of this month's edition

- **Bilateral trade:** Exports up and imports down, improving the U.S. trade balance with China; transport equipment and computer electronics lead exports
- **Bilateral policy issues:** U.S. wins poultry dispute in WTO; S&ED talks yield progress on bilateral investment, financial services, and energy and climate cooperation; United States to support Shanghai Free Trade Zone
- **Sector spotlight:** ATP trade helps buoy U.S. exports to China; WTO information technology talks stalled by China; shipbuilding and steel emblematic of China's industrial overcapacity as economy slows
- **China's economy:** Q2 GDP slows to 7.5 percent, destabilizing world economy; industrial output and exports drop; Beijing sticks firmly to reform and "fine-tuning" over stimulus; landmark reform of bank lending rates; new crackdown on foreign firms on anti-trust and bribery charges

The U.S. Trade Deficit with China Grows

In June, the monthly U.S.-China trade deficit was 4.3 percent lower than in May, due to an increase in exports and slight drop in imports. Exports increased month-on-month for the first time since March. Compared with data in 2012, this month's export numbers signaled the highest year-on-year growth since January, rising by 7.8 percent. Meanwhile, imports from China declined by $815 million in June.

Total trade volume increased by 1.4 percent year-on-year. Overall, China's continual economic slowdown, with 7.5 percent GDP growth in the second quarter, has not affected U.S. exports to China.

U.S.-China Monthly Trade Balance YTD
(US$ millions)

		Jan	Feb	Mar	Apr	May	Jun
Value	Exports	9,385	9,303	9,435	8,992	8,787	9,182
	Imports	37,172	32,715	27,322	33,102	36,646	35,831
	Balance	-27,787	-23,412	-17,886	-24,110	-27,860	-26,650

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, August 2013). http://www.census.gov/foreign-trade/balance/c5700.html.

Year-on-Year Growth
(US$ millions)

	Jan	Feb	Mar	Apr	May	Jun
Exports	12.1%	6.2%	-4.0%	6.3%	-1.3%	7.8%
Imports	8.1%	16.3%	-13.3%	0.3%	4.9%	-0.2%

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, August 2013). http://www.census.gov/foreign-trade/balance/c5700.html.

Top Exports and Imports

The value of the leading U.S. export to China, transportation equipment, continued to grow in June, increasing 33.9 percent month-on-month and an impressive 117.6 percent year-on-year. Its share of total U.S. exports to China was up 5.2 percent from May. Computer and electronic products also performed well. On the other hand, machinery and waste and scrap imports were down from last year, perhaps due to decelerating industrial output in China.

On the import side, leather and related products replaced non-electrical machinery as one of the top five imports. Apparel and accessories imports also jumped from fifth to the third largest import by value in June, increasing 9.9 percent month on month. Lower value-added, low technology goods thus remain an important component of China's goods shipments to the United States.

Top Exports and Imports through June 2013
(in US$ millions)

U.S. Top-Five Exports to China

	Exports	Share of total (%)	Change over Jun'12 (%)
Monthly (June 2013)			
Transportation Equipment	2,188.6	23.8%	117.6%
Computer and Electronic Products	1,558.1	17.0%	10.2%
Chemicals	1,238.9	13.5%	10.6%
Machinery, Except Electrical	859.9	9.4%	-11.3%
Waste and Scrap	692.0	7.5%	-4.0%
Other	2,644.1	28.8%	
Total	**9,181.5**	**100.0%**	
Year-to-date (thru May 2013)			
Transportation Equipment	10,032.8	28.0%	
Computer and Electronic Products	7,835.7	21.9%	
Agricultural Products	6,654.0	18.6%	
Chemicals	6,555.9	18.3%	
Machinery, Except Electrical	5,047.4	14.1%	
Other	-294.6	-0.8%	
Total	**35,831.3**	**100.0%**	

U.S. Top-Five Imports from China

	Imports	Share of total (%)	Change over Jun'12 (%)
Monthly (May 2013)			
Computer and Electronic Products	13,390.4	24.3%	1.8%
Electrical Equipment, Appliances, and Component	2,691.5	4.9%	9.3%
Apparel and Accessories	2,627.7	4.8%	-2.3%
Miscellaneous Manufactured Commodities	2,372.0	4.3%	-5.3%
Leather and Allied Products	2,129.4	3.9%	-1.3%
Other	31,871.5	57.9%	
Total	**55,082.5**	**100.0%**	
Year-to-date (thru May 2013)			
Computer and Electronic Products	74,811.4	36.9%	
Electrical Equipment, Appliances, and Component	15,155.2	7.5%	
Miscellaneous Manufactured Commodities	14,518.4	7.2%	
Apparel and Accessories	13,670.9	6.7%	
Machinery, Except Electrical	12,007.1	5.9%	
Other	72,625.0	35.8%	
Total	**202,787.9**	**100.0%**	

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, August 2013). http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl.

Bilateral Policy Issues

US-China S&ED Meetings

The fifth round of the U.S.-China Strategic and Economic dialogue (S&ED) was held on July 10-11, 2013 in Washington, DC. During the run-up to the talks, the Administration took pains to lower expectations for any "deliverables" or tangible results. Earlier this year, after the June 7-8 meeting of Xi Jinping and Barak Obama at the "Sunnyland Summit" in Rancho Mirage, expectations had been raised that Chinese hacking and cyber-espionage would be added to the topics discussed at this S&ED negotiation. However, Edward Snowden's revelations on NSA surveillance activities, including on China, have tempered expectations that China would make any concessions on cyber-security issues. Prior to the S&ED, the United States and China held the first meeting of the civilian-military Cyber Working Group, where the two sides committed to work together on cooperative activities and further discussions on international norms of state behavior in cyberspace, but there were no tangible results.[1] Both sides agreed to hold the next meeting before the end of 2013.

On the economic front, more progress was achieved. The most relevant outcomes were (1) resumption of bilateral investment treaty talks; (2) the launch of the Shanghai Free Trade Zone; (3) new measures to liberalize China's financial sector; and (4) closer energy and climate cooperation.

Outcome #1: Bilateral Investment Treaty Talks Resumed

Of the economic outcomes, the most significant development was an agreement to restart the 2008 talks to reach a Bilateral Investment Treaty (BIT). Six months before leaving office, the Bush administration had launched talks for a U.S.-China BIT. In November 2009, President Obama then issued a joint statement with President Hu Jintao, announcing plans to expedite these negotiations. But until now little progress has been made.[2]

At the S&ED talks, China agreed to negotiate market access using a negative list approach (which means that the United States and China will start by assuming all sectors are negotiable rather than to start with a short list and add to it). China also agreed to grant U.S. investors national treatments protections in the "pre-establishment" phase of investment, or before U.S. firms are actually invested in China. This means, for example, that China will not discriminate against U.S. firms while they're trying to obtain a license.[3]

Treasury Secretary Jacob Lew described this as a "significant breakthrough" that "would work to level the playing field for American workers and businesses by opening markets for fair competition."[4] U.S. business groups welcomed the development as a possible cure for Chinese opposition to foreign investment in large sectors of the Chinese economy, most notably financial services.

Others have urged caution, however. Nicholas Lardy at the Peterson Institute for International Economics called the BIT "a noble goal but one which will be very difficult to

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[1] U.S. Department of State, "U.S.-China Strategic and Economic Dialogue V Strategic Track Select Outcomes," July 12, 2013. *http://www.state.gov/r/pa/prs/ps/2013/07/211862.htm*.
[2] U.S. Department of the Treasury, "Joint U.S.-China Economic Track Fact Sheet of the Fifth Meeting of the U.S.-China Strategic and Economic Dialogue," July 12, 2013. *http://www.treasury.gov/press-center/press-releases/Pages/jl2010.aspx*.
[3] "China Agrees to Key BIT Principles; Negotiations Now Poised to Intensify," *Inside U.S.-China Trade*, July 186, 2013.
[4] Geoff Dyer, "Sino-US Investment Deal Sought," *Financial Times,* July 12, 2013. *http://www.ft.com/intl/cms/s/0/83094a3e-ea76-11e2-913c-00144feabdc0.html#axzz2bCdUUlvF*.

conclude in any reasonable time period and it might well fail."[5] Derek Scissors at the Heritage Foundation was similarly skeptical, noting, "BITs are primarily about protecting investors from discriminatory government policies. They are not transformative instruments that change the nature of economies, especially not large economies."[6]

A comprehensive BIT with China would be highly controversial and involve protracted Senate debate over details. BITs are treaties rather than executive agreements,[7] such as the North American Free Trade Agreement, and require a two-thirds vote of the Senate to ratify. A BIT would also potentially curtail the powers of state and local governments to regulate health and safety issues and even zoning, raising sovereignty concerns. Moreover, with the exception of a few failed deals, Chinese firms have had success investing in the United States even without an investment treaty. Similarly, U.S. companies have been investing in China for years, fully cognizant of various restrictions on investment, policies that discriminated against foreign investors in favor of Chinese firms, and rampant IPR theft of intellectual property. China may not be willing to make major concessions for a deal.

