



### Highlights of this month's edition

- **Bilateral trade:** Bilateral trade picks up; U.S. exports to China stronger than in 2012; transportation equipment exports to China perform well
- **Bilateral policy issues:** Lead-up to June 7-8 Obama-Xi California summit; VP Biden and President Xi now on concurrent trips to Latin America; new bilateral agreement on company audits
- **Sector spotlight:** Advanced technology products deficit lower than a year ago, with strong gains for opto-electronics exports; Shuanghui takeover of Smithfield raises security issues in food sector; solar trade disputes escalate, possibility of US-EU-China settlement
- **China's economy:** Forecasts revised down for the year; questions about export figures; risk of hot money, inflation, and property bubbles; PBOC seeks to diversify foreign exchange holdings; State Council announces ambitious economic reforms

### The U.S. Trade Deficit with China Grows

The U.S. trade deficit with China was \$24.1 billion in April – up from \$17.9 billion in March. Two-way trade was \$42.1 billion, \$5.3 billion higher than the month before. The increase in trade was solely due to higher imports from China, which increased by \$5.8 billion. Exports to China actually declined by \$444 million month-on-month.

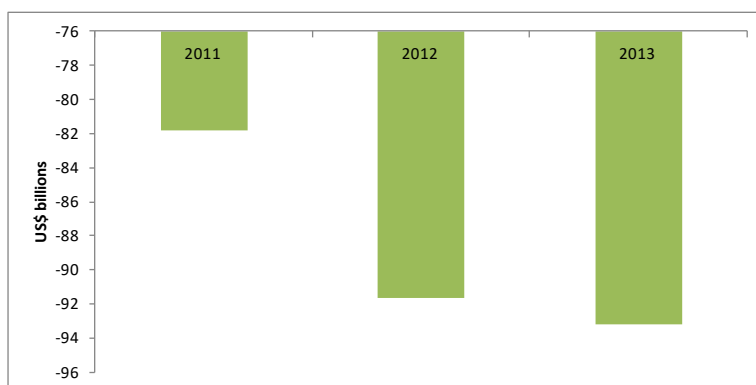
However, viewed in comparison to 2012, the trend was more positive for the United States. Exports to China grew 6.3 percent year-on-year in April, 0.6 percentage points higher than in 2011-12. Imports from China rose by just 0.3 percent, compared to 11.6 percent a year ago.

#### *Year-on-Year Growth in U.S. Trade with China, January 2012 – April 2013*

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
<i>2012</i>												
Exports	4.4%	4.6%	2.8%	5.7%	13.5%	10.2%	4.9%	2.2%	5.0%	11.1%	6.1%	6.8%
Imports	9.6%	3.2%	14.1%	11.6%	6.6%	4.5%	7.9%	-0.2%	3.9%	6.5%	7.6%	6.0%
<i>2013</i>												
Exports	12.1%	6.2%	-4.0%	6.3%								
Imports	8.1%	16.3%	-13.3%	0.3%								

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, June 2013). [http://censtats.census.gov/cgi-bin/naic3\\_6/naicCty.pl](http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl).

## Cumulative U.S. Trade Deficit with China through April: 2011, 2012, and 2013



Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, June 2013). [http://censtats.census.gov/cgi-bin/naic3\\_6/naicCty.pl](http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl).

## Top Exports and Imports

Among top U.S. exports to China, transportation equipment marked the strongest year-on-year gains. Agricultural goods, the second-largest U.S. export to China so far this year, were not among the top-five exports in April. Taken together, technology-intensive exports did well, although the United States still has a large trade deficit with China in machinery and computer and electronic products. Top imports from China, in turn, registered low or declining growth in April. Computer and electronic products have accounted for over one-third of China's exports to the United States this year, far ahead of any other goods.

### Top Exports and Imports through April 2013 (in US\$ millions)

U.S. Top-Five Exports to China				U.S. Top-Five Imports from China			
	Exports	Share of total (%)	Change over Apr'12 (%)		Imports	Share of total (%)	Change over Apr'12 (%)
<i>Monthly (April 2013)</i>				<i>Monthly (April 2013)</i>			
Transportation Equipment	1,812.5	20.2%	47.3%	Computer and Electronic Products	12,355.8	33.3%	4.9%
Computer and Electronic Products	1,261.9	14.0%	19.5%	Electrical Equipment, Appliances, and Component	2,584.8	7.0%	4.2%
Chemicals	1,068.3	11.9%	-2.2%	Miscellaneous Manufactured Commodities	2,241.7	6.0%	-10.1%
Machinery, Except Electrical	952.1	10.6%	17.6%	Machinery, Except Electrical	2,167.2	5.8%	-2.0%
Waste and Scrap	660.5	7.3%	-19.2%	Apparel and Accessories	1,979.4	5.3%	-6.4%
Other	3,236.6	36.0%		Other	15,785.6	42.5%	
<b>Total</b>	<b>8,991.9</b>	<b>100.0%</b>		<b>Total</b>	<b>37,114.5</b>	<b>100.0%</b>	
<i>Year-to-date (thru April 2013)</i>				<i>Year-to-date (thru April 2013)</i>			
Transportation Equipment	6,209.4	18.8%		Computer and Electronic Products	47,435.5	36.4%	
Agricultural Products	6,023.0	18.2%		Miscellaneous Manufactured Commodities	9,755.7	7.5%	
Computer and Electronic Products	4,783.3	14.5%		Electrical Equipment, Appliances, and Component	9,636.1	7.4%	
Chemicals	4,137.5	12.5%		Apparel and Accessories	8,846.5	6.8%	
Machinery, Except Electrical	3,305.6	10.0%		Machinery, Except Electrical	7,763.2	6.0%	
Other	8,643.0	26.1%		Other	46,873.5	36.0%	
<b>Total</b>	<b>33,101.8</b>	<b>100.0%</b>		<b>Total</b>	<b>130,310.5</b>	<b>100.0%</b>	

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, June 2013). [http://censtats.census.gov/cgi-bin/naic3\\_6/naicCty.pl](http://censtats.census.gov/cgi-bin/naic3_6/naicCty.pl).

## **Bilateral Policy Issues**

### ***Cyber Talks At US-China Summit in California***

On June 7-8, President Obama and President Xi Jinping of China will meet in Rancho Mirage, California for an informal summit. One of the issues that will figure prominently is cyber-security. Press reports earlier this year about Chinese cyber-attacks on the United States have increased pressure on the White House to be more assertive. Some estimate that cyber-attacks are costing the U.S. economy anywhere between \$20 billion and \$100 billion per year.<sup>1</sup> On June 1, Defense Secretary Chuck Hagel spoke of a "growing threat of cyber-intrusions" at a security conference in Singapore.<sup>2</sup>

*The New York Times* reported that the United States and China agreed to follow up with high-level talks beginning this July on how to set standards of behavior for cyber-security and commercial espionage. The informal agreement coincided with National Security Adviser Thomas Donilon's trip to Beijing, where he met with President Xi on May 27 to prepare the agenda for the California summit.<sup>3</sup> Further cyber talks are likely to also be part of the Strategic and Economic Dialogue (S&ED), which will be held from 8-12 July in Washington DC.<sup>4</sup>

On June 1, Ian Bremmer, the president of Eurasia Group, and Jon M. Huntsman Jr., the former U.S. ambassador to China (2009-11), in an op-ed in the *New York Times* exhorted the Obama administration to try a new approach. The authors argued that bilateral friction is increasing over many issues, such as trade, North Korea, and cyber-security. The Obama administration, is "hedging" by shifting resources and attention to Asia, in what amounts to a "policy of damage control". Unless this approach is complemented by a "sincere attempt to open up a dialogue," bilateral competition with China will be transformed into conflict. The United States no longer has the leverage to "negotiate with the China they want to see", and so should "engage China as it is". A more pragmatic approach would yield more results; in particular, improving access for U.S. goods and services in China, and enhancing cooperation in global governance.<sup>5</sup>

### ***Joe Biden and Xi Jinping Make Concurrent Trips to Latin America***

Prior to the summit with the United States, China's new president Xi Jinping is making his first trip to Latin America. He first traveled to Trinidad and Tobago – a key Caribbean trade partner – before moving on to Venezuela, Costa Rica, and Mexico.<sup>6</sup> China is exerting growing influence over Latin America, displacing the United States as the leading trade partner and source of credit in many countries. The central driver of relations is China's demand for iron ore, petroleum, soybeans, and other commodities.

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<sup>1</sup> "The cost of cyber espionage: 'A rounding error'," *Foreign Policy*, March 25, 2013.

[http://killerapps.foreignpolicy.com/posts/2013/03/25/the\\_cost\\_of\\_cyber\\_espionage\\_a\\_rounding\\_error](http://killerapps.foreignpolicy.com/posts/2013/03/25/the_cost_of_cyber_espionage_a_rounding_error).

<sup>2</sup> David E. Sanger and Mark Landler, "U.S. and China Agree to Hold Regular Talks on Hacking," *New York Times*, June 1, 2013. <http://www.nytimes.com/2013/06/02/world/asia/us-and-china-to-hold-talks-on-hacking.html?hp>.

<sup>3</sup> Jane Perlez, "Chinese President to Seek New Relationship with U.S. in Talks," *New York Times*, May 28, 2013.

<http://www.nytimes.com/2013/05/29/world/asia/china-to-seek-more-equal-footing-with-us-in-talks.html?hp&r=0>.

<sup>4</sup> For more on the S&ED talks, see <http://www.state.gov/r/pa/prs/ps/2013/04/207462.htm>.

<sup>5</sup> "How to Play Well with China," *New York Times*, June 1, 2013.

<http://www.nytimes.com/2013/06/02/opinion/sunday/how-to-play-well-with-china.html?hp>.

<sup>6</sup> "Xi Jinping arrives in Trinidad to boost Caribbean trade with China," *South China Morning Post*, June 1, 2013.

<http://www.scmp.com/news/china/article/1251310/xi-jinping-arrives-trinidad-boost-caribbean-trade-china>.

