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Hearing on Countering China’s Trade and Investment Agenda:
Opportunities for American Leadership

My name is Thomas J. Duesterberg, and I am a senior fellow at Hudson Institute in Washington, DC. I have served in various positions in the Congress of the United States and as US assistant secretary of commerce for international economic policy in the George H. W. Bush administration. I have also served as president and CEO of the Manufacturers Alliance for Productivity and Innovation, as a senior fellow at the Aspen Institute, and on the Board of Advisors of the Manufacturing Policy Initiative at the O’Neill School of Public and Environmental Affairs at Indiana University. I would like to acknowledge the research assistance of Abby Fu, also of Hudson Institute. The views expressed in this testimony are mine alone and do not represent Hudson Institute or any other organization or firm.

Overview: The Need to Push Back against Chinese Mercantilism

The United States and many of its allies in recent years have come to better understand that the mercantilism pursued most openly by Xi Jinping since he rose to leadership of the People’s Republic of China (PRC) is undermining their economic prosperity and global leadership. China’s determination to pursue a long-term path toward economic autonomy has been evident since the Chinese Communist Party (CCP) came to power in 1949. Xi has broadened these ambitions to create an alternative economic and political order to challenge the post-war, rules-based system that has been largely successful in terms of economic prosperity and political stability.

Trade policy has been at the forefront of the growing clash between the two systems since China’s entry into the World Trade Organization (WTO). China’s participation in the WTO has greatly accelerated its growth path while undermining the very rules of the liberal economic order on which it is built. It has become increasingly clear under the rule of Xi that China will continue its drive toward economic self-sufficiency and its selective
acceptance of WTO rules. It undermines the WTO by selectively enforcing the WTO bedrock principles of reciprocity, protection of intellectual property (IP), very limited use of state subsidies, and equal treatment of other members. China is effectively trying to decouple from the United States and other developed countries while erecting a zone of like-minded authoritarian countries. In so doing, China is undermining the principles of a rules-based global economic system based on market principles.

As it did so effectively after the global crisis of the 1930s and 1940s, the United States needs to rethink trade and other international economic policies to counter Chinese practices and build new, regionally based alliances of like-minded nations as China pursues its own path toward autarchy. While China tries to build its zone of authoritarian political and autarchic economic actors, the United States should lead other market-oriented actors toward an economic system founded on market orientation, protection of national sovereignty, and of individual freedom. This system should preserve as much of the existing order as is politically feasible with allies to counter Chinese mercantilism.

**Understanding the Realities of the Chinese Economy**

A starting point in better understanding how US policies might best counteract the Chinese challenge is a realistic assessment of the state of its economy and its growth model. While China has compiled an impressive record of economic growth, the pace of its advance and its sustainability have come into doubt in recent years. Glaring weaknesses in its model of growth have been exposed.

Deng Xiaoping’s early success was in building a modern economy from the shambles of Mao Zedong’s failed policies. Deng and his immediate successors deployed classic development tools such as repairing and expanding infrastructure and basic industries like steel and utilities, moving rural populations to cities to work in a budding manufacturing sector, and building housing for an expanding urban population. Low-cost labor propelled a low-cost manufacturing ecosystem that quickly became export-oriented as per capita income was constrained by the need to save for basic services in an economy weak in providing modern services like health care and pensions.

When China became a member of the WTO, foreign markets increasingly came to be a primary source of growth. By the time Xi Jinping became the PRC’s paramount leader, he began to expand the reach of its export markets by starting the Belt and Road Initiative (BRI). While the fast growth period started by Deng relied on a growing private sector, the CCP increasingly became wary of alternative centers of economic power and the civil
institutions of a market economy. Xi responded soon after his ascension to leadership by reinforcing a centralized command and control economy and systematically (and often forcefully) removing powerful company innovators and leaders from their positions.

In the previous five years, the accumulated weaknesses of the Chinese economy, mostly driven by official policies and by the imperatives of the CCP to maintain ironclad control of the state and society, have resulted in slower growth. Just a few weeks ago, the International Monetary Fund lowered its estimates of GDP growth in China to 4-5% for the next five years, far from the high single- and double-digit growth rates of the last 40 years. Growth in 2022 barely reached 3%. Many analysts project even slower growth. The most pressing economic problems on the Chinese agenda are the following: 1 demographic stagnation, with an aging population and declining workforce; an imploding real estate bubble; declining productivity and returns on capital investment; regulatory and disciplinary crackdowns on some of the most dynamic and innovative leaders and industries of the modern economy; high youth unemployment that hovers in the high teens; persistent rural poverty with poor health and education standards; wage gaps between men and women and between rural and urban workers; a deteriorating physical environment; overleveraged national and local government, corporate, and household finances (see figure 1 in the Appendix); and lack of progress in building a modern social safety net.