Further, BITs have in the past proven useful mainly to smaller developing nations seeking to attract foreign investment. By signing the BIT, they promise not to expropriate or otherwise grossly discriminate against foreign investors, and can be litigated against in international courts. China has been a prolific signatory of "low-level" BITs, ranking just behind Germany. The United States, by contrast, sets higher standards for its BITs, and as a result, has signed far fewer.

Bilateral Investment Treaties by Country

Country	Rank	No. of BITs	Country	Rank	No. of BITs
Germany	1	137	Indonesia	8	63
China	**2**	**127**	**United States**	**9**	**48**
UK	3	105	Thailand	10	41
France	4	103	Singapore	11	37
South Korea	5	92	Canada	12	29
India	6	83	Japan	13	15
Russia	7	71	Brazil	14	14

Source: UNCTAD

Like other developing countries, China initially viewed BITs as an expedient means to attract foreign investment. In the 1980s, it signed 17 BITs – among these were many advanced economies eager to improve relations with Communist China and to protect their foreign investments in China's growing manufacturing sector. Five Western European countries signed, as did Australia, New Zealand, and Japan. China's BITs further surged in the 1990s – yet almost all the signatories were developing countries, from the newly independent Eastern European states to countries in Latin America and Sub-Saharan Africa. In the period 2000-10, advanced economies came back into the fold. The European countries that had not yet signed with China did so, most notably Germany, France, and Switzerland.[8]

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[5] Bob Davis, "U.S.-China Investment Treaty: Less than Meets the Eye," *Wall Street Journal China RealTimes Report*, July 12, 2013. *http://blogs.wsj.com/chinarealtime/2013/07/12/u-s-china-investment-treaty-less-than-meets-the-eye/*.

[6] Derek Scissors, "An Investment Treaty with China: Don't Hold Your Breath," *The Heritage Foundation Foundry blog*, July 12, 2013. *http://blog.heritage.org/2013/07/12/an-investment-treaty-with-china-dont-hold-your-breath/*.

[7] Free trade agreements are generally passed under an expedited "fast track" rule that doesn't allow amendments on the floor or the usual stalling tactics in the Senate.

[8] UNCTAD. "Total Bilateral Investment Treaties Concluded, 1 June 2011: Reporter: China." (June 2011).

A quarter of China's 127 BITs have never entered into force. Those include 22 states from Sub-Saharan Africa and the Middle East. It appears that China has overzealously pursued BITs as part of its economic diplomacy, without giving much thought to the ratification, let alone the efficacy, of these agreements. Even so, the nature of China's BITs has changed over time. Historically, BITs were of a *restrictive* nature, meaning they were designed to give Beijing more leverage over investors. But beginning in 1998, China began to sign BITs with *liberal* clauses that provided more rights to the investor than the government. This reflected China's greater interest in protecting its own investors in foreign countries.[9]

China's Bilateral Investment Treaties

	1980-85	1986-90	1991-95	1996-2000	2001-05	2006-10	Total	Share
Advanced countries	5	4	5	0	7	3	24	19%
Developing countries	2	7	33	25	23	13	103	81%
Total	7	11	38	25	30	16	127	
ASEAN	2	1	4	1	1	0	9	7.1%
Eastern Europe and CIS	0	1	15	1	2	1	20	15.7%
EU27	4	2	5	0	9	4	24	18.9%
Latin America	0	0	7	1	1	4	13	10.2%
MENA	1	1	5	9	3	1	20	15.7%
Northeast Asia	0	1	1	0	1	1	4	3.1%
Oceania	0	2	1	0	0	1	4	3.1%
South Asia	0	2	0	1	0	1	4	3.1%
Sub-Saharan Africa	0	1	0	12	13	3	29	22.8%
Total	7	11	38	25	30	16	127	

Source: UNCTAD

Outcome #2: Shanghai Free Trade Zone

At the S&ED talks, China also agreed to expand access to its financial services sector for foreign investors. The most relevant outcome involves the establishment of a pilot free-trade zone in Shanghai, which will guarantee equal access to domestic and foreign enterprises. Led by the new Premier Li Keqiang, the State Council, China's highest administrative body, approved the plans on July 3, a week prior to the S&ED talks. Unlike China's existing special economic zones (SEZs), which were established in the early 1980s to attract foreign investment in manufacturing to boost exports, the Shanghai Free Trade Zone (FTZ) will not simply provide fiscal and other incentives. It will also serve as a platform to test an assortment of controversial market reforms.[10]

Although the details of the FTZ are vague and not yet official, the proposed measures are broad in scope. A tariff-free port, first of all, would minimize customs approvals and help attract high-end manufacturing. But the plan would also experiment with monetary reforms, including RMB capital account convertibility and the liberalization of exchange rates and interest rates. The FTZ will also grant foreigners greater access to the Chinese services sector. Financial institutions in the pilot zone will be allowed more freedom to experiment with new products and services beyond what is currently permissible. That may allow foreign firms to increase the quantity and sophistication of financial products, providing

[9] Axel Berger, "China's new bilateral investment treaty programme: Substance, rational and implications for international investment law making."
[10] "[Shanghai Pilot Free Trade Zone Plan Approved Creating an Economic Upgrade], *Shanghai Ziyou Maoyi Shiyanqu Fangan Huopi Dazao Jingji 'Shengjiban',"* Xinhua, July 5, 2013. *http://www.gov.cn/jrzg/2013-07/05/content_2440946.htm*.

Chinese firms with new credit channels. The FTZ may also allow foreign commodities exchanges to set up their own delivery warehouses, foreign health insurance companies to establish wholly owned operations, and foreign shipping companies to join in cargo joint ventures.[11]

If initiated, the new pilot zone will take up to 10 years to construct and will cover 28 sq. km within Shanghai's existing Waigaoqiao bonded trade zone and three other special customs supervision zones. If successful, the model can be replicated nationwide. In response to the Shanghai pilot free trade zone, other port cities including Xiamen and Tianjin have expressed interest in establishing similar pilot zones.[12]

Outcome #3: Financial Sector Liberalization

As in past S&ED talks, China once again promised to move toward a market-determined exchange rate and to submit another proposal to join the WTO's Government Procurement Agreement (GPA). After China was admitted to the WTO in 2001, it agreed to sign the procurement agreement "as soon as possible". However, its first bid was only submitted in February 2008. Because the terms of accession that China offered did not satisfy other WTO members, China subsequently submitted two more bids, the latest in November of last year. Three bids are generally the maximum required for GPA applicants; yet several obstacles make China's imminent accession unlikely, not least its huge public sector and narrow definition of procurement in domestic law.

China also signaled greater market access for U.S. firms, particularly in trading government bond futures and underwriting corporate bonds. This form of foreign participation would be conducive to China's financial sector reform, as the government seeks novel ways to raise funds for companies while reigning in credit issued by trust companies, local government financing vehicles, and other non-traditional lenders. China also welcomed participation by foreign banks in RMB settlement of cross-border trade and investment. [13] A day after the adjournment of the S&ED talks, China announced that the Qualified Foreign Institutional Investor program will expand to $150 billion from $80 billion, while a similar plan for Hong Kong-based RMB investors will grow to encompass Singapore, London and other cities.[14]

China's securities regulator also announced at the S&ED talks that it will begin providing certain audit work papers to the U.S. Securities and Exchange Commission and the Public Company Accounting Oversight Board, an important step towards resolving a longstanding impasse on enforcement cooperation related to companies that are listed in the United States. U.S. and Chinese audit regulators also committed to accelerating efforts towards establishing a cooperation mechanism for cross-border audit oversight. [15]
Less than two weeks after the S&ED talks, the U.S. Securities and Exchange Commission filed a complaint in a federal court in Manhattan against two Chinese companies, China