Concurrent with President Xi's trip, Vice-President Biden began a tour of Latin America on May 26. Some observers interpreted the trip as a conscious effort to balance China's influence. Biden met with 15 Caribbean leaders on May 28 to discuss trade, economic growth, and security. In Colombia, he boasted that the year-old U.S.-Colombia free trade agreement was "just the beginning". On May 30, Biden traveled to Brazil, the region's largest economy.<sup>7</sup> Biden made headlines in the Brazilian press by declaring that Brazil is the most important partner for the United States in a "new era" of U.S.-Latin American relations. Claiming that Brazil is no longer an emerging country, he urged Brasilia to become more proactive in global governance.<sup>8</sup>

### ***New Bilateral Agreement on Audits of China-Based Accounting Firms***

U.S. and Chinese authorities reached a preliminary agreement in May on access to auditing information. The Securities and Exchange Commission (SEC) has argued since last year that Chinese affiliates of the world's top four auditing firms withheld documents from investigators probing potential fraud by China-based companies listed in the United States. Non-compliant auditors face temporary or permanent deregistration in the United States, which in turn would prompt the delisting of Chinese firms audited by those firms. SEC negotiations with China failed last year, prompting the SEC to sue accounting firms directly. The auditors, in turn, refused the request, claiming that Chinese law prohibits them from complying with SEC requests.<sup>9</sup>

On May 7, however, the Public Company Accounting Oversight Board (PCAOB), the U.S. auditing watchdog, was able to reach its own agreement with the China Securities and Regulatory Commission (CSRC) and Ministry of Finance (MOF) to secure access to audit documents from Chinese accounting firms for PCAOB investigations. But many experts say the agreement is only a limited success. Information will not be provided for the PCAOB's regular inspections of accounting firms. China can still resort to a loosely defined "public interest" or "essential national interest" clause to block information. In effect, PCAOB still lacks information to do its job, and international investors will continue to distrust Chinese audits. Moreover, SEC lawsuits against auditors in China remain unresolved.<sup>10</sup>

In the meantime, regulatory uncertainty has been good business for global buyout firms like Blackstone, the Carlyle Group, and TPG Capital, which are helping US-listed Chinese companies go private. In May, a fund run by Blackstone led a \$662.3 million bid for a technology outsourcing firm based in China. As the *New York Times* has noted, these deals involve major risks: buyouts are often priced at large premiums to plummeting share prices, and the balance sheets of many Chinese companies are dubious.<sup>11</sup> In Blackstone's case, there appears to be a broader incentive to support China: the firm is minority-owned by China Investment Corp. (CIC), China's official sovereign wealth fund.

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<sup>7</sup> Joshua Goodman, "Biden Plays Defence as China Muscles in on 'Backyard'," *Bloomberg*, May 29, 2013.

<http://www.smh.com.au/world/biden-plays-defence-as-china-muscles-in-on-backyard-20130529-2nb0z.html>.

<sup>8</sup> Brazil Is No Longer Emerging, Biden Affirms [Brasil não é mais emergente, afirma Biden]," *Folha de Sao Paulo*, May 30, 2013. <http://www1.folha.uol.com.br/mundo/2013/05/1287250-brasil-nao-e-mais-emergente-afirma-biden.shtml>.

<sup>9</sup> "China Reaches Agreement with U.S. for Sharing Auditors' Records," *Bloomberg News*, May 24, 2013.

<http://www.bloomberg.com/news/2013-05-24/china-u-s-reach-agreement-on-audit-record-access-wsj-reports.html>.

<sup>10</sup> Paul Gillis, "There's No Accounting for China's Accounting," *Wall Street Journal*, May 29, 2013.

<http://online.wsj.com/article/SB10001424127887323855804578512270547620446.html>.

<sup>11</sup> Neil Gough, "Blackstone Leads Latest Chinese Privatization Bid," *New York Times*, May 21, 2013.

<http://dealbook.nytimes.com/2013/05/21/blackstone-leads-latest-chinese-privatization-bid/>.

## Sector Spotlight

### **Advanced Technology Product (ATP) Trade**

The U.S. trade deficit with China in advanced technology is nearly \$1 billion lower than at the same point a year ago. The greatest gains have been in opto-electronics, where the deficit was reduced by \$1.2 billion, or 49 percent. There was also a \$483 million increase in the trade surplus for aerospace products.

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

	Monthly			Cumulative year-to-date			
	Exports	Imports	Balance Apr'13	Exports	Imports	YTD Balance Apr'13	YTD Balance Apr'12
<b>TOTAL</b>	<b>2,127</b>	<b>10,945</b>	<b>-8,818</b>	<b>7,828</b>	<b>42,327</b>	<b>-34,499</b>	<b>-35,418</b>
(01) Biotechnology	31	7	24	122	25	97	58
(02) Life Science	234	169	65	901	667	234	156
(03) Opto-Electronics	23	415	-392	102	1,335	-1,233	-2,429
(04) Information & Communications	368	9,911	-9,543	1,375	38,607	-37,232	-35,717
(05) Electronics	344	271	73	1,439	1,049	390	163
(06) Flexible Manufacturing	219	73	146	713	278	435	185
(07) Advanced Materials	19	24	-5	77	70	7	15
(08) Aerospace	873	64	809	2,901	256	2,645	2,162
(09) Weapons	0	11	-11	1	39	-38	-34
(10) Nuclear Technology	15	0	15	199	1	198	23

Source: U.S. Census Bureau, NAICS database (Washington, DC: U.S. Department of Commerce, Foreign Trade Division, June 2013). [http://censtats.census.gov/cqi-bin/naic3\\_6/naicCty.pl](http://censtats.census.gov/cqi-bin/naic3_6/naicCty.pl).

### **The Food Sector: Shuanghui's Acquisition of Smithfield**

On May 29, Shuanghui International Holdings Ltd. (also known as Shineway), announced it would acquire Smithfield Foods, one of the largest U.S. meat producers, for \$4.72 billion dollars. The takeover marked the first large outbound investment by a Chinese firm in the U.S. food and agriculture sector. According to data from the Heritage Foundation, Chinese firms invested about \$10 billion in food and agriculture overseas prior to the deal, concentrated in Europe, Australia, and Latin America. Smithfield is among the first Chinese outbound investments in the meat processing sector – investments so far have focused more on crops, fertilizer, and land.

*China's Outbound Investments in the Agriculture Sector*

Year	Month	Investor	Investment (\$ millions)	Share Size	Partner/Target	Country
2006	January	ChemChina	\$480		Adisseo	France
<b>2008</b>	<b>June</b>	<b>China National Cereals, Oils and Foodstuffs</b>	<b>\$140</b>	<b>5%</b>	<b>Smithfield Foods</b>	<b>USA</b>
2009	July	CIC	\$370	1%	Diageo	Britain
2010	October	Sinochem	\$1,440	60%	Makhteshim-Agan	Israel
2011	February	Fulida Group	\$250		Neucel Specialty	Canada
2011	March	Chongqing Grain	\$1,410			Brazil
2011	June	Heilongjiang Beidahuang Nongken	\$1,510		Cresud	Argentina
2011	July	COFCO	\$140	99%	Tully Sugar	Australia
2011	August	Bright Foods	\$390	75%	Manassen Foods	Australia
2011	August	Complant	\$170			Jamaica
2012	April	Shanghai Pengxin	\$170		Crafar Farms	New Zealand
2012	May	Bright Foods	\$1,940	60%	Weetabix	Britain
2012	August	Hubei private consortium	\$250			Mozambique
2012	September	Synutra	\$120		Sodiaal	France
2012	November	CIC	\$110	13%	Brookefield	Canada
2012	November	Shanghai Zhongfu	\$730			Australia
2012	December	Yili Industrial	\$210		Oceania Dairy	New Zealand

Source: Heritage Foundation. <http://www.heritage.org/research/projects/china-global-investment-tracker-interactive-map>.

Note: Investments in "agriculture" include products like chemical fertilizer.

The deal is a boon to Smithfield shareholders. Shuanghui agreed to pay \$34 per share, a 31 percent premium on Smithfield's closing stock price of \$25.97. Smithfield has struggled since the global financial crisis, due to rising feed costs for livestock and uncertain global demand for meat products. Sales and profits performed worse in 2012 than in 2011. The company's stock price fell below \$30 in late 2009, and has not broken the \$30 threshold since then. Smithfield's second-largest shareholder, Continental Grain Co., has urged Smithfield to restructure in order to "get serious about creating shareholder value."<sup>12</sup>

For the U.S. economy, however, the deal poses risks. In the short term, it could set a bad precedent for U.S. meat producers if China favors its foreign-owned meat processors. China has been the largest export market for U.S. food products since 2010; yet the largest U.S. exports to China are commodities, such as soybeans and corn, used as feed grains for China's meat industry. The U.S. pork, beef, and poultry industries have only benefited marginally from China's entry into the World Trade Organization (WTO).

Smithfield has come to depend on pork exports to China to boost its overall business, and Shuanghui has been one of its main clients on the Mainland. Last year, at Shuanghui's

<sup>12</sup> Steve Helber, "Smithfield Chinese Firm Agrees to Buy Smithfield Foods for \$4.72 Billion," *Associated Press*, May 29, 2013. [http://www.timesdispatch.com/business/article\\_5e8ea6a8-c853-11e2-bf9b-001a4bcf6878.html](http://www.timesdispatch.com/business/article_5e8ea6a8-c853-11e2-bf9b-001a4bcf6878.html).

request, Smithfield began converting two of its North Carolina facilities to be free of ractopamine. Ractopamine has been banned in China.

In the medium to long-term, the deal has graver implications for free markets, intellectual property, and U.S. food safety. Shuanghui insists that its primary aim is to import more high-quality meat products from the United States through Smithfield.<sup>13</sup> However, in China, Shuanghui has contributed to the government's efforts to create an industrial, quasi-autarkic meat industry. Shuanghui has invested aggressively in new facilities to better service the urban markets in Beijing and Tianjin.<sup>14</sup> Shuanghui could absorb Smithfield's know-how and technology in order to gain a competitive edge globally, while doing little to improve Chinese market access for U.S. meat exporters. Shuanghui is particularly keen to get Smithfield's expertise in developing breeding farms that would help the Chinese firm establish a domestic product chain, and to learn Smithfield's methods of U.S. quality control.<sup>15</sup> Further, Shuanghui could potentially use Smithfield's animal gene technology to increase production at its Chinese hog farms. There could eventually be a reverse flow of trade, with the United States importing cheap pork from China. That in turn, would raise serious concerns about food safety – Shuanghui has been known to use harmful additives like clenbuterol to make pork leaner.<sup>16</sup>

A final concern is that Shuanghui is an instrument for the Chinese government's industrial policy. Shuanghui Group was founded in 1994 as a state-owned enterprise (SOE) in a poor inland province. In 1998, a subsidiary of the group – Henan Shuanghui Investment & Development Ltd. – listed on the Shenzhen stock exchange. In 2004, Shuanghui Group was taken over by a municipal branch of the government's State-Owned Asset Supervision and Administration Commission (SASAC), an agency charged with restructuring SOEs. In 2006, the government divested its interest in Shuanghui Group, which was sold to Rotary Vortex Limited, a private investment company, for \$256 million.<sup>17</sup>

Today, the company is owned by an array of funds, including Goldman Sachs. Even so, in November 2010, the control of Shuanghui Group was transferred to Rise Grand Group Ltd., an entity created by Shuanghui's leadership in a management buyout (MBO). The management-owned entity became the controlling shareholder of Shuanghui International Holdings Ltd. when its stake surpassed 30 percent.<sup>18</sup> Rise Grand Group was registered in

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<sup>13</sup> David Bracken, "Chinese Company to Acquire Smithfield Foods for \$4.7 Billion," *Charlotte Observer*, May 30, 2013. <http://www.charlotteobserver.com/2013/05/30/4074792/chinese-company-to-acquire-smithfield.html>.