China’s economic growth has been aided and, in many cases, abetted by Western countries’ investments in production and research firms in China, by forced technology transfers and, in some cases, outright theft of valuable IP, by purchases of foreign technology and natural resources firms, and by research projects and academic exchanges with the United States and other developed countries. As Chinese government and corporate balance sheets have accumulated more and more leverage, the importance of foreign direct investment and portfolio investment, as well as of the issuance of debt denominated in dollars and euros in foreign markets, have become more important to maintaining financial stability and limiting domestic exposure to risk. Between 2016 and 2020 alone, US holdings of Chinese stocks and debt instruments rose from $368 billion to $1.15 trillion. 2 Several hundred Chinese firms with an aggregate market value nearing $2 trillion at their peak have been listed on US stock exchanges.

A few details help explain why the Chinese economy has few levers to achieve the type of growth needed to bring more of its population into the middle class and solve the many

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problems of an underdeveloped social safety net. Average per capita income in urban areas in 2022 was nearly $7,000, while in rural areas it lagged at just under $3,000, far from what is considered middle class. As China industrialized and populations moved into cities, housing growth was imperative to maintaining social cohesion and maintaining strong growth. In the last two decades, according to economist Kenneth Rogoff, housing investment stimulated up to 30% of economic growth and 18% of urban employment in China.³

At the same time, local governments, which are responsible for providing education and health care as well as stimulating industrial production, came to rely on income from the sale of land for housing and industrial development. Income from these projects accounted for up to one-third or more of their revenues (see table 1). The housing boom also led families to put their savings into real estate. Up to three-fourths or more of total household savings went into this sector, which in boom times steadily increased in value and became a source of speculation. Real estate holdings also served as a hedge for spending on retirement and medical emergencies, as the social safety net rarely covered these major life outlays adequately. When real estate prices and construction activity tipped over into negative growth in the last few years, both local government and household finances became endangered.

As the economy slowed under Covid lockdowns and a worldwide recession, Xi and his government tried to stimulate growth through increased consumption. But these efforts have been unsuccessful even after the end of lockdowns due to the need for more precautionary savings. Average growth in per capita consumption slumped from over 6% in 2013 to 2019 to a range of 2 to 2.8% since the onset of Covid and the bursting of the real estate bubble.⁴ Overall household savings rates have returned to more traditional levels hovering around 40% (for comparative purposes, US household savings rarely move above 8%). These developments have removed most of the oxygen from Xi’s efforts to stimulate the economy and reduce China’s dependence on foreign markets by increasing domestic consumption.

The second engine of growth employed by Chinese authorities, especially during the global recession of 2009 and later the Covid crisis, has been massive infrastructure investment. The gradual deterioration of local government finances due to the real estate crises, poor return on investment in state-owned industries, and the increase of debt on local and central government balance sheets have undermined the ability of infrastructure investment to drive

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growth in China. One telling indicator is that the average gain in one unit of GDP required only about two units of capital investment in the first decades of China’s growth spurt, but has now risen to around nine units of capital investment. Such investment inefficiency also contributes to an overall decline in productivity growth.

Figure 2 shows the principal drivers of economic growth in China in recent years. The data show that after Deng’s opening of the economy, the major sources of growth were capital investment, consumption, and net trade, specifically a persistent trade surplus. Chinese goods exports to the United States have grown by over 500% since it entered the WTO (see figure 3). Its mercantilist policies have engineered such a large trade surplus, some 80% of which over time has been with the United States (see table 2). In more recent years, the various problems afflicting the Chinese economy have reduced its ability to rely on consumption spending and investment to produce GDP growth at high levels, although official policy remains directed toward these two tools. Since the Covid crisis, trade surpluses have accounted for 21% to 25% of overall growth; 44% to 59% of that surplus has been with the United States.