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[11] George Chen, "Shanghai Plan to Lure Foreign Investors to Free-trade Zone," *South China Morning Post*, July 11, 2013. *http://www.scmp.com/news/china/article/1279855/beijing-plans-lure-foreign-investors-shanghai-free-trade-zone*.
[12] Bloomberg News, "Shanghai Economic Test Zone Lures Imitators From China Ports," July 11, 2013. *http://www.bloomberg.com/news/2013-07-11/shanghai-trade-zone-test-attracts-attention-from-chinese-cities.html*; Yu Ran and Shi Jing, "Shanghai Gets Go-ahead for Free Trade Zone," China Daily, July 4, 2013. *http://www.chinadaily.com.cn/cndy/2013-07/04/content_16722759.htm*.
[13] U.S. Department of the Treasury, "U.S. Fact Sheet – Economic Track Fifth Meeting of the U.S.-China Strategic and Economic Dialogue," Press Release, July 12, 2013. http://www.treasury.gov/press-center/press-releases/Pages/jl2011.aspx
[14] "China Almost Doubles Foreign Funds' Access to Capital Markets," *Bloomberg*, July 12, 2013. http://www.bloomberg.com/news/2013-07-12/china-almost-doubles-foreign-funds-access-to-capital-markets.html.
[15] For details on this issue, see our June trade bulletin. U.S. Department of the Treasury, "U.S. Fact Sheet – Economic Track Fifth Meeting of the U.S.-China Strategic and Economic Dialogue," Press Release, July 12, 2013. http://www.treasury.gov/press-center/press-releases/Pages/jl2011.aspx

Intelligent Lighting & Electronics Inc. and NIVS IntelliMedia Technology Group Inc. (NIVS) over an alleged scheme to divert more than $29 million from investors in 2010. Both companies deceived the same auditor in China. Although the companies and sums in question are small, the SEC's actions demonstrate that it will persist in its investigation, launched in 2010, into auditing fraud by Chinese companies listed in the United States. U.S. stock exchanges have already frozen or delisted shares of more than a dozen China-based firms since the investigations began.[16]

Outcome #4: Progress on Energy and Environment Cooperation

China and the United States agreed at the S&ED meeting to step up cooperation on climate and energy issues. Although not legally binding, the agreement could advance efforts by the world's two largest energy users to reduce carbon emissions and enhance energy efficiency. The two sides agreed on several concrete measures:

- Reducing emissions of soot and carbon dioxide from heavy vehicles
- Cutting energy use in buildings and factories
- Promoting more efficient energy transmission systems
- Developing carbon sequestration technology, including ways to trap, store and reuse carbon emissions from power plants that use fossil fuels
- Publishing accurate and timely information on emissions and energy use

The United States is the world's leading carbon emitter per capita, while China is the largest total emitter. The United States is undergoing a transition to domestic energy production. China, in turn, is rapidly adding nuclear power capacity and has surpassed the United States as the leader in installed solar and wind power capacity. Both countries face challenges with energy efficiency, grid infrastructure, and overreliance on coal for power generation.

The agreement also marked a tacit rapprochement after China and the United States had a falling out at the Copenhagen climate talks in 2009. Those talks failed in part because China joined other major developing countries in opposing reduction targets and imposing tough conditions on U.S. negotiators. Further, the agreement may help to mitigate the ongoing disputes among U.S. and Chinese companies in the renewable energy sector. In late June, China imposed tariff duties on U.S. solar and wind components, an outgrowth of China's dispute with the EU over antidumping duties on Chinese solar panels. In addition, American Superconductor Corporation (AMSC), a leading U.S. provider of electrical systems for wind turbines, has been embroiled for two years in an IP lawsuit against Sinovel, one of China's largest wind turbine makers. Sinovel has already been found guilty of IP theft in U.S. and European courts, but because most of Sinovel's assets are based in China, the key is a guilty verdict from a Chinese court. Currently, both companies have appealed to China's Supreme Court for a decision.[17]

United States Wins WTO Chicken Dispute

[16] "SEC Sues China Intelligent Lighting for Offering Fraud," *Bloomberg*, July 22, 2013. http://www.bloomberg.com/news/2013-07-22/sec-sues-china-intelligent-lighting-for-offering-fraud.html.

[17] Melanie Hart, "Criminal Charges Mark New Phase in Bellwether U.S.-China Intellectual Property Dispute," Center for American Progress, June 27, 2013. http://www.americanprogress.org/issues/china/news/2013/06/27/68339/criminal-charges-mark-new-phase-in-bellwether-u-s-china-intellectual-property-dispute/.

On August 2, 2013, a World Trade Organization (WTO) panel found that China has violated WTO rules in applying antidumping (AD) and countervailing duties (CVD) on U.S. exports of so-called broiler products.[18] China's Ministry of Commerce (MOFCOM) imposed AD and CVD duties on these products in August and September 2010, respectively. The AD duties ranged from 50.3 percent to 53.4 percent for the U.S. producers who responded to MOFCOM's investigation notice, while MOFCOM set an "all others" rate of 105.4 percent. In the CVD investigation, MOFCOM imposed countervailing duties ranging between 4.0 percent and 12.5 percent for the participating U.S. producers and an "all others" rate of 30.3 percent. According to the Office of the U.S. Trade Representative, American exports to China of broiler products fell by 80 percent following the application of the duties.[19] The United States brought the case in September 2011.

In its report, the WTO dispute settlement panel found in favor of the United States on nearly all U.S. claims, including substantive errors in MOFCOM's calculations and procedural errors.[20] In particular, the United States scored a major victory against China's use of the average cost of production methodology in calculating dumping margins (i.e. the difference between the price of poultry products in the U.S. market and the price of the same product in China). In order to estimate the cost of production for a given chicken part, China would estimate the average cost of producing a whole chicken and assign the cost of producing that part depending on its weight. The United States argued that this methodology dramatically overestimated the cost of production for cheap parts of a chicken, such as paws.[21]

China has 60 days to drop the duties or file an appeal.

This marks the latest in an increasingly acrimonious series of retaliations by China for U.S. trade actions. Beijing threatened to impose the duties on chicken in September 2009, weeks after the United States applied a 35 percent tariff on Chinese-made tires. Within a week of the United States' announcement that it would challenge the tariffs on broiler products, China applied AD duties on U.S. automobiles and auto-part industries.[22]

Sector Spotlight

Advanced Technology Product (ATP) Trade

The U.S. ATP monthly trade deficit with China was down by 19 percent month-on-month in June. Indeed, ATP products have played a central role in promoting overall U.S. exports to China. ATP exports in June increased by 34 percent over May. So far this year, total ATP exports have gained 46.4 percent, led by aerospace products. By comparison, total ATP imports have experienced a moderate increase of 2.2 percent.

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[18] Broiler products include most chicken products, with the exception of live chickens and a few other products such as cooked and canned chicken.
[19] USTR, "United States Wins Trade Enforcement Case for American Farmers, Proves Export-Blocking Chinese Duties Unjustified Under WTO Rules," *USTR Press Release*, August 2, 2013.
[20] "China — Anti-Dumping and Countervailing Duty Measures on Broiler Products from the United States," Dispute DS427. *http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds427_e.htm#bkmk427r*.

[21] "U.S. Wins China Poultry Dispute in WTO, Including on 'Average Cost' Method," *China Trade Extra*, August 5, The economy is forecast to advance by a median 7.5 percent this year, according to 55 economists surveyed by Bloomberg this month. Last month's projection was 7.7 percent. [21]

2013.
[22] This is now a separate WTO complaint by the United States. See "China — Certain Measures Affecting the Automobile and Automobile-Parts Industries," Dispute DS450. *http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds450_e.htm*.

U.S. Trade with China in Advanced Technology Products
(US$ millions)

	Monthly			Cumulative year-to-date			
	Exports	Imports	Balance Jun'13	Exports	Imports	YTD Balance Jun'13	YTD Balance Jun'12
TOTAL	**2,842**	**12,020**	**-9,178**	**12,783**	**66,935**	**-54,152**	**-54,400**
(01) Biotechnology	54	5	49	206	35	171	92
(02) Life Science	303	167	136	1,458	1,007	451	317
(03) Opto-Electronics	35	388	-353	165	2,086	-1,921	-3,481
(04) Information & Communications	381	11,016	-10,635	2,188	61,205	-59,017	-55,372
(05) Electronics	401	272	129	2,274	1,600	674	443
(06) Flexible Manufacturing	361	79	282	1,338	436	902	493
(07) Advanced Materials	18	19	-1	110	112	-2	30
(08) Aerospace	1,279	61	1,218	4,831	387	4,444	3,105
(09) Weapons	0	13	-13	1	65	-64	-59
(10) Nuclear Technology	8	0	8	212	1	211	34

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, August 2013). http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl.

Tech Tariff Talks Suspended

In July, WTO talks aimed at eliminating tariffs on an array of tech products were derailed after China said that it could not accept tariff cuts on 106 of the 256 products being considered, apparently to protect its domestic industry.[23] China is one of 20 WTO members, along with the United States and the 28-nation European Union, that have been negotiating to expand the 1996 Information Technology Agreement (ITA) to eliminate tariffs on new generation technology products like speakers and flat-panel displays.