<sup>14</sup> Mindi Schneider, "Feeding China's Pigs: Implications for the Environment, China's Smallholder Farmers and Food Security." *Institute for Agriculture and Trade Policy* (May 2011), pp.8-9.

<sup>15</sup> Kazunori Takada and Dominique Patton, "With Big-Name Backers, Chinese Firm Eyes Smithfield's Know-How, Brands," *Reuters*, May 30, 2013. <http://www.reuters.com/article/2013/05/30/us-smithfield-shuanghui-investors-idUSBRE94T0LP20130530>.

<sup>16</sup> Clyde Prestowitz, "The China Conundrum," *Foreign Policy*, June 3, 2012. <http://prestowitz.foreignpolicy.com/>; "Smithfield Foods Purchase Exposes Need for Broader Oversight," *Washington Post*, May 31, 2013. [http://www.washingtonpost.com/opinions/smithfield-foods-purchase-exposes-need-for-broader-oversight/2013/05/31/64271c86-ca0a-11e2-9245-773c0123c027\\_story.html](http://www.washingtonpost.com/opinions/smithfield-foods-purchase-exposes-need-for-broader-oversight/2013/05/31/64271c86-ca0a-11e2-9245-773c0123c027_story.html).

<sup>17</sup> "Development History [Fazhan Licheng]," Shuanghui Group (Retrieved June 7, 2013). <http://www.shuanghui.net/html/category/about/fzlc>; "Leadership Introduction [Linghangren Jieshao]," Shuanghui Group (Retrieved June 7, 2013). <http://www.shuanghui.net/html/category/about/lhrjs>; "Development History [Fazhan Licheng]," Shuanghui Group. <http://www.shuanghui.net/html/category/about/fzlc>; Henan Shuanghui Investment & Development Company Limited, 2004 Annual Report, p.6. <http://www.shuanghui.net/shfz/pdf/nb2006.pdf>; Henan Shuanghui Investment & Development Company Limited, 2006 Annual Report, p.4; <http://www.shuanghui.net/shfz/pdf/nb2006.pdf>; "Goldman Sachs Gets Nod for China Shuanghui Purchase," *Reuters*, December 12, 2006. <http://news.oneindia.in/2006/12/12/goldman-sachs-gets-nod-for-china-shuanghui-purchase-1165905597.html>.

<sup>18</sup> Henan Shuanghui Investment & Development Company Limited, 2010 Annual Report. <http://disclosure.szse.cn/m/finalpage/2012-03-02/60612313.PDF>, p.9.

2007 in the British Virgin Islands. Owners of the group include Shuanghui chairman, Wan Long, who in 2010 had a 14.4 percent controlling stake in Rise Grand Group.<sup>19</sup>

Wan Long, in turn, is a member of the Communist party and sits in the National People’s Congress. Wen Yunsong, the son of former Premier Wen Jiabao, also supports Shuanghui through a private equity firm, New Horizon.<sup>20</sup> Moreover, it is noteworthy that COFCO, China’s largest state-owned agribusiness, divested its minority stake in Smithfield last November, vaguely citing “commercial considerations.”<sup>21</sup> It is possible that COFCO helped facilitate the Shuanghui deal.

### Shuanghui Shareholder Structure

1998-2003



Source: Henan Shuanghui & Development Company Limited, 1998-2003 annual reports.

2004-2006



Source: Henan Shuanghui & Development Company Limited, 2004-2006 annual reports

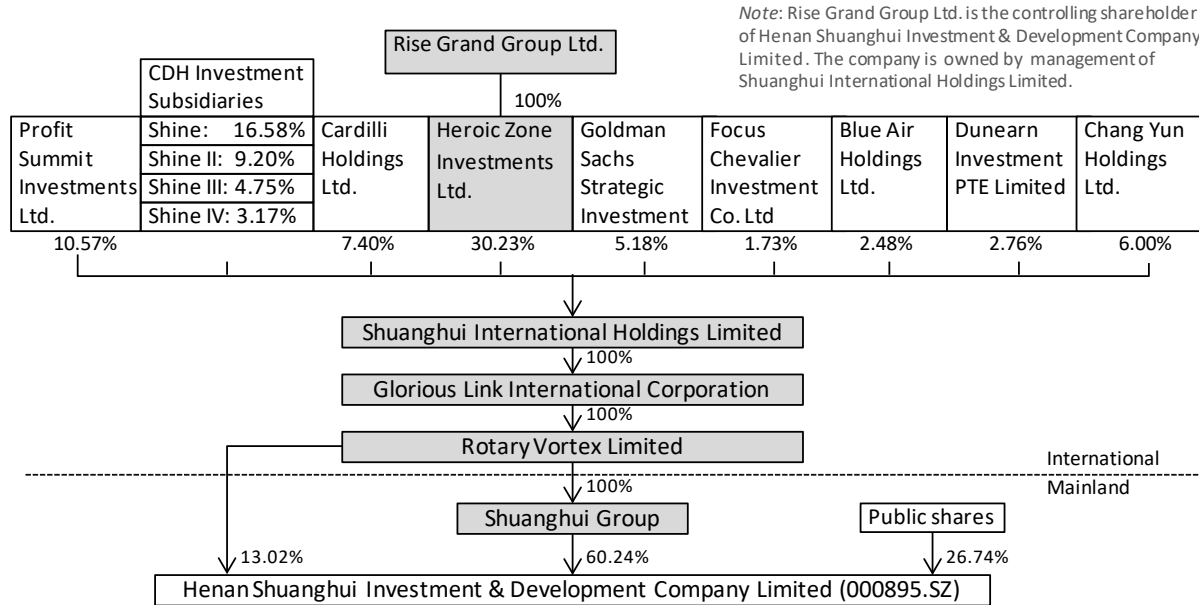
<sup>19</sup> “[Shuanghui Management MBO Entity Actually Owns Shuanghui], *Shei de Shuangxin: Shuanghui Guangliceng MBO Shiti Shiji Shuanghui*,” *Caixin*, November 29, 2010. <http://companies.caixin.com/2010-11-29/100202520.html>.

<sup>20</sup> Kazunori Takada and Dominique Patton, “With Big-Name Backers, Chinese Firm Eyes Smithfield’s Know-How, Brands,” *Reuters*, May 30, 2013. <http://www.reuters.com/article/2013/05/30/us-smithfield-shuanghui-investors-idUSBRE94T0LP20130530>.

<sup>21</sup> Chui-Wei Yap, “China’s COFCO: Sold Smithfield Foods Stake on Commercial Considerations,” *Dow Jones Chinese Financial Wire*, November 30, 2012. Via Factiva.



Most recent



Source: Henan Shuanghui Investment & Development Company Limited, *2012 Annual Report* (March 2013), p.40. <http://www.shuanghui.net/shfz/pdf/2012nb.PDF>

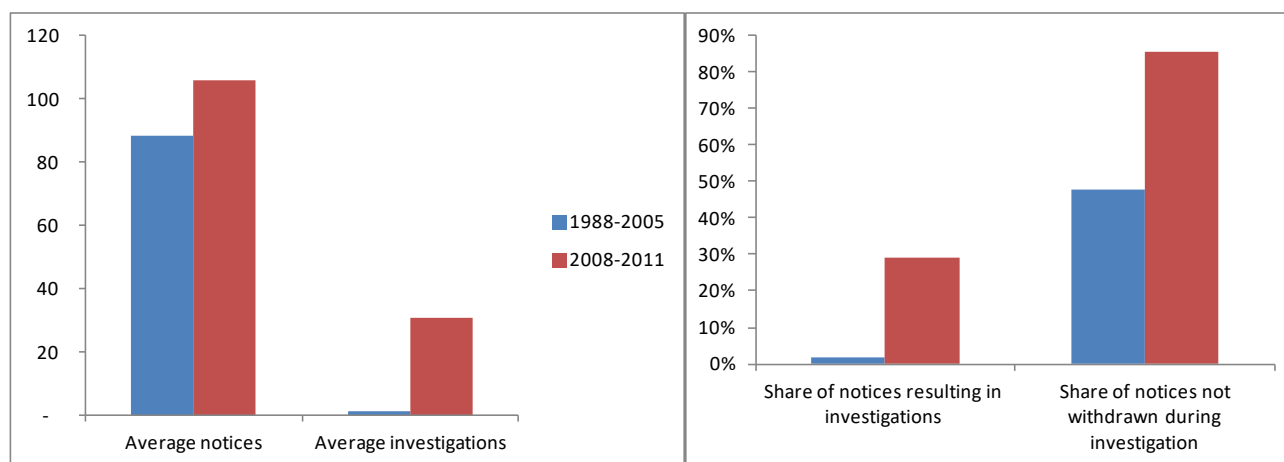
Shuanghui and Smithfield voluntarily submitted the deal for approval to the Committee on Foreign Investment in the United States (CFIUS), an interagency committee in the U.S. government that screens foreign investments on national security grounds. According to a *Reuters* report on June 5, a draft filing to CFIUS could be delivered within a week, and an official filing would follow within five business days.<sup>22</sup> The workload of CFIUS is growing since a change in the law, the Foreign Investment and National Security Act (FISIA) in 2007. That change significantly expanded the scope and intensity of its reviews. In 2008-11, CFIUS reviewed 26 investments by Chinese companies. Many argue that the Smithfield acquisition is unlikely to be blocked, as the bulk of the Chinese investments reviewed by CFIUS have gone through. In three cases, however, CFIUS has contributed to blocking Chinese investments – most recently a wind turbine farm in Oregon.