China has diversified its export markets in recent decades, largely to Europe and Southeast Asia. It has strategically deployed Xi’s signature BRI to achieve this diversification. The multiple objectives of this program include gaining access to raw materials, such as iron ore, copper, grains, oil, and critical minerals that its economy desperately needs, and building transportation networks to facilitate trade and gain access to ports and military bases for its growing military presence. China has been successful in building new markets for its surplus manufacturing and construction industries. The BRI helped double its trade surplus with Europe and facilitated its capture of critical mineral mining in Africa, South Asia, and Latin America. A recent study of seven prominent BRI partners in the developing world shows a strong correlation between BRI investments and increasing Chinese trade surpluses with recipient countries. China now has a trade surplus with Africa approaching $40-50 billion each year despite also purchasing large amounts of oil and minerals from that continent.6

Policy Tools to Counter and Deter Chinese Mercantilism

The depth and political importance of the “economic cracks in the Great Wall of China” should not be underestimated in thinking about US policy responses. Political dissent is rigorously suppressed in China, but forms of unrest have appeared with some frequency in recent years: Xi was forced to back down on his zero-Covid policy by popular- and elite-level pushback; mortgage holders of unfinished housing units in major cities went on strike for repayments and forced some changes in payment terms; and workers at Foxconn’s massive Apple plant rioted over harsh working conditions. Further discontent is likely as local governments’ budgets suffer, municipal workers in some cities go unpaid for months, and cities reduce subventions for medical and pension insurance. A more digitally connected population is closely monitoring how Xi increasingly privileges CCP leaders and state-owned enterprises (SOEs) that crowd out capital available for private companies, is indifferent to youth unemployment and rural welfare, and cannot stop the unfolding economic slowdown.

US trade and investment policies in recent years to combat Chinese violations of WTO commitments—as well as US criticism of China’s environmental, human rights policies, and exploitative investment and credit practices (both internally in regions like Xinjiang and Tibet and externally through the BRI)—have gotten the attention of Chinese leadership and provoked both bellicose rhetoric and “charm offensives.” The United States has had some success in winning allies for its various trade and human rights actions, and surveys of public opinion around the world show some weakening of China’s prestige and “soft power.” In short, aggressive use of policy tools can have an impact on the Chinese economy and Beijing’s politics.

Enforcement of WTO Obligations and Deployment of US Unilateral Trade Instruments

Because of the importance of external trade, especially with the United States, to growth and the acquisition of modern technology, the United States should continue to bring cases to the WTO, such as antidumping and countervailing duty actions and challenges to Intellectual Property Protection (IP) violations and impairment of most favored nation (MFN) benefits. Due to its lengthy procedures and the rights of member countries accused of violations, it is unrealistic to expect much change in behavior by China due to these actions. But if like-minded allies can be convinced to cooperate, then efforts will sometimes be successful and can at least shine a light on China’s mercantilist practices and outright violation of its commitments. Attention should be paid to rules on the reporting of subsidies.

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and to prohibited export controls. China has demonstrated its willingness to use export controls in the case of rare earths, and the US and its allies did secure a decision in the WTO to sanction this practice. Eventually, Beijing decided to lift the prohibition. But China’s capture of rare earths and other critical minerals required for green technologies (see table 3) and its even greater dominance of the processing and production of these goods suggest that vigilance with allies, and indeed joint efforts to create alternative supply chains, are increasingly important. The United States should also work with allies to demand that China renounce its self-determination as a developing country under WTO rules.

The Trump administration relied on the use of Section 301, its national security authority, and other unilateral trade tools to combat Chinese practices not well covered by existing WTO rules and enforcement. Reform of the WTO in areas like industrial subsidies is no longer a realistic objective due to the obdurate opposition of China and some of its allies. But the United States ought at least to continue the trilateral dialogue with the European Union and Japan to continue to draw attention to this and other weaknesses in the WTO so that broader support against Chinese practices might develop in the medium to longer term.

Given the relative weakness of the WTO system, continued use of US trade law is warranted. Even though China failed in significant ways to honor its commitments in the Phase One trade agreement, this initiative had some impact on Chinese exports to the United States and focused global attention on the many ways in which China fails to honor its trade and economic commitments to a rules-based system.