The original ITA eliminated tariffs on computers, semiconductors, software, fax machines, telephones and other information technology goods among member countries, but some important products such as semiconductor manufacturing equipment, certain types of memory chips, and many types of audio-visual equipment such as audio speakers, DVD players, and video cameras were left off the list. U.S. industry has also been pushing to include products such as video-game consoles, GPS systems, flat-panel displays, and a new class of semiconductor chips called multi-component semiconductors (MCOs).[24]

According to the Information Technology and Innovation Foundation, an industry think tank, the United States holds a 26 percent share of the global market in the information and telecommunications products, and expanding the ITA would boost U.S. exports by about $2.8 billion annually.[25] Michael Froman, the U.S. Trade Representative, said the United States was "extremely disappointed" that the talks broke down. "Unfortunately, a diverse group of Members participating in the negotiations determined that China's current position makes progress impossible at this stage," he said.[26]

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[23] "U.S., Others Suspend ITA Talks to Pressure China to Soften Its Stance," *Inside U.S.-China Trade*, July 23, 2013.
[24] Stephen Ezell, *Boosting Exports, Jobs, and Economic Growth by Expanding the ITA* (Information Technology and Innovation Foundation: March 15, 2012). *http://www.itif.org/publications/boosting-exports-jobs-and-economic-growth-expanding-ita*.
[25] Doug Palmer, "U.S. Blames China for Breakdown of Trade Talks," *Reuters*, July 17, 2013. *http://www.reuters.com/article/2013/07/17/us-wto-china-technology-idUSBRE96G10320130717*.
[26] Office of the U.S. Trade Representative, "USTR Froman Expresses U.S. Disappointment at Halt of Information Technology Agreement Talks," July 17, 2013. *http://www.ustr.gov/about-us/press-office/press-releases/2013/july/amb-froman-disappointment-ita*.

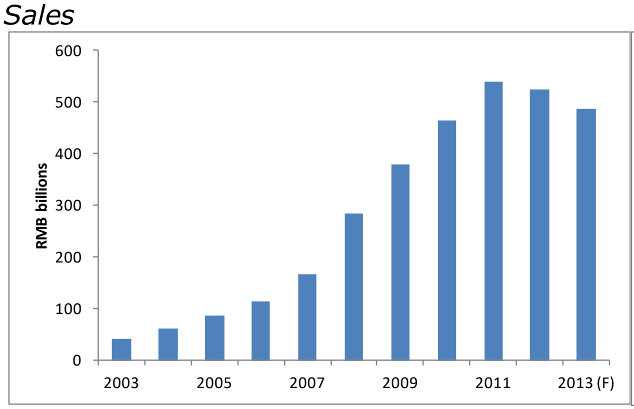
Shipbuilding and Iron and Steel

As China's economy has slowed in recent quarters, many of its heavy industries have suffered from overcapacity. Companies have been forced to cut prices, and profit margins have declined. The deteriorating economic climate has intensified competition, especially in industries that fragmented. The government is faced with a delicate balancing act between saving pillar industries and local jobs on the one hand and encouraging consolidation and de-industrialization on the other.

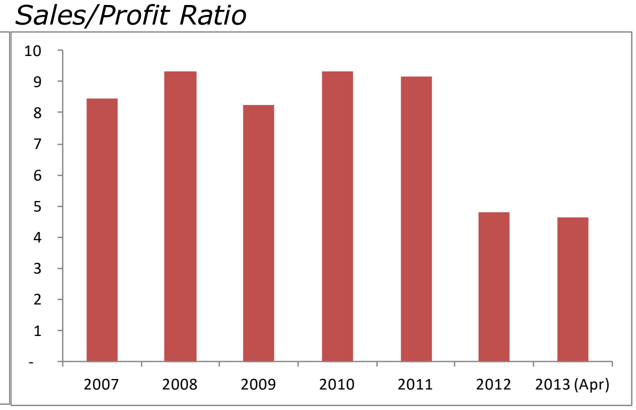
The shipbuilding industry is a prime example of this. Shipbuilding has boomed over the past decade, as China vies to rival Japan and Korea as the world leader. Revenues peaked in 2011, but have declined over the past two years. Profitability has suffered even more. In contrast to Japan and Korea, which have only a handful of massive shipyards, China has some 1,647, the majority of which are based in Jiangsu province. Although moderate consolidation has been achieved since 2010 to reduce the number of competitors in the industry, official figures indicate that the number of loss-making companies continues to rise. At present, China Rongsheng Heavy Industries Group Holdings Ltd., the largest shipbuilder outside state control, is on the brink of bankruptcy and is seeking refinancing from local governments in Jiangsu province.[27]

Sales and Profitability of China's Shipbuilding Enterprises

Sales



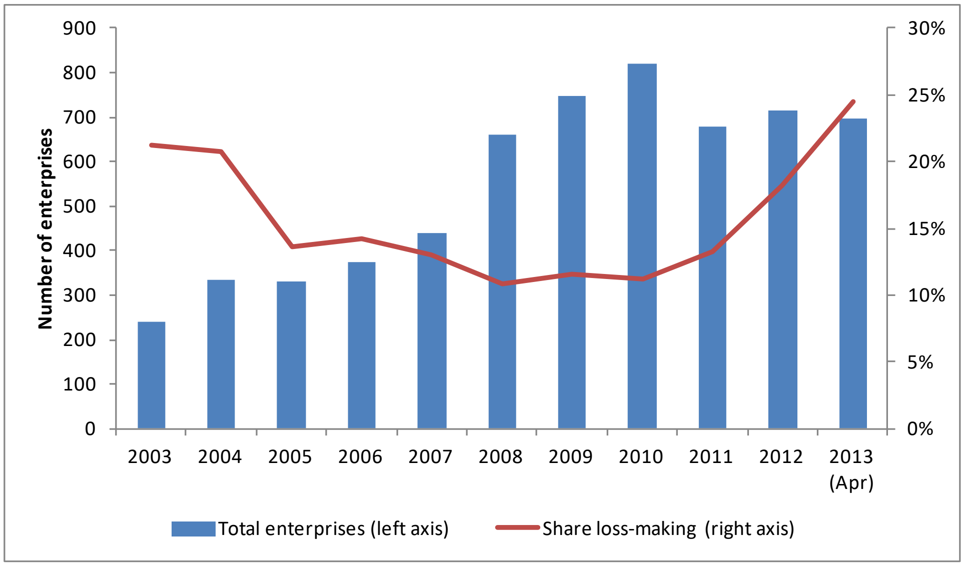
Sales/Profit Ratio



Source: National Bureau of Statistics, via CEIC data.

[27] "Rongsheng Talks with Chinese Cities to Seek Financial Aid," *Bloomberg*, July 9, 2013. http://www.bloomberg.com/news/2013-07-09/rongsheng-talks-with-chinese-cities-to-seek-financial-aid.html.

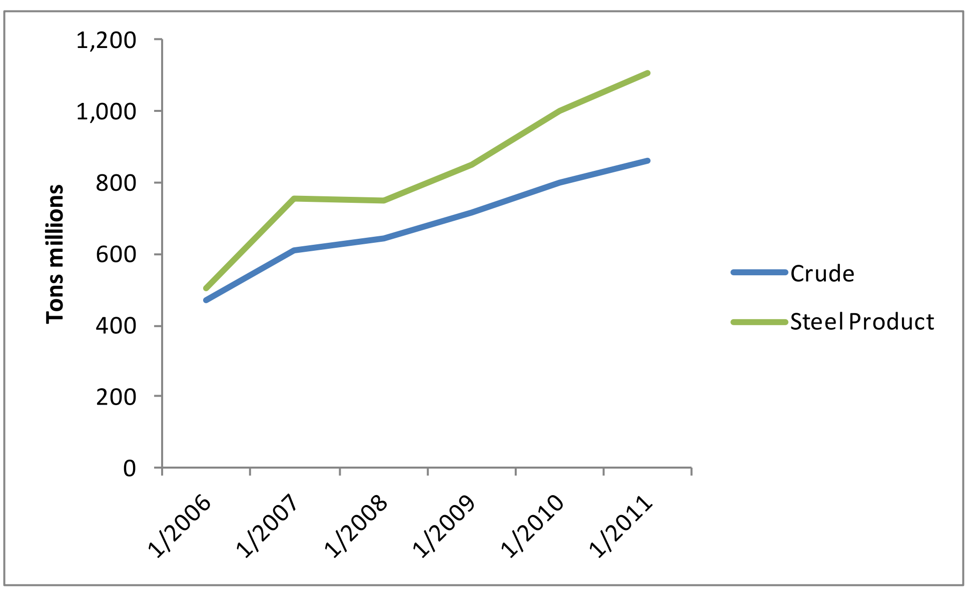
Health of Enterprises in China's Shipbuilding Industry



Source: National Bureau of Statistics, via CEIC data.