<sup>22</sup> "U.S. Lawmakers Air Concerns about Smithfield-Shuanghui Deal," *Reuters*, June 5, 2013. <http://www.reuters.com/article/2013/06/05/us-smithfield-shuanghui-congress-idUSBRE9540YN20130605>.

## Intensity of CFIUS Reviews, Before and After FINSA

Annual Average Notices and Investigations

Intensity of Investigations



Source: James K. Jackson, "The Exon-Florio National Security Test for Foreign Investment," Congressional Research Service, March 29, 2013; Committee on Foreign Investment in the United States (CFIUS), Annual Report to Congress, December 2012.

### Four Major Chinese Investments Examined by CFIUS

Date	Investor	Value (\$ millions)	Target Company	Industry	Status
2005	China National Offshore Oil Corp.	\$18,500	Unocal Corp.	Oil & gas	Withdrawn proposal
2009	Northwest Nonferrous International Investment Corp.	\$26	Firstgold Corp.	Mining	Withdrawn proposal
2011	Huawei	\$2	3Leaf	IT	Withdrawn proposal
2012	Ralls Corporation	\$6	Terna Energy Holding USA Corp.	Wind power	Blocked by presidential decree

### The Solar Sector

On June 6, the European Commission (EC), the executive arm of the European Union (EU) in Brussels, will vote on whether to apply antidumping duties to imports of Chinese solar panels, cells, and wafers. Provisional duties would be extremely high, averaging 47 percent, with a range of 37 percent to 68 percent.<sup>23</sup> The measures would further escalate the trade dispute between China and the EU. The case was launched by the EC on May 8. The EU has 31 trade investigations, 18 of them involving China. The solar duties would be the largest duties that the EU has applied to China, involving some \$27 billion worth of imports.<sup>24</sup> Given that the EU accounts for 57 percent of the global solar market, and China is by far the largest exporter, the duties would profoundly impact the global solar industry.<sup>25</sup>

<sup>23</sup> Leslie Hook and Joshua Chaffin, "China Calls for Closer Negotiations on Solar Panel Tariffs," *Financial Times*, May 9, 2013. [http://www.ft.com/intl/cms/s/0/b80ff94e-b8c1-11e2-869f-00144feabdc0.html?ftcamp=published\\_links%2Ffrss%2Fworld\\_asia-pacific\\_china%2Ffeed%2F%2Fproduct#axzz2StctURz0](http://www.ft.com/intl/cms/s/0/b80ff94e-b8c1-11e2-869f-00144feabdc0.html?ftcamp=published_links%2Ffrss%2Fworld_asia-pacific_china%2Ffeed%2F%2Fproduct#axzz2StctURz0).

<sup>24</sup> Ethan Bilby, "EU Warns China It Is Ready to Launch Telecoms Dispute," *Reuters*, May 15, 2013. <http://www.reuters.com/article/2013/05/15/us-eu-trade-china-idUSBRE94E0IP20130515>.

<sup>25</sup> Todd Woody, "Chinese solar panel prices reverse four-year slide thanks to demand in China," *Quartz*, April 23, 2013. <http://qz.com/77460/chinese-solar-panel-prices-reverse-four-year-slide-thanks-to-demand-in-china/>.

### Timeline of Trade Disputes Concerning Solar PV

<b>Date</b>	<b>Involved Parties</b>	<b>Details</b>
October 19, 2011	SolarWorld America and seven other U.S. solar PV manufacturers	German-owned solar company SolarWorld's U.S. arm and a coalition of seven other solar PV manufacturers bring Chinese solar panel dumping complaint to the U.S. Department of Commerce and International Trade Commission. <sup>26</sup>
November 21, 2011	U.S. Department of Commerce	The U.S. Department of Commerce begins their investigation into SolarWorld America's complaint that China is dumping solar panels into the U.S. market. China responds by sending wafers to Taiwan, South Korea and the United States for the final step of production to convert wafers into solar cells in an attempt to avoid tariffs. <sup>27</sup>
November 16, 2011	SolarWorld AG	SolarWorld AG issues petition to European solar firms prior to issuing formal complaint to EU on Chinese dumping of solar panels. <sup>28</sup>
July 25, 2012	SolarWorld AG	SolarWorld AG files formal complaint to EU on Chinese dumping of solar panels into European market. <sup>29</sup>
September 5, 2012	European Commission	European Commission begins investigation into SolarWorld AG complaint. <sup>30</sup>
October 10, 2012	U.S. Department of Commerce	The U.S. Department of Commerce announces tariffs ranging from 24 to almost 36 percent on imports of Chinese solar panels. <sup>31</sup>
June 6, 2013	European Commission	European Commission set to enact tariff on Chinese solar panel imports, however a majority vote from EU member countries could stop the tariffs from going into effect. The preliminary tariffs would last for six months. <sup>32</sup>

The main sponsors of the duties are European solar panel makers, especially in Germany, which hosts the largest solar market. SolarWorld, once Germany's biggest solar group, is saddled with \$1.2 billion in liabilities, while its smaller rival, Q-Cells, filed for insolvency last year.<sup>33</sup> These companies have blamed China for their misfortunes. China barely had any solar production a decade ago; yet in 2009-11, its production quadrupled to more than the entire global demand.<sup>34</sup> In 2010, China's market share was 55 percent and the EU's 16 percent; just two years later, China's share increased to 71 percent, and the EU's dropped

<sup>26</sup> "SolarWorld and coalition of U.S. solar manufacturers petition to stop unfair trade by Chinese state-sponsored industry," *SolarWorld*, October 19, 2011. <http://www.solarworld-usa.com/news-and-resources/news/domestic-solar-manufacturers-petition-to-stop-unfair-trade-by-china.aspx>.

<sup>27</sup> Keith Bradsher, "China Bends to U.S. Complaint on Solar Panels but Plans Retaliation," *New York Times*, November 21, 2011. <http://www.nytimes.com/2011/11/22/business/global/china-bends-to-us-complaint-on-solar-panels-but-also-plans-retaliation.html?pagewanted=all>.

<sup>28</sup> Miriam Widman, "SolarWorld Circulates Petition for European Trade Complaint." *Renewable Energy World*, November 16, 2011. <http://www.renewableenergyworld.com/rea/news/article/2011/11/solarworld-circulates-petition-for-european-trade-complaint>.

<sup>29</sup> Anneli Palmen & Christoph Steitz, "SolarWorld files anti-dumping complaint in EU," *Reuters*, July 25, 2012. <http://www.reuters.com/article/2012/07/25/solarworld-eu-complaint-idUSL6E8IPBD920120725>.

<sup>30</sup> Keith Bradsher, "Europe to Investigate Chinese Exports of Solar Panels," *New York Times*, September 5, 2012. <http://www.nytimes.com/2012/09/06/business/global/eu-prepares-to-investigate-chinese-dumping-of-solar-panels.html?pagewanted=all>.

<sup>31</sup> "Fact Sheet: Commerce Finds Dumping and Subsidization of Crystalline Silicon Photovoltaic Cells, Whether or Not Assembled into Modules from the People's Republic of China," *International Trade Administration* (October 10, 2012). [http://ia.ita.doc.gov/download/factsheets/factsheet\\_prc-solar-cells-ad-cvd-finals-20121010.pdf](http://ia.ita.doc.gov/download/factsheets/factsheet_prc-solar-cells-ad-cvd-finals-20121010.pdf).

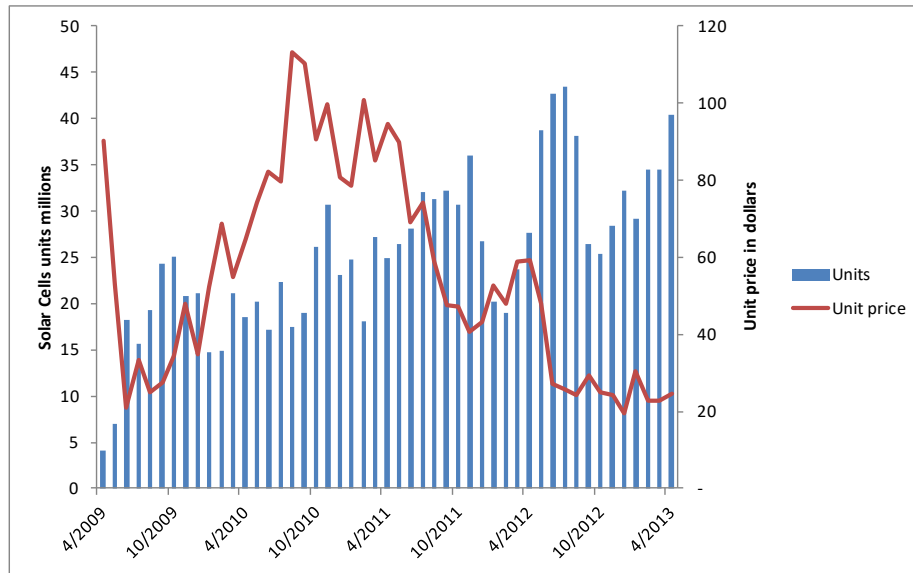
<sup>32</sup> Matthew Dalton, "EU to Push Ahead With Tariffs on Chinese Solar Sector," *Wall Street Journal*, May 27, 2013. <http://online.wsj.com/article/SB10001424127887324125504578509302593743088.html>.

<sup>33</sup> Robin Emmott and Francesco Guarascio, "Exclusive: EU to Propose Punitive Duties on Chinese Solar Panels," *Reuters*, May 3, 2013. <http://www.reuters.com/article/2013/05/03/us-eu-china-solar-idUSBRE9420B720130503>.

<sup>34</sup> *Ibid.*

to 10 percent.<sup>35</sup> Even as EU solar panel makers have lost market share, they have also suffered from solar panel prices that plummeted by 75 percent in 2009-12.<sup>36</sup>

*Monthly Exports of Solar Cells from China*



Source: China Electricity Council, via CEIC data.