Reciprocity Principle

One bedrock principle of the global trading system in its modern form is reciprocity, and this concept ought to be employed to combat the highly advantageous Chinese use of protecting its own markets from foreign competition as it builds up its technologies and scale advantages by tapping its huge internal market. For example, China failed to honor its commitment under its WTO accession agreement to open its financial markets, delaying such an opening by 20 years or more to allow its domestic firms to develop new digital payment tools and other service offerings at a scale that eventually provided advantages of efficiency and size. At the same time, the United States has allowed the WeChat payment service to gain a foothold in its domestic market. The digital social and ecommerce platforms created in China and exported to the United States in recent years—such as TikTok and the Amazon competitors Alibaba, Shein, and CapCut—enjoyed the same early-mover advantage in China’s closed domestic market. This advantage facilitated its success in the open US market, causing economic and political damage to US interests. Chinese
digital companies such as TikTok and WeChat also collect enormous amounts of personal information that is valuable for artificial intelligence development, and they serve as news outlets for their American users. About 25% of all Americans have TikTok on their phones, and 25% of young Americans list TikTok as their primary source of news. This provides leverage for the Chinese owners who must answer to the CCP whenever it asks for data or the censorship of news. All of these Chinese digital platforms ought to be banned unilaterally (if allies do not join the effort) on national security grounds and on the basis of the simple concept of reciprocity.

Regional Trade Agreements

Because of the singular determination of Xi and the CCP to avoid any economic or technological dependence on the United States or its allies, and because of the PRC’s efforts to build dependence on its own emerging economic sphere, the United States should be more assertive in building regional agreements, which in most instances are allowed by the WTO. During the last two administrations, attention to building new agreements has weakened considerably, as symbolized by the bipartisan rejection of the Trans-Pacific Partnership (TPP) since 2016. As a result, the United States is losing market share in East and Southeast Asia in trade sectors like agriculture because the TPP’s successor, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), set up a favorable tariff regime for its members.

The path set out by Xi for as much autonomy as possible will not change in the foreseeable future, so the United States will need to support regional arrangements such as the CPTPP and perhaps some expansion of the United States–Mexico–Canada Agreement (USMCA) in the future. My fellow panelist Mr. Goodman has clarified some of the flaws in the CPTPP, especially related to IP protection. But with the entry of the United Kingdom into this agreement and the attempt of China to build out a competitive regional agreement or even join the CPTPP, the United States needs to show Southeast Asian and Pacific Rim nations that it is willing to renew its commitment to more open trade than it has exhibited in recent years, including in the ongoing Indo-Pacific Economic Framework (IPEF) talks. Without this commitment, the economic attraction of the huge Chinese market and Xi’s coercive policies will make it difficult for nearby economies to avoid.

On the other hand, weakening the Chinese export-oriented growth model would be facilitated by the US joining the CPTPP after working with key allies like Japan, Australia,
and the UK to address its weaknesses. The CPTPP has the added advantage of strong disciplines on state subsidies and a state-of-the-art digital economy that could be models for further expansion of a market-oriented trade area.

*Investment Tools*

The United States should also consider more vigorous efforts to discourage or prohibit investments in Chinese firms and markets where China does not abide by global trade, human rights, or environmental standards, and in which the firms produce technologies such as military or surveillance products that raise national security concerns. Increasingly in the age of digital technologies where a civil-military dichotomy is no longer viable, the scope of investment scrutiny has necessarily expanded. US policymakers also need to enact a program to examine—and where necessary block—outward-bound investments that compromise national security, as Senators Bob Casey and John Cornyn have promoted for several years. This could be done by executive action or, to lend it more weight and shield it from overzealous legal authorities, by new statutory authorities. In any case, policymakers should be prudent in limiting the scope of coverage to technologies that are clearly necessary to protect national security. Any new program should also cover basic research investments in China (or other adversary states) that develop technologies of national security concern.

In a broader sense, it is important to ensure that US investors are protected from fraudulent or opaque Chinese equity or bond issuers in the same ways investors are protected by transparent disclosure and auditing requirements for securities issued by US or other developed world firms. The Holding Foreign Companies Accountable Act signed into law in December 2020 should be rigorously enforced, and requirements for making reports by Chinese firms or bonds listed on US exchanges should be subject to the same accounting standards as those of US firms or bond issuers.

Additionally, as many pension funds, exchange-traded and mutual funds (including the Thrift Savings Plan, or TSP), and bond funds are including Chinese securities in their portfolios, it is important to require transparency regarding the Chinese firms included in them. At a minimum, transparency reporting ought to include verifiable information regarding the industries and their major suppliers of firms in these funds. Such transparency should clarify if any Chinese firms in the portfolios are linked to the military, the national surveillance state apparatus, or human rights–abusing firms such as the many identified in
Legislation offered by Senators Marco Rubio, Maggie Hassan, and Tommy Tuberville in the last two Congresses would prohibit the TSP from including the shares of Chinese firms implicated in these abuses or industries. President Joe Biden has appointed TSP board members who pledged to prohibit such investments. Congress ought to consider broadening this transparency requirement for all pension and mutual funds.