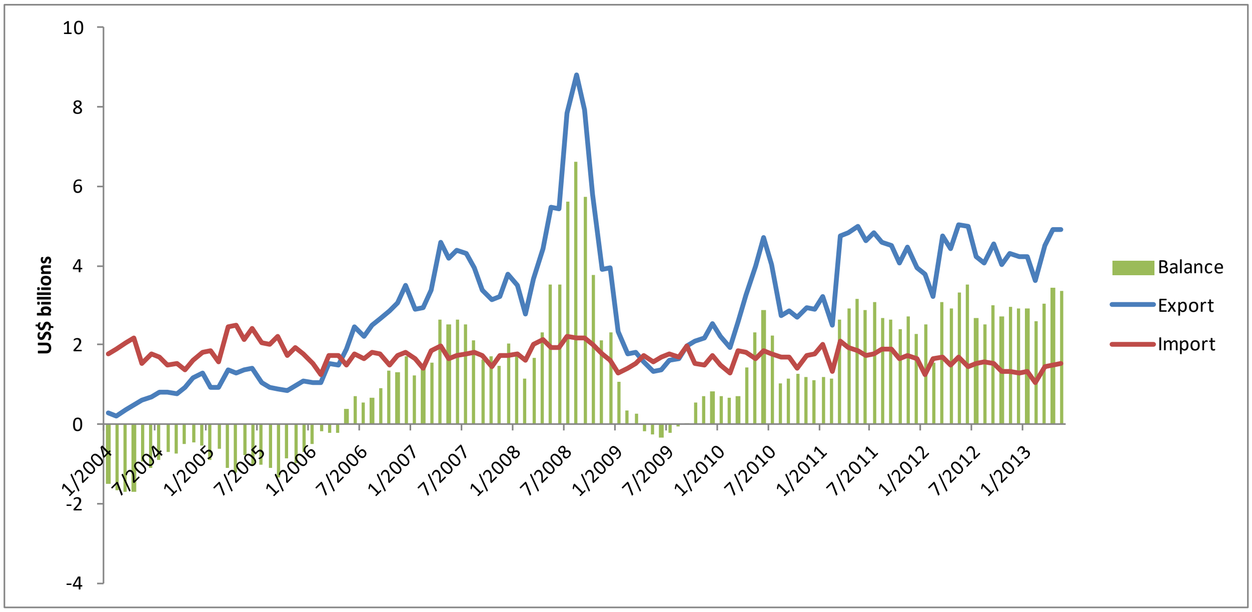
Shipbuilding is also emblematic of the overproduction plaguing China's steel industry further upstream. China's steelmaking capacity nearly doubled in 2006-2011. Cheap steel has incentivized overproduction of ships and other steel products. As China's infrastructure, commodity, and export manufacturing sectors slow, steel mills are unable to secure enough demand domestically, and are exporting an increasing amount of their steel output.

China's Steel Capacity, 2006-2011



Source: China Iron and Steel Association, via CEIC data.

China's Steel Trade through May 2013
(US$ billions)



Source: China Iron and Steel Association, via CEIC data.

China's Economy

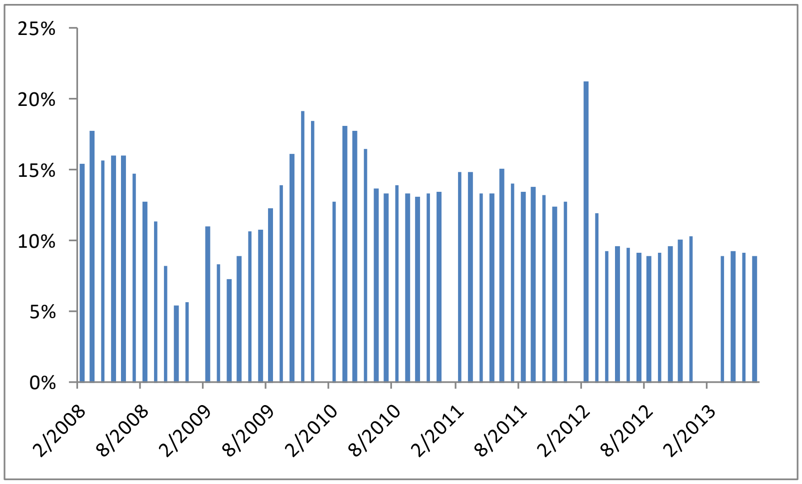
GDP Growth Falls to 7.5 Percent in Second Quarter

China's GDP growth fell to 7.5 percent in the second quarter, from 7.7 percent in the first quarter. Although the figure matched the government's full-year growth target, it sent a shudder through global markets. It is noteworthy that there were fewer grumblings about inaccurate GDP statistics than a year ago, as the official GDP number roughly matched a consensus forecast among economists. And yet, it is possible that GDP growth was even slower than the government numbers suggest.

Other indicators in China's economy likewise point to weak growth. Industrial output declined in June, reversing the slight rebound in April and May. Exports were also down 3.1 percent in June from a year earlier, the most since the global financial crisis, and counter to market forecasts of a 4 percent rise. Exports continued to be affected by rising labor costs, an appreciating currency, and weak consumer demand in Europe and other advanced economies.[28]

[28] Langi Chiang and Kevin Yao, "China Warns of 'Grim' Trade Outlook after Surprise Exports Fall," Reuters, July 10, 2013. http://www.reuters.com/article/2013/07/10/us-china-economy-trade-idUSBRE96902L20130710.

Growth of Industrial Value Added
Year-on-year (%)



Source: National Bureau of Statistics, via CEIC data.

Although consumer price inflation rose in June, it averaged just 2.4 per cent in the first half, missing the government's 3.5 per cent target by a large margin. Even more worrying to Beijing was the 16th straight month of deflation in the producer price index, as companies shed excess capacity and cut prices.[29]

One of the few positive notes was a slight rise in retail sales, suggesting some rebalancing of growth toward domestic consumption. Sales of cars have stayed strong, rising 12 percent in the first half of the year to 10.7 million vehicles. Auto makers predict solid sales for the rest of the year in China.[30]

Surveys of businesses in July confirmed the decline in manufacturing and continual expansion of services. The July HSBC purchasing managers' index (PMI) for the manufacturing sector was reported at 47.7, signaling the weakest growth in production for 2013 so far, and the third consecutive month of contraction. In contrast, the PMI survey conducted by the China Federation of Logistics and Purchasing (CFLP), manufacturing PMI registered at 50.3, a slightly more optimistic reading than HSBC. However, it showed that the manufacturing sector had shed jobs at the highest rate since February 2009.

On the other hand, both PMI surveys showed that services continue to expand, albeit less than last year.

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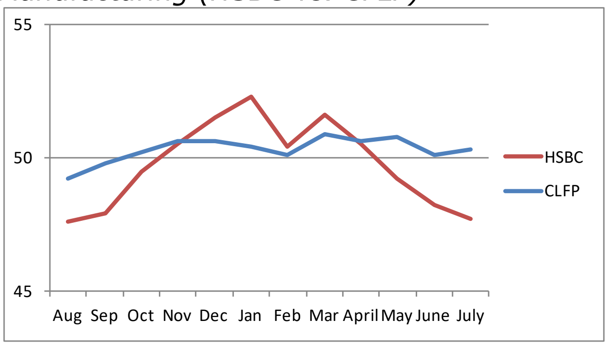
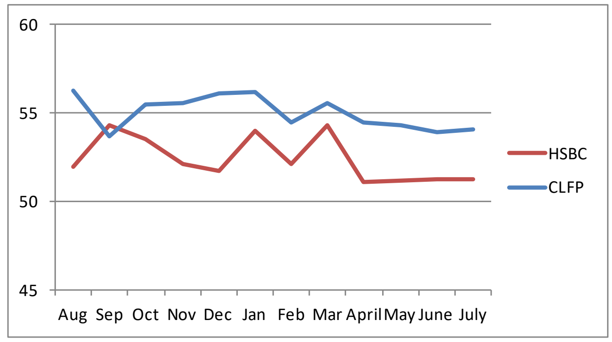
[29] Simon Rabinovitch, "China Faces Tug-of-war over Growth Strategy," *Financial Times*, July 10, 2013. http://www.ft.com/intl/cms/s/0/5656fe76-e942-11e2-bf03-00144feabdc0.html?ftcamp=published_links%2Frss%2Fworld_asia-pacific_china%2Ffeed%2F%2Fproduct#axzz2YeLCjegw.
[30] Richard Silk, "Economists See Further Slowdown in China," *Wall Street Journal*, July 8, 2013. http://online.wsj.com/article/SB10001424127887323823004578593200107930868.html.