However, other market actors in Europe oppose the solar duties. Importers and installers have benefitted immensely from cheap solar panel imports. A recent Deutsche Bank report forecast that, if low prices persisted, solar energy could compete in an open energy market without subsidies by 2014.<sup>37</sup> According to energy consultancy IHS, the imposition of duties against China could raise the average price of panels in Europe by an average of 45 percent.<sup>38</sup> Trade groups representing users of solar panels in six EU member states have complained to the EC that their clients are already canceling orders in expectation of higher prices.<sup>39</sup>

Other opponents argue that the duties will harm producers of solar components. Tariffs on Chinese solar panels may not be enough to save Europe’s uncompetitive solar panel makers, many of whom have already exited the market.<sup>40</sup> At the same time, the duties would damage intermediate goods suppliers, since Chinese solar companies buy large amounts of European polysilicon and machinery.<sup>41</sup> Indeed, the duties could have an effect on the United

<sup>35</sup> “EU Panel Penalties to Hurt Solar Firms from China to UK,” *Bloomberg News*, May 22, 2013.

<http://www.bloomberg.com/news/2013-05-21/eu-panel-penalties-to-hurt-solar-firms-from-china-to-u-k.html>.

<sup>36</sup> *The Pew Charitable Trusts*. “Innovate, Manufacture, Compete: A Clean Energy Action Plan,” January 17, 2013, 13.

<sup>37</sup> Beetz, Becky. “Deutsche Bank: Sustainable solar market expected in 2014,” *PV Magazine*, February 26, 2013. Retrieved at [http://www.pv-magazine.com/news/details/beitrag/deutsche-bank--sustainable-solar-market-expected-in-2014\\_100010338/#axzz2MakRo2WJ](http://www.pv-magazine.com/news/details/beitrag/deutsche-bank--sustainable-solar-market-expected-in-2014_100010338/#axzz2MakRo2WJ) 26 Feb 2013.

<sup>38</sup> Mark Roca, “EU Panel Penalties to Hurt Solar Firms from China to UK,” *Bloomberg News*, May 22, 2013.

<http://www.bloomberg.com/news/2013-05-21/eu-panel-penalties-to-hurt-solar-firms-from-china-to-u-k.html>.

<sup>39</sup> Emmott and Guarascio.

<sup>40</sup> *Ibid.*

<sup>41</sup> Hook and Chaffin.

States, which registered a \$1.63 billion trade surplus with China in clean energy in 2011, owing largely to exports of solar panel components.<sup>42</sup>

The Chinese government, for its part, has made an effort to block the duties. In mid-May, the Ministry of Commerce (MOFCOM) warned that imposing duties would "seriously harm" bilateral trade ties.<sup>43</sup> On May 29, a commentary in the *People's Daily*, the official newspaper of the Communist Party, argued that the duties constituted "bean counting by EU institutions...for the sake of raising their own authority and influence within the European Union."<sup>44</sup> A statement posted on the Chinese government's main website on May 30 asserted that EU member states did not all agree on the need for the tariff duties.<sup>45</sup>

China's diplomatic efforts may have had some effect. In late May, Reuters news agency found that just six out of 27 EU countries openly supported the duties. Many countries do not want duties because they fear being shut out of China's lucrative market in other sectors.<sup>46</sup> Ironically, the German government has been very critical of the EC's approach, even though Germany's solar companies are among the worst affected by China's dumping practices.<sup>47</sup> The solar trade dispute happened to coincide with the first visit to Germany of China's new Premier Li Keqiang.<sup>48</sup> Much of Germany's economic success during the Eurozone crisis has been premised on exports to China.

There are numerous reports that a settlement is now in the works to prevent the duties, possibly on a trilateral basis between the United States, the EU, and China. The settlement could involve a "price undertaking", whereby Chinese exporters agree not to sell their goods in Europe below a certain minimum price.<sup>49</sup> It could also close a loophole whereby Chinese exporters circumvent trade barriers by processing panels in Taiwan.<sup>50</sup> The EC, led by trade commissioner Karl De Gucht, has claimed to be unimpressed by these efforts, maintaining that its anti-dumping law does not permit settlement negotiations before provisional duties are first imposed.<sup>51</sup>

Even if China were to prevent major trade barriers in Europe, its solar industry will still face dim prospects. As in many other manufacturing sectors, the Chinese government over the past decade has been eager to boost more production. The 2007 Medium and Long-Term Development Plan for Renewable Energy set an initial target of 1.8 GW by 2020, a six-fold increase from 2010 levels.<sup>52</sup> In May 2011, the target was revised upward to 50 GW.<sup>53</sup> In

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<sup>42</sup> "Advantage America: The U.S.-China Clean Energy Technology Trade Relationship in 2011." *The Pew Charitable Trusts*, March 6, 2013. <http://www.pewenvironment.org/news-room/reports/advantage-america-the-us-china-clean-energy-technology-trade-relationship-in-2011-85899456253>.

<sup>43</sup> "China Says EU Solar Duties to 'Seriously Harm' Trade Ties," *Reuters*, May 16, 2013. <http://www.reuters.com/article/2013/05/16/us-china-eu-solar-idUSBRE94F0BD20130516>.

<sup>44</sup> "China's Top Paper Says EU Solar Probe 'Bean Counting,'" *Reuters*, May 29, 2013. <http://www.reuters.com/article/2013/05/29/us-china-eu-solar-idUSBRE94S07620130529>.

<sup>45</sup> Ben Blanchard, "Chinese Media Rejects Accusation of Pressure on EU in Solar Row," *Reuters*, May 30, 2013. <http://www.reuters.com/article/2013/05/30/us-china-eu-solar-idUSBRE94S07620130530>.

<sup>46</sup> *Ibid.*

<sup>47</sup> "China Says EU Solar Duties to 'Seriously Harm' Trade Ties."

<sup>48</sup> "Li Keqiang Arrives in Berlin for Official Germany Visit [Li Keqiang dida Bolin dui Deguo jinxing zhengshi fangwen]," *Xinhua*, May 26, 2013. [http://news.xinhuanet.com/world/2013-05/26/c\\_124763749.htm](http://news.xinhuanet.com/world/2013-05/26/c_124763749.htm).

<sup>49</sup> Hook and Chaffin.

<sup>50</sup> Kenneth Rapoza, "China May Escape E.U. Solar Tariffs." *Forbes*, May 27, 2013.

<http://www.forbes.com/sites/kenrapoza/2013/05/27/china-may-escape-e-u-solar-tariffs/>.

<sup>51</sup> Roca.

<sup>52</sup> "Medium and Long-Term Development Plan for Renewable Energy in China," National Development and Reform Commission, People's Republic of China, Sept 2007. Retrieved at [http://usa.chinadaily.com.cn/business/2011-04/01/content\\_12263360.htm](http://usa.chinadaily.com.cn/business/2011-04/01/content_12263360.htm).

order to achieve these targets, the government has provided easy access to credit and large subsidies to scale up solar photovoltaic (PV) production. Local governments, eager to boost growth, foreign investment, and green credentials, have lured solar producers with fiscal incentives. Since 2009, the government has also made a concerted effort to reduce the solar industry's reliance on export markets, by means of subsidies, concession-bidding programs, and most recently, feed-in-tariffs.<sup>54</sup>

China now ranks third worldwide in installed solar PV capacity, recently overtaking the United States. Yet export reliance remains high: recent estimates are that China will reduce the ratio of exports to production from 95 percent in 2010 to 70 percent in 2013. Meanwhile, unchecked growth has led to excess capacity and falling prices. In March 2013, Suntech, the largest solar module manufacturer, declared bankruptcy after running dry of cash and defaulting on a bond payment of over \$541 million.<sup>55</sup> Last year over half of all solar companies in Jiangsu province, where two-thirds of solar PV is produced, were forced to stop production entirely.<sup>56</sup> Beijing's refusal to completely rescue Chaori, Suntech and LDK, three of its largest solar panel makers, suggests that it favors consolidation pushed by the National Development and Reform Commission (NDRC), China's premier planning agency.<sup>57</sup>

U.S. and EU tariffs could actually be useful scapegoats for allowing more companies to fail. And yet, the question remains whether vested interests in China would allow this to happen. Local governments would lose revenue. Major state-owned banks are also affected by defaults on large loans and bonds.<sup>58</sup> Other companies have invested heavily in intermediate suppliers of polysilicon: CIC, China's official sovereign wealth fund, has invested in the Hong Kong subsidiary of China's largest polysilicon maker, GCL-Poly; ChemChina, China's second-largest chemical company, has also taken over a polysilicon producer in Norway.

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<sup>53</sup> Fayen Wong and Chen Yixin, "China doubles solar power target to 10 GW by 2015," *Reuters*, May 6, 2011. Retrieved at <http://www.reuters.com/article/2011/05/06/china-solar-idUSL3E7G554620110506>.

<sup>54</sup> For details, see Richard J. Campbell, "China and the United States – A Comparison of Green Energy Programs and Policies," *Congressional Research Service*, March 30, 2011, 11-12; Becky Beetz & Wenjing Feng, "China: 2.83 GW of solar to be installed under Golden Sun program," *PV Magazine*, December 11, 2012. Retrieved at [http://www.pv-magazine.com/news/details/beitrag/china--283-gw-of-solar-to-be-installed-under-golden-sun-program\\_100009542/#ixzz2Mao8mcXf](http://www.pv-magazine.com/news/details/beitrag/china--283-gw-of-solar-to-be-installed-under-golden-sun-program_100009542/#ixzz2Mao8mcXf); "U.S.-China Quarterly Market Review." *U.S.-China Program of ACORE and CREIA*, Oct 2010. Retrieved at [http://www.acore.org/wp-content/uploads/2011/02/ACORE\\_US\\_CHINA\\_Q\\_REVIEW\\_F\\_low-21.pdf](http://www.acore.org/wp-content/uploads/2011/02/ACORE_US_CHINA_Q_REVIEW_F_low-21.pdf); Coco Liu, "China Uses Feed-In Tariff to Build Domestic Solar Market," *New York Times*, September 14, 2011. Retrieved at <http://www.nytimes.com/cwire/2011/09/14/14climatewire-china-uses-feed-in-tariff-to-build-domestic-25559.html>.