Purchasing Managers' Index (Past 12 Months)
(<50 = contraction, >50 = expansion)

Manufacturing (HSBC vs. CFLP)



Services

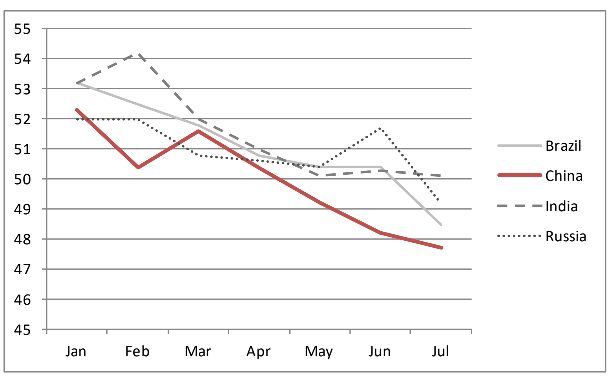


Source: China's National Bureau of Statistics, via CEIC data; HSBC Purchasing Managers' Index. http://www.hsbc.com/1/2/emerging-markets/em-index/purchasing-managers-index.

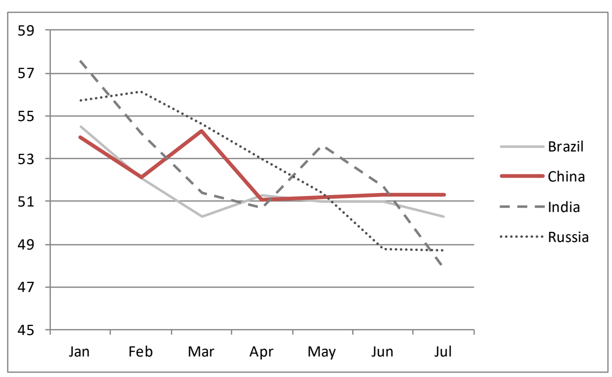
The contrast between sentiment in the manufacturing and services sectors was even more drastic in international comparison. According the July HSBC PMI data, China's services sector outperformed other BRIC nations, surpassing India for the first time since April. Brazil was the only other BRIC nation besides China to show expansion in its services sector in July. India, on the other hand, experienced a severe drop in PMI in July, dropping to an annual low of 47.9. However, unlike the services sector, China has underperformed other BRIC nations for four consecutive months in manufacturing PMI.

China's PMI Performance vs. Other BRIC Nations (YTD)

Manufacturing



Services



Source: HSBC Purchasing Managers' Index. http://www.hsbc.com/1/2/emerging-markets/em-index/purchasing-managers-index.

As China's economy slows but gradually rebalances, economists have adopted starkly different views on the prospects for the months and years ahead. Nomura, a Japanese financial services company, estimates a one-in-three chance of a sharp drop in China's growth by the end of 2014.[31] The bank points to the interconnected problems of China's heavy leveraging, asset bubbles, and already slowing growth. Martin Wolf of the *Financial Times* and Michael Pettis of Tsinghua University, two prominent economists, also take the bearish view that China cannot shift to a consumer-driven economy with ease. Wolf argues that there is more pain to come as investment and inventory growth decline, hurting

[31] Shamim Adam, "China 3% Growth Risk Seen by Barclays Shows Likonomics Angst," *Bloomberg*, July 29, 2013. http://www.bloomberg.com/news/2013-07-28/china-3-growth-risk-seen-by-barclays-signals-likonomics-anxiety.html.

thousands of already indebted companies. [32] Pettis argues that consumption growth must exceed GDP growth by some four percentage points per year, but can only do so sustainably if GDP growth as a whole slows to around 3 to 4 percent. [33]

GDP Growth Forecasts for China Compared, 2013-2014

	2013F	2014F
Nomura	7.5	6.9
Barclays	7.4	7.4
IMF	7.8	7.7
Deutsche Bank	7.6	8.5

Source: Various media reports. Jun Ma and Michael Spencer, "Global Economic Perspectives: Addressing China Bears, Prospects for Africa," Deutsche Bank Markets Research (July 19, 2013).

Optimists, on the other hand, argue that China is doing fairly well in terms of mixing structural reform with moderate growth. Jim O'Neil, an economist formerly at Goldman Sachs, notes that China is adjusting in the right direction as retail sales outpace industrial production. [34] Deutsche Bank, in a new report issued in July, argues that China's low inflation rates imply a huge output gap – the historical relationship between GDP growth and producer prices suggests that "potential" growth could be as high as 10 percent at present. Deutsche also bases its optimism on China's labor surplus, potential productivity gains, urbanization, and a gradual deleveraging in credit markets already underway.[35]

Negative Impact of China Slowdown on U.S. Companies and the World Economy

China is the world's fastest growing economy, and now accounts for some 13 percent of global (nominal) GDP. Its economic slowdown this year has had a powerful ripple effect on global markets. One victim has been U.S. companies. Among 18 U.S. companies in the S&P 500 with large exposure to China, 12 were underperforming year-to-date in July. The contraction in China's industrial demand was especially bad for U.S. machinery maker Caterpillar, which derives a quarter of its revenue from the Asia/Pacific region. Caterpillar's revised outlook for 2013 reflects an expected 50 percent decline in sales of its traditional mining trucks and loaders.[36]

Victims of China's slowdown also include Asian countries tied into China's production networks. Japan tops that list. Tokyo in recent months has promoted a loose monetary policy, leading the yen to devalue by 20 percent against the dollar, in order to boost exports. But Japan's exports were up just 7.4 percent through June, well below the median prediction of 10.3 percent. [37] China played a big role in dampening those exports. From 1995 to 2011, increased shipments to China accounted for 45 percent of the overall growth

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[32] Martin Wolf, "Risks of a Hard Landing for China," *Financial Times*, July 3, 2013. http://www.ft.com/intl/cms/s/0/ae5d1d8c-e26f-11e2-87ec-00144feabdc0.html.
[33] Michael Pettis, "What's in a Number? In China, Not Much," *Bloomberg*, July 21, 2013. http://www.bloomberg.com/news/2013-07-21/what-s-in-a-number-in-china-not-much.html.
[34] Shamim Adam, "China 3% Growth Risk Seen by Barclays Shows Likonomics Angst," *Bloomberg*, July 29, 2013. http://www.bloomberg.com/news/2013-07-28/china-3-growth-risk-seen-by-barclays-signals-likonomics-anxiety.html.
[35] Jun Ma and Michael Spencer, "Global Economic Perspectives: Addressing China Bears, Prospects for Africa," Deutsche Bank Markets Research (July 19, 2013).
[36] Angela Moon, "China, U.S. Companies' Great Hope, Now a Drag," *Reuters*, July 19, 2013. http://www.reuters.com/article/2013/07/19/us-usa-earnings-china-idUSBRE96I06620130719.
[37] Kaori Kaneko, "Japan Export Slowdown Raises Concern on China's Economy," Reuters, July 23, 2013. http://www.reuters.com/article/2013/07/24/us-japan-economy-trade-idUSBRE96N01G20130724.

in Japanese exports. Since the crisis erupted last July, however, Japan's price-adjusted exports to China have fallen by 20 percent, compared with an 11 percent drop in its global exports (as of March). Sixty to seventy percent of the goods that China imports from Japan are intermediate goods for industry, and hence are tightly linked to the success of China's manufacturers, rather than its end-consumers. [38]

Similarly, the Asian Development Bank revised its 2013 GDP growth forecast for the five largest economies in the Association of South-East Asian Nations — Indonesia, Malaysia, the Philippines, Thailand and Vietnam – to 5.2 percent from the earlier 5.4 percent, stating: "The downward revision to growth forecasts for the People's Republic of China is a key factor underlying the aggregate, unexpectedly subdued economic activity cuts across sub-regions."[39]

But perhaps the hardest hit are economies dependent on commodity exports. Some of the effect has been indirect, as commodity prices have dipped in reaction to China's credit squeeze in June and the release of its disappointing GDP data in July. The metals industry, in turn, is among those directly hit by less demand from China. Metals prices have plummeted. Rio and Glencore Xstrata Plc, two major Australian mining companies, have deferred massive mining and infrastructure projects and cut spending amid the price slump. Vale SA, Brazil's largest iron ore exporter which sells almost half of its ore to China, has had one of the worst-performing major mining stocks.[40]

Movements in Commodity Markets, September 2012-July 2013

Source: Adapted from Bloomberg. http://www.bloomberg.com/markets/commodities/futures/.

A study by the investment house Nomura suggests that a growth rate in China of 5.9 percent in 2014 would lead metal prices to fall as much as 30 percent, while oil prices may drop as much as 20 percent.[41] Similarly, a Barclays study predicts that, if China's growth dips to 3 percent in the next three years, the world copper price will collapse by more than

[38] Richard Katz, "Mutual Assured Production: Why Trade Will Limit Conflict Between China and Japan," *Foreign Affairs* (July/August 2013). http://www.foreignaffairs.com/articles/139451/richard-katz/mutual-assured-production.
[39] "ADB: China's Economic Woes Will Impact Region," *The Malaysian Reserve*, July 22, 2013. http://themalaysianreserve.com/main/news/corporate-malaysia/4191-chinas-economic-woes-could-stifle-growth-for-other-economies-in-the-region-including-malaysia-according-to-asian-development-bank-adb.
[40] Shamim Adam, "China 3% Growth Risk Seen by Barclays Shows Likonomics Angst," *Bloomberg*, July 29, 2013. http://www.bloomberg.com/news/2013-07-28/china-3-growth-risk-seen-by-barclays-signals-likonomics-anxiety.html.
[41] Shamim Adam, "China 3% Growth Risk Seen by Barclays Shows Likonomics Angst," *Bloomberg*, July 29, 2013. http://www.bloomberg.com/news/2013-07-28/china-3-growth-risk-seen-by-barclays-signals-likonomics-anxiety.html.

60 percent, the zinc price will be cut by up to a half, and even the price of oil would drop from the current $107 to just $70 a barrel.[42]

Credit Crunch Aftermath

Even as the real economy slowed, China's credit markets in July continued to reel from a credit squeeze imposed by the People's Bank of China (PBOC), China's central bank, in June. By refusing to inject new liquidity into the market, the central bank had forced lending rates among Chinese banks to historic highs. That exposed many borrowers who were depending on short-term borrowing to meet their debt obligations. Bad loans at China's major banks have already climbed for six straight quarters, the longest streak in at least nine years. Those figures didn't reflect the real amount of debt because of the ways banks move loans off their books. [43]

New data in July showed that, while bank loans rose in June, broader money expansion (M2) slowed, suggesting that the cash crunch was felt mostly outside of traditional lending, particularly among trust companies and other "shadow banking" institutions.[44] According to Nick Lardy, an economist at the Peterson Institute, the PBOC "deliberately allowed rates to rise as a shot across the bow of midsized financial institutions that were borrowing heavily in the short-term interbank market to finance longer-term loans." [45]

The credit crunch also dealt a massive blow to investor perceptions of China's financial health. The average price to earnings ratio for ICBC, China Construction Bank, and Bank of China equities fell to 5.2 by the end of June from 19 at the end of 2007, according to data compiled by Bloomberg.[46] By early July, just three of China's largest banks were trading above book value.[47] The credit crunch also prompted foreign investors to take more of their money out of China, with pros and cons for the Chinese economy. The downside was that China's equity markets were dealt a blow, mimicking a pattern across emerging markets as investors migrated to the United States and Europe.

On the other hand, capital outflows eased the pressure on China's central bank, which has had to combat "hot money" inflows and rapid currency appreciation. A July report by the State Administration of Foreign Exchange, the central bank branch in charge of foreign currency management, stated that the RMB exchange rate was beginning to stabilize, in what will likely boost the competitiveness of China's exports and allow the central bank to intervene less in currency markets.[48]

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[42] Shamim Adam, "China 3% Growth Risk Seen by Barclays Shows Likonomics Angst," *Bloomberg*, July 29, 2013. http://www.bloomberg.com/news/2013-07-28/china-3-growth-risk-seen-by-barclays-signals-likonomics-anxiety.html.

[43] "China Removes Floor on Lending Rates as Economy Slows," *Bloomberg*, July 20, 2013. http://www.bloomberg.com/news/2013-07-20/china-removes-floor-on-lending-rates-as-economy-slows.html.

[44] Richard Silk, "Economists See Further Slowdown in China," *Wall Street Journal*, July 8, 2013. http://online.wsj.com/article/SB10001424127887323823004578593200107930868.html.

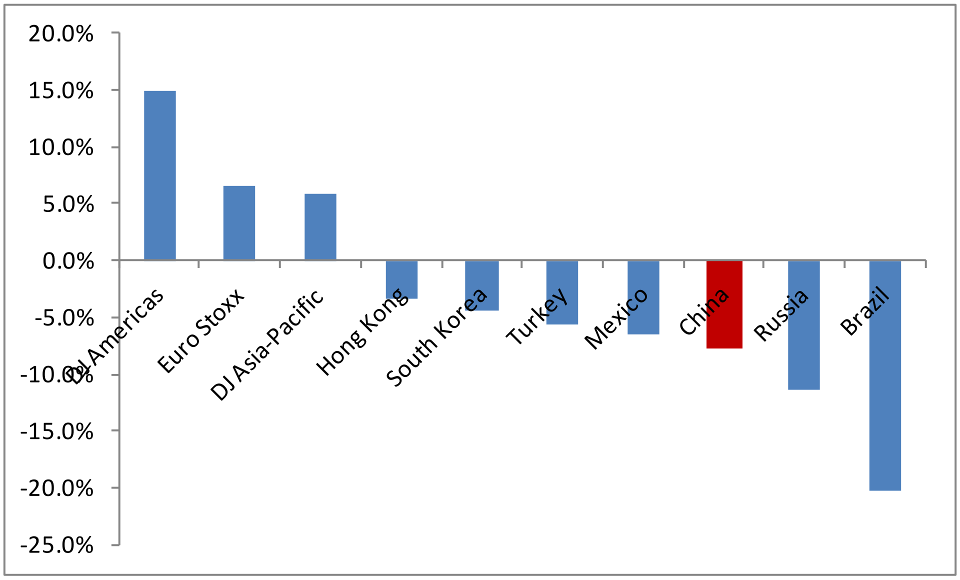
[45] Nicholas Lardy, "China Could Reform Its State Businesses by Stealth," *Financial Times*, June 27, 2013. http://www.ft.com/intl/cms/s/0/543be898-df44-11e2-881f-00144feab7de.html?ftcamp=published_links%2Frss%2Fworld_asia-pacific_china%2Ffeed%2F%2Fproduct#axzz2XWOyXBtP.

[46] "China Banks' Golden Era Fades as Crunch Raises Default Risk," *Bloomberg*, July 2, 2013. http://www.bloomberg.com/news/2013-07-02/golden-era-fades-for-china-s-banks-as-crunch-raises-default-risk.html.

[47] Lingling Wei, "Beijing Lendign Shift May Force Banks to Raise Capital," *Wall Street Journal*, July 21, 2013. http://online.wsj.com/article/SB10001424127887324144304578619662099198992.html.

[48] Langi Chang and Jonathan Standing, "China Committed to Reforms, to Take Decisive Steps: Vice Premier," Reuters, July 22, 2013. http://www.reuters.com/article/2013/07/22/us-china-economy-policy-idUSBRE96L0AQ20130722.

Growth of Global Equity Markets Compared, through July 25
Year-on-year Growth (%)



Source: Adapted from Wall Street Journal, Sunday, July 26-28, p.25

Fine-Tuning and Reform but No Stimulus

As China's new leadership faces a slowdown of the economy, it has rejected the stimulus measures it applied in 2009, at the height of the global financial crisis, and instead has advocated "fine-tuning" and reform. On July 16, after the second-quarter GDP data was released, Premier Li Keqiang stated that China should not change policy direction because of short-term changes in economic indicators, losing rare opportunities to restructure, nor lack alertness and preparedness in case the economy slides out of a "reasonable" range or has "large swings."[49] At the G20 meetings in Moscow in late July, Finance Minister Lou Jiwei affirmed that China would not use "large-scale fiscal stimulus" measures this year, nor run large fiscal deficits.[50] He spoke instead of recent successes in rebalancing, noting a greater share of the service industry in electricity consumption.[51]

Huang Yiping, a professor at Peking University, has popularized the term "Likonomics", which stands for three things: deleveraging; no further stimulus; and structural reform.