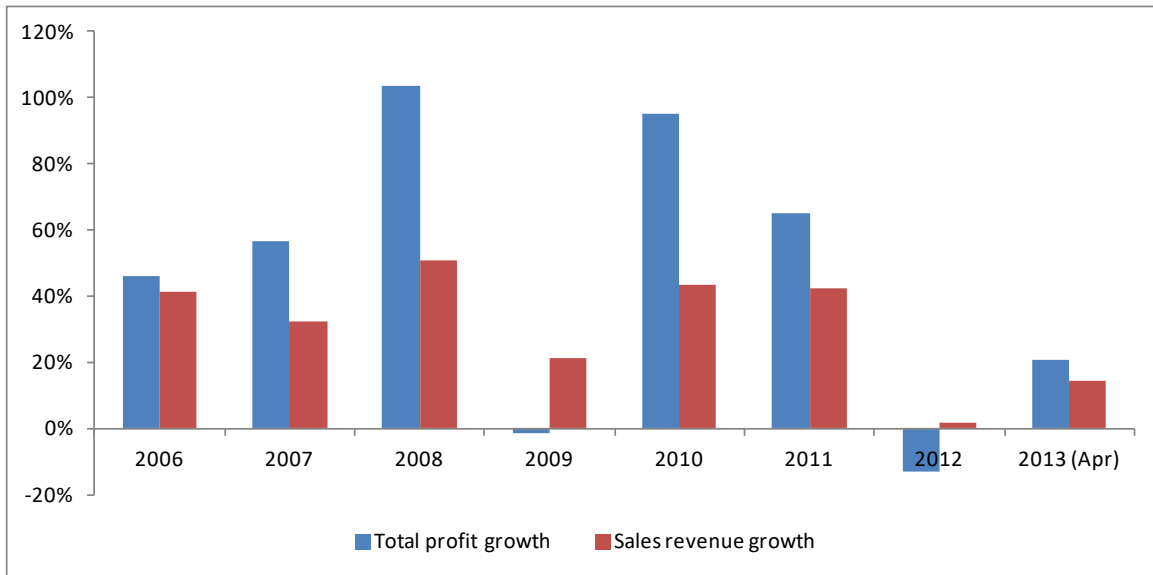
<sup>55</sup> Keith Bradsher, "Suntech Unit Declares Bankruptcy," *New York Times*, March 20, 2013. Retrieved at <http://www.nytimes.com/2013/03/21/business/energy-environment/suntech-declares-bankruptcy-china-says.html>.

<sup>56</sup> Liu Yuanyuan, "Photovoltaic Production in China's Jiangsu Province Falls 30% in 2012," *Renewable Energy World*, February 13, 2013. Retrieved at <http://www.renewableenergyworld.com/rea/news/article/2013/02/photovoltaic-production-in-chinas-jiangsu-province-falls-30-in-2012>.

<sup>57</sup> James Parker, "Will the EU Kill China's Solar Industry," *The Diplomat*, May 7, 2013. <http://thediplomat.com/pacific-money/2013/05/07/will-the-eu-kill-chinas-solar-industry/>.

<sup>58</sup> *Ibid.*

### Solar Appliance Companies in China: Year-on-Year Growth of Revenue and Profits



Source: China National Bureau of Statistics, via CEIC data.

Note: The category refers, more precisely, to companies that produce “gas, solar, and similar appliances”.

### China’s Economy

In May, many economists cut their forecasts for China’s economy after a fourth month of disappointing data. A *Wall Street Journal* survey of 18 economists late last year showed the median forecast for growth in 2013 at 8 percent; yet a new survey of 12 economists revealed a lower median forecast of 7.8 percent.<sup>59</sup> Industrial output rose 9.3 percent in April from a year earlier, up from 8.9 percent in March but below market expectations. Retail sales remained lackluster, and investment showed no sign of accelerating despite a surge in new lending in the first quarter.<sup>60</sup>

Purchasing managers’ indexes (PMI) also showed a lack of optimism. HSBC PMI hit a seven-month low for manufacturing.<sup>61</sup> The PMI survey conducted by the China Federation of Logistics and Purchasing (CFLP) performed slightly better than the HSBC survey, showing stable output and new orders. But export orders, according to the survey, continued to contract. The news was not much better in the non-manufacturing sector: the CFLP survey showed sentiment about new business at its lowest since November 2011 – a highly unusual finding for a busy month like May.

<sup>59</sup> “Economists Trim China Growth Forecasts,” *Wall Street Journal*, May 14, 2013. <http://online.wsj.com/article/SB10001424127887324031404578482373897417986.html>.

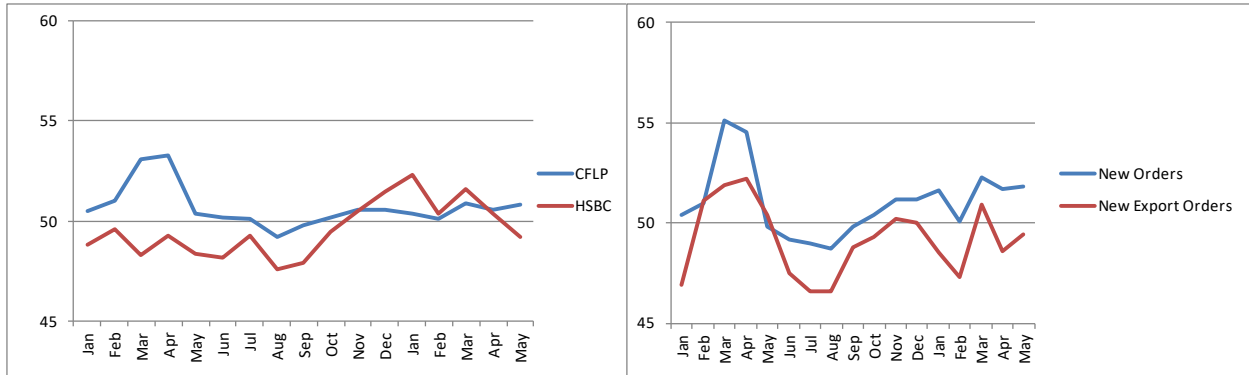
<sup>60</sup> Ibid.

<sup>61</sup> “China Official PMI to Show Minimal Growth in May,” *Reuters*, May 30, 2013. <http://www.reuters.com/article/2013/05/30/us-china-economy-pmi-idUSBRE94T07220130530>.

*Purchasing Managers' Index through May 2013*  
 (<50 = contraction, >50 = expansion)

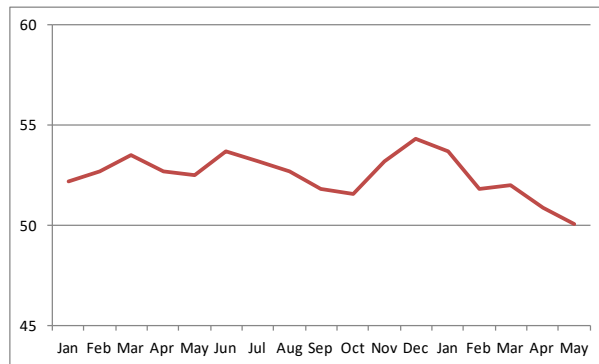
*Manufacturing (HSBC vs. CFLP)*

*New Manufacturing Orders (CFLP)*



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>.  
 Note: HSBC PMI is based on early "flash" reading. Subsequent reading may differ slightly.

*Purchasing Managers' Index through May 2013: New Business in Non-Manufacturing*  
 (<50 = contraction, >50 = expansion)

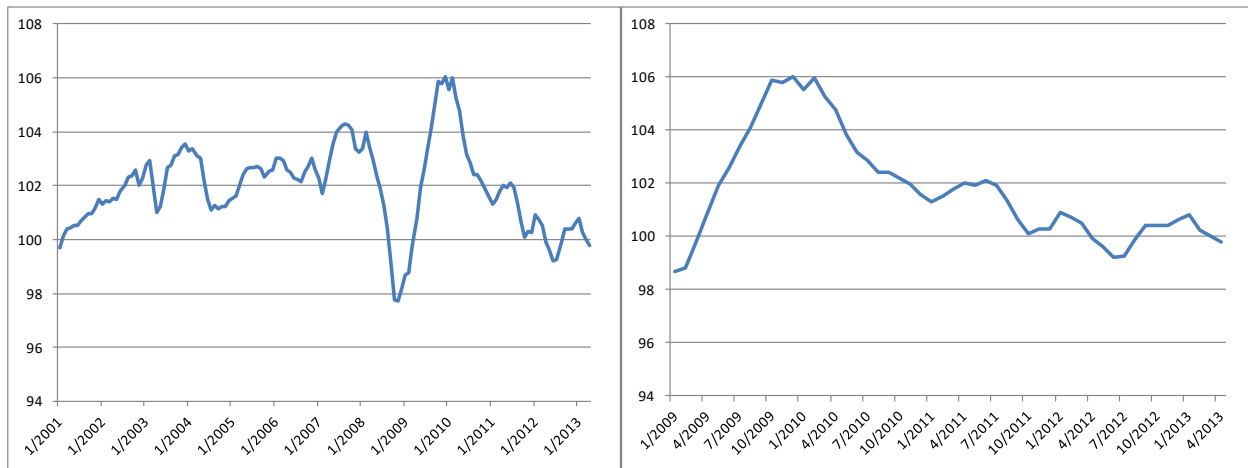


Source: China's National Bureau of Statistics, via CEIC data

The China National Bureau of Statistics leading index, which takes into account a wide range of economic indicators to gauge growth, also showed visible drops in March and April.



*Leading Index through April 2013*  
(1996 = 100)



Source: China National Bureau of Statistics, via CEIC data.

Note: (1) Treasury Bond Interest Rate Spread (7-year and above weighted average government bond yield minus 1-year or less weighted average government bond); (2) Product Sales Rate; (3) New Investment Projects Started (4) Index of Logistics (Freight volume and ports throughput); (5) Money Supply, M2; (6) Index on Real Estate Investment (Land Area Developed and Floor Space Started); (7) Consumer Expectation Index; (8) Hang Seng Mainland Freefloat Index

Due to the slump, employment has again become a concern. China now has a smaller labor pool, and private sector wages rose by 14 percent in real terms in 2012. However, research by the *Wall Street Journal* shows a 22 percent drop in new job postings on online recruiting websites in May, the steepest decline since this data was first collected in 2010. That was backed by data on employment in the HSBC PMI, showing that producers were shedding jobs for a second straight month.<sup>62</sup> In mid-May, President Xi Jinping made a surprise visit to a job fair in the eastern city of Tianjin, while Premier Li Keqiang warned of the problem of finding sufficient jobs for university graduates.<sup>63</sup>

The downturn has also made China less attractive for foreign investors. New statistics showed that foreign direct investment (FDI) in April rose by just 0.4 percent year-on-year in April, compared to 5.7 percent in March, and far below the 6.2 percent median estimate of eight analysts by Bloomberg News.<sup>64</sup> In an effort to boost FDI, SAFE announced in May that it would abolish 24 regulations on the administration of funds for foreign direct investment, in line with State Council orders to cut red tape and increase transparency. The rules cover matters including the re-investment of renminbi by foreign companies and property purchases by overseas individuals.<sup>65</sup> Meanwhile, China has tried to leverage its influential position on the World Bank board to water down the organization's "Doing Business" study,

<sup>62</sup> Tom Orlik, "China's Not Hiring," *Wall Street Journal*, May 22, 2013. <http://online.wsj.com/article/SB10001424127887324659404578500073004094486.html>

<sup>63</sup> "Beijing Signals Concerns at Rising Unemployment," *Financial Times*, May 15, 2013. [http://www.ft.com/intl/cms/s/0/481dd63e-bd66-11e2-a735-00144feab7de.html?ftcamp=published\\_links%2Frs%2Fworld\\_asia-pacific\\_china%2Ffeed%2F%2Fproduct#axzz2TGvdNkrR](http://www.ft.com/intl/cms/s/0/481dd63e-bd66-11e2-a735-00144feab7de.html?ftcamp=published_links%2Frs%2Fworld_asia-pacific_china%2Ffeed%2F%2Fproduct#axzz2TGvdNkrR).

<sup>64</sup> "Foreign Investment in China Misses Estimates amid Growth Concern," *Bloomberg News*, May 15, 2013. <http://www.bloomberg.com/news/2013-05-16/foreign-investment-in-china-misses-estimates-amid-growth-concern.html>.

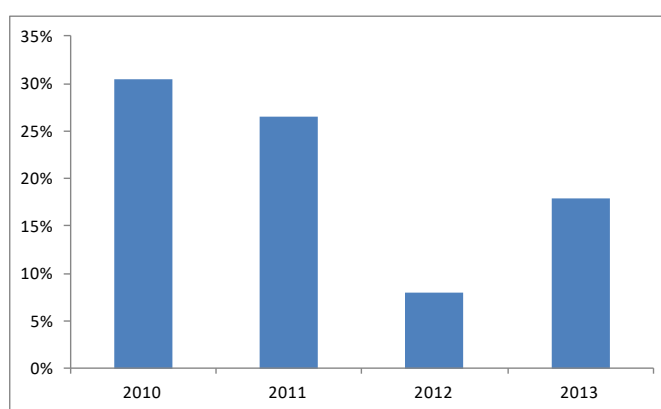
<sup>65</sup> "China Currency Regulator Scrap Some Foreign Investment Rules," *Bloomberg News*, May 11, 2013. <http://www.bloomberg.com/news/2013-05-11/china-currency-regulator-scrap-some-foreign-investment-rules.html>.

which compares business regulations – such as the difficulty of starting a company – in 185 different nations. China ranks just 91<sup>st</sup> out of 185 companies. The *Financial Times* has reported that China wants to eliminate the ranking of countries in the Doing Business report.<sup>66</sup>

### **Questions about Export Data**

An odd trend over the past month is that Chinese export growth has held up despite the weak industrial figures. Exports registered a 14.7 percent year-over-year rise in April.<sup>67</sup> According to a trade value index, monthly growth in China’s exports has averaged much better than last year.

*China’s Trade Value Index: Average Monthly Growth in Exports, January-April*



Source: China General Administration of Customs, via CEIC data.

However, many economists were skeptical of the numbers, pointing to inflated invoicing by some exporters to take advantage of tax rebates and avoid capital controls.<sup>68</sup> China admitted in late April that it had overstated exports in the final months of 2012 by over \$20 billion. Moreover, there were severe discrepancies in China’s export data in the first quarter that aroused suspicions that Chinese companies were using trade deals to evade capital controls and bring cash onshore. The problem of unreliable export data was seemingly confirmed by SAFE, which issued warnings on May 5 to companies that have serious mismatches between declared deal size and actual transactions in goods. If companies are unable to provide satisfactory explanations for the gaps, SAFE will blacklist them and subject them to “strict supervision” until they demonstrate compliance with regulations.<sup>69</sup>

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<sup>66</sup> Robin Harding, “China Seeks to Water Down Key World Bank Report,” *Financial Times*, May 6, 2013. <http://www.ft.com/intl/cms/s/0/a1ca36d2-b654-11e2-b1e5-00144feabdc0.html>.

<sup>67</sup> “Economists Trim China Growth Forecasts,” *Wall Street Journal*, May 14, 2013. <http://online.wsj.com/article/SB10001424127887324031404578482373897417986.html>.

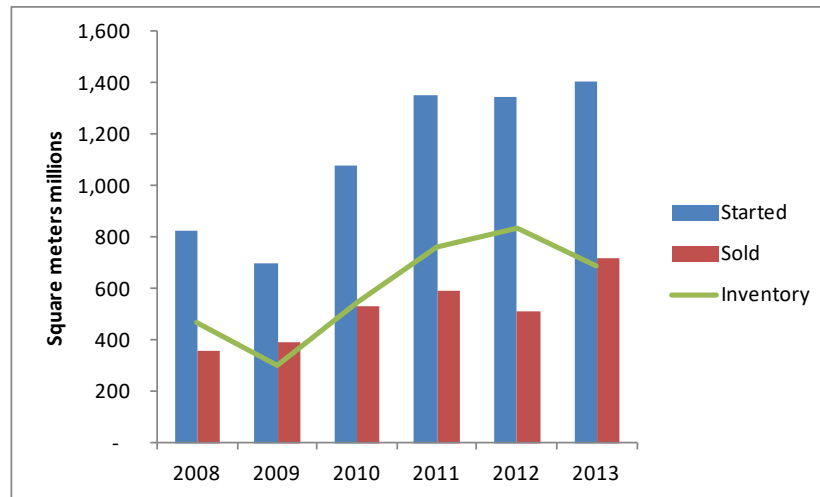
<sup>68</sup> *Ibid.*

<sup>69</sup> Simon Rabinovitch, “China to Crack Down on Faked Export Deals,” *Financial Times*, May 6, 2013. [http://www.ft.com/intl/cms/s/0/5f6501b6-b616-11e2-b1e5-00144feabdc0.html?ftcamp=published\\_links%2Frss%2Fworld\\_asia-pacific\\_china%2Ffeed%2F%2Fproduct#axzz2SWRY52hB](http://www.ft.com/intl/cms/s/0/5f6501b6-b616-11e2-b1e5-00144feabdc0.html?ftcamp=published_links%2Frss%2Fworld_asia-pacific_china%2Ffeed%2F%2Fproduct#axzz2SWRY52hB).

## Liquidity and Debt

The problems with China's export numbers point to broader monetary policy dilemmas. Inflation rose by 0.3 percent in April, and the money supply was 3 percent higher than the government's 2013 target of 13 percent.<sup>70</sup> A key problem is that hot money is once again pouring into China, based on speculation that the renminbi will appreciate.<sup>71</sup> The central bank is keeping interest rates low partly to discourage speculators from pushing even more money into China. But low interest rates have ignited further surges in home prices.<sup>72</sup> Even as new floor space was started, more was sold than last year in the first four months, leading inventory to fall for the first time since 2009. Prices and investment have also rebounded in comparison to 2012.

*China's Real Estate: Residential Floor Space Started and Sold, January-April*



Source: China National Bureau of Statistics, via CEIC data.

<sup>70</sup> Bill Bishop, "As China's Economy Stumbles, Government Eyes Reform," *New York Times*, May 13, 2013. <http://dealbook.nytimes.com/2013/05/13/as-chinas-economy-stumbles-government-eyes-reform/>.

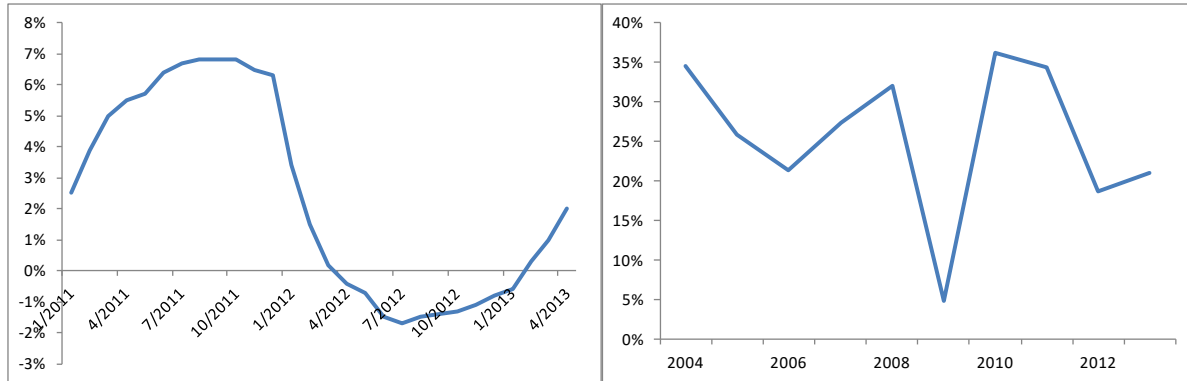
<sup>71</sup> Koh Gui Qing and Kevin Yao, "Risks to China Recovery Seen as Factory Output Underwhelms," *Reuters*, May 13, 2013. <http://www.reuters.com/article/2013/05/13/us-china-economy-output-idUSBRE94C05120130513>.

<sup>72</sup> Keith Bradsher, "China's Central Bank Has Its Own Worries," *New York Times*, May 28, 2013. [http://www.nytimes.com/2013/05/29/business/global/chinas-economic-problems-unlike-those-elsewhere.html?\\_r=0](http://www.nytimes.com/2013/05/29/business/global/chinas-economic-problems-unlike-those-elsewhere.html?_r=0).

## Year-on-Year Growth in China's Real Estate Sector

*Property Prices (2011-2013) (Monthly)*

*Real Estate Investment (2004-2013) (Ytd)*



Source: China National Bureau of Statistics, via CEIC data.