As part of its reforms, the government followed its credit crunch policy in June with several financial sector reforms in July. The major reform was to China's lending rates. Commercial banks were formerly allowed to lend at rates no lower than 70 percent of the government benchmark of 6 percent, or roughly 4.2 percent. At the same time, the rate banks could pay depositors was capped at 110 percent of another benchmark rate of 3 percent, or about 3.3 percent. The result was that banks were virtually guaranteed a 0.9 percentage point profit margin on every loan. To maximize profitability of a fixed margin, banks lent primarily to

[49] "China to Avoid 'Wide Fluctuations' in Economy, Li Says," *Bloomberg*, July 16, 2013. http://www.bloomberg.com/news/2013-07-16/china-to-avoid-wide-fluctuations-in-economy-li-says.html.
[50] "China Won't Have Large Stimulus This Year, Finance Minister Says," *Bloomberg*, July 17, 2013. http://www.bloomberg.com/news/2013-07-17/china-won-t-have-large-stimulus-this-year-finance-minister-says.html.
[51] "China's Economy Set to Turn Around, No Hard Landing: Finance Minister," Reuters, July 21, 2013. http://www.reuters.com/article/2013/07/21/us-china-finmin-idUSBRE96K02J20130721.

only the lowest-risk borrowers, such as big state-connected companies.[52] According to economist Nick Lardy at the Peterson Institute, the rate reform will eventually lead more credit to flow to creditworthy businesses, especially private firms, which are already earning a much higher return on their assets than state-owned firms.[53]

Critics, however, argue that the lending rate reform is insufficient. Only about 11 percent of loans extended by China's biggest banks are below the official rate, and more are in fact priced well above it.[54] Moreover, some argue that in the short run, the reform could end up benefitting the local governments and corporations that are already leveraged, by lowering the cost of their debt. The timing of the move was just a few weeks after the credit crunch, suggesting that it was designed to keep some borrowers from defaulting.[55] The timing of the reform may also have been intended to impress foreign governments pressuring China to reform its financial sector, as it came just ahead of the G20 meeting in Moscow.[56]

The bigger issue is whether China will reform its deposit and mortgage rates. No plans have been announced. Liberalizing deposit rates could boost personal income by at least 5 percentage points as a share of Chinese GDP, according to Stephen Roach, a prominent China economist. The problem is that China has given no timeline for implementing a deposit insurance scheme, which many view as the key prerequisite for liberalizing deposit rates – if some lenders go bankrupt, their depositors will be guaranteed some compensation, thus preempting bank runs.

In addition to the rate reform, the government promoted other reforms in July that could help to boost growth and also rebalance the economy:

- *More lending to individuals and small business.* The China Securities Regulatory Commission (CSRC) allowed Alibaba Group, a Chinese online exchange, to expand funding for its online loans business by up to $815 million, which primarily target small businesses.[57] People's Bank of China Governor Zhou Xiaochuan also said China would maintain a "prudent monetary policy" as it steps up lending to smaller companies.[58] The State Council further announced that, as of August 1, the government would suspend the value-added tax and the business tax for businesses with a monthly sales value of no more than 20,000 yuan. The policy is expected to benefit more than 6 million small companies.[59]
- *Cutting industrial capacity*. The government on July 25 ordered more than 1,400 companies in 19 industries to cut excess production capacity this year. Steel, ferroalloys, cement and copper smelting were among the industries identified by the

[52] Wayne Arnold, "China's Rate Reform May Serve to Shield Indebted State Firms," Reuters, July 21, 2013. http://www.reuters.com/article/2013/07/21/us-china-economy-rates-idUSBRE96K02920130721.
[53] Nicholas Lardy, "China Could Reform Its State Businesses by Stealth," *Financial Times*, June 27, 2013. http://www.ft.com/intl/cms/s/0/543be898-df44-11e2-881f-00144feab7de.html?ftcamp=published_links%2Frss%2Fworld_asia-pacific_china%2Ffeed%2F%2Fproduct#axzz2XWOyXBtP.
[54] Wayne Arnold, "China's Rate Reform May Serve to Shield Indebted State Firms," Reuters, July 21, 2013. http://www.reuters.com/article/2013/07/21/us-china-economy-rates-idUSBRE96K02920130721.
[55] Wayne Arnold, "China's Rate Reform May Serve to Shield Indebted State Firms," Reuters, July 21, 2013. http://www.reuters.com/article/2013/07/21/us-china-economy-rates-idUSBRE96K02920130721.
[56] "China Frees Up Lending Rates in Major Reform," Reuters, July 19, 2013. http://www.reuters.com/article/2013/07/19/china-economy-rates-idUSL4N0FP2UA20130719.
[57] Lulu Yilun Chen, "Billionaire Ma's Alibabe Gets Nod to Stir Up Loans: China Credit," *Bloomberg*, July 15, 2013. http://www.bloomberg.com/news/2013-07-14/billionaire-ma-s-alibaba-gets-nod-to-stir-up-loans-china-credit.html.
[58] "China to Support Growth with 'Targeted' Measures," *MarketWatch*, July 28, 2013. http://www.marketwatch.com/story/china-to-support-growth-with-targeted-measures-2013-07-28/.
[59] Yin Guang, "Inside China's Economy," *The China Perspective*, July 26, 2013. http://www.thechinaperspective.com/articles/inside-china-s-economy-anti-graft-order-stems-corporate-entertainment-more-policies-to-support-foreign-trade-10291/.

Ministry of Industry and Information Technology.[60] It is not clear whether this policy worked in the steel industry, as China's crude steel production hit a new record in late July. [61]

- *Crackdown on excessive infrastructure investment*. So far this year, the leadership has rejected the notion that urbanization policy would require a lot more infrastructure investment. In the spring, Premier Li Keqiang turned down an expensive urbanization plan unveiled by the National Development and Reform Commission (NDRC), China's premier planning agency.[62] The government on July 2 also banned the construction of new government buildings, a symbolic move to discourage wasteful infrastructure spending by local governments.[63] At the same time, Beijing continued to promote infrastructure projects in the country's poorest regions by setting up a railway development fund, which will combine central government funding and private investment.[64]
- *New measures to boost consumption*. The government launched a pilot scheme in some provinces to establish a settlement system for inter-provincial medical treatment, which is expected to help patients receiving medical services in a different place get reimbursed in time. The State Council will step up efforts to standardize basic medical insurance, and to encourage companies and individuals to buy supplementary commercial insurance for severe illness. [65]

The key question now is what major reforms the leadership will unveil at the 3rd Plenum in October. Notably, Chinese regulators have held meetings to collect opinions on expanding bond markets and other capital market reforms.[66] Other reforms have been intimated throughout the year.

Anti-Monopoly Law and the GlaxoSmithKline Case

On July 5, China launched a drug pricing probe into the costs of medicines at 60 domestic and international pharmaceutical companies, in an effort to reduce the cost of medicines. Local affiliates of foreign companies such as Merck of the US, GlaxoSmithKline, Astellas, Baxter Healthcare and Sandoz were targeted. The probe came after a similar probe by the National Development and Reform Commission (NDRC) into price fixing by manufacturers of baby milk. [67]

Grabbing the most headlines was GlaxoSmithKline, which in addition to price fixing was also accused of "using bribes, kickbacks, and other fraudulent means to bolster drug sales in China". The state-run media reported extensively on the case. The Ministry of Public Security said people working for the drug maker had bribed doctors, hospitals and government officials and funneled illicit payoffs through travel agencies, pharmaceutical

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[65] Yin Guang, "Inside China's Economy," *The China Perspective*, July 26, 2013. http://www.thechinaperspective.com/articles/inside-china-s-economy-anti-graft-order-stems-corporate-entertainment-more-policies-to-support-foreign-trade-10291/.

[66] Yin Guang, "Inside China's Economy," *The China Perspective*, July 26, 2013. http://www.thechinaperspective.com/articles/inside-china-s-economy-anti-graft-order-stems-corporate-entertainment-more-policies-to-support-foreign-trade-10291/.

[67] "China Launches Drug Pricing Probe," *Financial Times*, July 5, 2013. http://www.ft.com/intl/cms/s/0/837e3fd6-e47e-11e2-875b-00144feabdc0.html#axzz2YAv0lFev.

industry associations and project financing. GSK admitted to the charges and agreed to cooperate with the authorities. It also dismissed the head of its China operations.[68]

The moves signaled a growing preference for anti-trust activism among Chinese regulators. Since the 2011 introduction of regulations implementing the 2008 Anti-Monopoly Law, the NDRC has been stepping up its investigations into pricing practices. It investigated six foreign LCD makers in January; liquor firms in March, and now is looking at price fixing among big foreign companies in the dairy and pharmaceuticals sectors.[69]

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