The combination of weak growth and rapid money expansion and housing bubbles present China's policymakers with a difficult dilemma. The PMI will be a wake-up call for officials. Shen Jianguang, an economist with Mizuho Securities, is among those projecting a more expansionary fiscal policy this summer, with tax cuts and more spending. However, the new Chinese leadership seems very concerned about the inflationary impact of more stimulus measures.<sup>73</sup> In mid-May Premier Li ruled out a large government-directed stimulus or investment boom this year, citing the need to "rely on market mechanisms", because government stimulus "is not only difficult to sustain but also creates new problems and risks".<sup>74</sup>

The government has taken a very ambivalent approach to reining in debt. New data released in May showed that bad debt in China climbed to \$86 billion in the three months through March, the longest deterioration streak in at least nine years.<sup>75</sup> The NDRC moved to tighten approval of bond sales with new measures in May. Bond sales have been a leading source of debt accumulation in China.

### **Outbound Investment and Monetary Policy**

Even as China is dealing with large inflows of hot money, its foreign exchange reserves reached a record \$3.44 trillion, the largest in the world. In the face of a rising RMB currency, and low yields on U.S. treasuries, the central bank is under pressure to diversify its holdings into higher-yielding assets.

<sup>73</sup> Simon Rabinovitch, "China Factory Data to Test Political Calculations," *Financial Times*, May 23, 2013. [http://www.ft.com/intl/cms/s/0/a5778004-c34d-11e2-bbbd-00144feab7de.html?ftcamp=published\\_links%2Frss%2Fworld\\_asia-pacific\\_china%2Ffeed%2F%2Fproduct#axzz2U7XicF8v](http://www.ft.com/intl/cms/s/0/a5778004-c34d-11e2-bbbd-00144feab7de.html?ftcamp=published_links%2Frss%2Fworld_asia-pacific_china%2Ffeed%2F%2Fproduct#axzz2U7XicF8v).

<sup>74</sup> "Beijing Signals Concerns at Rising Unemployment," *Financial Times*, May 15, 2013. [http://www.ft.com/intl/cms/s/0/481dd63e-bd66-11e2-a735-00144feab7de.html?ftcamp=published\\_links%2Frss%2Fworld\\_asia-pacific\\_china%2Ffeed%2F%2Fproduct#axzz2TGvdNkrR](http://www.ft.com/intl/cms/s/0/481dd63e-bd66-11e2-a735-00144feab7de.html?ftcamp=published_links%2Frss%2Fworld_asia-pacific_china%2Ffeed%2F%2Fproduct#axzz2TGvdNkrR).

<sup>75</sup> "Block Says China Banks' Bad Loans Spread Beyond Government Debt," *Bloomberg News*, May 20, 2013. <http://www.bloomberg.com/news/2013-05-21/block-says-china-banks-bad-loans-spread-beyond-government-debt.html>.

One option would be to provide more capital to China's official sovereign wealth fund (SWF), the China Investment Corp. However, governance at the fund has been chaotic. As part of China's once-in-a-decade leadership transition, CIC's Chairman of the Board Lou Jiwei and Supervisory Board Chairman Jin Liqun left their posts. As yet, no successor has been named to head the fund. CIC is an anomaly, as Beijing's other top finance jobs – heading up the central bank, China Development Bank and the mainland's "big four" state-owned lenders – were all filled. Sources familiar with the situation have told the *South China Morning Post* that Gao Xiqing, CIC's current number-two, is not being considered for the chairmanship, because he lacks Communist Party credentials. A recent Standing Committee meeting of the Politburo, China's top-level political decision-making body, chaired by President Xi Jinping, failed to reach an agreement on the appointment. The Politburo has also failed to ratify Tu Guangshao, the Vice-Mayor of Shanghai, whom many expected would become the next chairman of CIC.<sup>76</sup>

In lieu of more funding for CIC, it appears that reserves are being channeled to other Chinese investors. SAFE, the arm of the central bank that manages foreign exchange reserves, is making more outbound investments through its subsidiaries. On May 29, two anonymous sources told *Bloomberg* that SAFE was beginning to study the U.S. property market for potential investments. U.S. house prices, according to the Case-Shiller index, have risen by their highest levels since 2007.<sup>77</sup> The real estate investments will likely be made from a New York office newly established by SAFE. SAFE already has a trading desk in New York, which primarily buys U.S. treasuries and equities; in contrast, the new office will make alternative investments in private equity, real estate, and other U.S. assets.<sup>78</sup>

Foreign exchange is also being channeled to China Development Bank, China's largest policy bank. Although the bank was set up to subsidize infrastructure investments in China's most backward regions, it has vastly expanded its dollar-denominated loan portfolio in recent years. In May, it signed a new \$1 billion oil-for-loan deal with India's largest oil company Essar Oil Ltd. CDB has issued several such loans to developing countries since 2007, notably to Venezuela, Russia, and Brazil. Details on the pricing of the products and how shipments would be credited against the loan still need to be worked out. The move evidently supports China's energy security, as Essar works closely with China's national oil companies.<sup>79</sup>

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<sup>76</sup> Chris Wright, "China's CIC: Change of the Guard," *Financial Times*, May 13, 2013. <http://blogs.ft.com/beyond-brics/2013/05/13/chinas-cic-change-of-the-guard/?#>; George Chen, "SCMP: Power Struggle in Beijing Leave CIC Leaderless," *South China Morning Post*, May 27, 2013. [http://www.scmp.com/news/china/article/1246905/power-struggle-beijing-leaves-cic-leaderless?utm\\_source=Sinocism+Newsletter&utm\\_campaign=342b9fadff-Sinocism05\\_28\\_13&utm\\_medium=email&utm\\_term=0\\_171f237867-342b9fadff-24564729](http://www.scmp.com/news/china/article/1246905/power-struggle-beijing-leaves-cic-leaderless?utm_source=Sinocism+Newsletter&utm_campaign=342b9fadff-Sinocism05_28_13&utm_medium=email&utm_term=0_171f237867-342b9fadff-24564729).

<sup>77</sup> "Home Prices See Strong Gains in the First Quarter of 2013 According to the S&P/Case-Shiller Home Price Indices," S&P Down Jones Indices Press Release (May 28, 2013).

<http://www.standardandpoors.com/servlet/BlobServer?blobheadername3=MDT-Type&blobcol=urldocumentfile&blobtable=SPComSecureDocument&blobheadervalue2=inline%3B+filename%3Ddownload.pdf&blobheadername2=Content->

[Disposition&blobheadervalue1=application%2Fpdf&blobkey=id&blobheadername1=content-type&blobwhere=1245352206396&blobheadervalue3=abinary%3B+charset%3DUTF-8&blobnocache=true](http://www.bloomberg.com/news/2013-05-27/china-said-to-study-investing-reserves-in-u-s-property-market.html); "China Said to Study U.S. Property Investments with Reserves," *Bloomberg*, May 27, 2013. <http://www.bloomberg.com/news/2013-05-27/china-said-to-study-investing-reserves-in-u-s-property-market.html>; William Alden, "A Toehold for China on Wall Street," *New York Times*, May 17, 2013. <http://dealbook.nytimes.com/2013/05/17/a-toehold-for-china-on-wall-street/?partner=bloomberg>.

<sup>78</sup> In addition to SAFE, another Chinese investment entity, China Investment Federation, established in office in the Trump Building in Manhattan. The group was started in the summer of 2012 with the aim of helping Chinese investors overcome cultural, political, and logistical hurdles to doing business in the United States. It is sponsored by DKI Capital, a Beijing-based investment firm. "China Is Seeking U.S. Assets," *The Wall Street Journal*, May 20, 2013. <http://online.wsj.com/article/SB20001424127887324787004578494632401290050.html?KEYWORDS=New+York+alternative+investments+China>.

<sup>79</sup> "India's Essar Oil to Sign \$1 Billion Debt-for-Fuel Deal with China," *Reuters*, May 20, 2013.

## **Long-Term Economic Reforms Announced**

In spite of a weak economy, it appears that China's new leadership is moving ahead with economic reforms. On May 24, the State Council announced a series of measures designed by the NDRC, China's planning agency. The measures were deemed "radical stuff" by Stephen Green, a leading China economist at the British bank Standard Chartered. Barry J. Naughton, a professor of Chinese economy at the UC-San Diego, asserted that Premier Li "wants the government to get out of the way" of the economy.<sup>80</sup> Key measures include:

- *Tax reform.* Expansion of the value-added tax, replacing a heavier business tax, especially for services industries. That reform could deliver a total tax cut of nearly \$20 billion to enterprises this year alone, helping to stimulate growth. A property tax, in turn, could help discourage excessive property development. Both of these taxes impinge on local governments, who rely on business taxes and land sales to raise revenue. The State Council also proposed higher taxes on natural resources – based on the value rather than the volume of resources used. That could help clean up the environment and boost local government coffers, but runs counter to the interests of many industrial enterprises.<sup>81</sup>
- *Urban planning reform.* A master plan for urbanization in some small- and midsize cities that would require an overhaul of the household registration, or "hukou" system, which has long prevented rural migrants from becoming official urban residents, and blocking access to local benefits such as health care and public education.<sup>82</sup>
- *Financial sector and currency reform.* Liberalization of China's interest rates, in tandem with a deposit insurance system to protect depositors against defaults by banks which cannot cope with the liberalized rates. These reforms arguably pave the way for opening the capital account and market convertibility of the RMB currency.<sup>83</sup> On May 4, the State Council also put forward a plan for allowing yuan capital-account convertibility as part of measures to loosen control over its currency and interest rates by year's end, without providing further details.<sup>84</sup>

*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](http://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.*

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<sup>80</sup> David Barboza and Chris Buckley, "China Plans to Reduce the State's Role in the Economy," *New York Times*, May 24, 2013. <http://www.nytimes.com/2013/05/25/business/global/beijing-signals-a-shift-on-economic-policy.html?pagewanted=2&r=1&hp>.

<sup>81</sup> Bill Bishop, "As China's Economy Stumbles, Government Eyes Reform," *New York Times*, May 13, 2013. <http://dealbook.nytimes.com/2013/05/13/as-chinas-economy-stumbles-government-eyes-reform/>.

<sup>82</sup> *Ibid.*

<sup>83</sup> *Ibid.*

<sup>84</sup> "China Names Yuan Convertibility Plan as Goal This Year," *Bloomberg News*, May 4, 2013.

<http://www.bloomberg.com/news/2013-05-06/china-names-yuan-convertibility-plan-among-goals-for-this-year.html>.