Currency Manipulation

In the Bush 41 and early Clinton administrations, the US Treasury designated China as a currency manipulator under the authority of the Trade Act of 1988. This action had no real implications except requesting consultations and drawing attention to this unfair trade practice. Since that time, China has consistently employed the “unfair currency practices” behind this designation without a firm response from the United States and its allies. China uses this tool partly to maintain its trade advantages and partly to lend some legitimacy to the renminbi as a stable currency. The latter goal presumably has the effect of boosting confidence among traders and investors both inside and outside China to hold the Chinese currency. The Xi regime is trying to increase the renminbi’s role in trade transactions and in global holdings of foreign exchange reserves, which would require considerable confidence in the financial world in the stability of the currency. Such confidence is always in question since China steadfastly refuses to make the currency fully convertible.

In recent years, both the Trump and Biden administrations have refrained from labeling China as a currency manipulator, even though countries like Switzerland and India have received this designation. Given the fact that China increasingly relies on foreign investment, while at the same time refusing to make the currency convertible, returning it to the list of manipulators would help at least to raise questions about the longer-term stability and value of the currency, and weaken resolve to hold it or to use it in trade finance.

A large majority of Chinese foreign exchange transactions are conducted through banks in Hong Kong. Because of the destruction of Chinese democracy and growing evidence of massive money laundering of drug or other illicit trade transactions likely implicating the financial sector, both open and in the shadows through shadowy money transfer operations, Chinese democracy advocates have urged the sanctioning of the financial sector in Hong Kong.

Kong. Hong Kong-based financial institutions, including Hong Kong Shanghai Bank (HSBC) and Fidelity have, on the orders of Beijing, frozen the pension assets held in trust by these institutions by more than 90,000 residents who have moved to the UK after the Chinese crackdown on democracy in Hong Kong.10

Growing evidence reveals the involvement of Chinese chemical suppliers and illicit money launderers operating in Mexico, the United States, and Europe who facilitate the repatriation of the billions of dollars of fentanyl and other drug sales in the transatlantic sphere. Massive money laundering schemes are also used to avoid capital export restrictions for wealthy Chinese. My Hudson colleagues Nate Sibley, director of Hudson’s Kleptocracy Initiative, and David Asher have advocated for a broader application of sanctions to the entire Chinese financial sector. These and other advocates have noted that Section 311 of the USA Patriot Act of 2001 allows the US Treasury to identify foreign banks, companies, or even entire countries as “primary money launderers.”11 The Corporate Transparency Act could also be invoked to place Hong Kong or Chinese intermediaries for money laundering on sanction lists.

Cutting off Beijing’s window to the Western financial world or more simply calling into question the stability and legitimacy of the renminbi would have grievous consequences for China’s ability to access Western capital and maintain enough confidence in that currency to allow its expanded use.

Development Finance

As a final suggestion, the United States ought to address the growing debt crisis in the developing world, which is largely linked to China’s development loans and investments.12 China’s assistance and BRI projects almost invariably are in repayable and collateralized debt at interest rates approaching or mirroring market rates, as opposed to the lower-than-market-rate loans and outright grants typical of Western development assistance. The Chinese assistance all too frequently saddles recipients with inefficient projects whose

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10 Primrose Riordan, “Hong Kong emigrants to UK blocked from addressing 2,2 bn (pounds) in pension,” Financial Times. April 11, 2023.
returns are unable to cover loan repayments. China’s assistance is indifferent to the nature of the regime it works with, often serving to support authoritarian regimes and often abetting or creating corruption. China refuses to participate in Paris Club debt restructuring and often demands World Bank or International Monetary Fund bailouts to bankrupt countries, which in effect implicates those institutions in partially subsidizing repayment to Chinese banks or development agencies. The United States should work with allies to demand China’s participation in the Paris Club restructuring process, and even to invoke the legal concept of “odious debt” to nullify debts owed to corrupt borrowers.

All of these financial and investment measures would compromise the ability of China to rely on developed world financing of its own industries or to exploit developing world economies for its own benefit. Such policies would further weaken the Chinese growth model, which will eventually get the attention of Xi Jinping and other Chinese leaders.
Appendix

Figure 1.

China's Debt as Percent of GDP, by Category
1996 - 2022

Source: Institute of International Finance, IMF.
Note: IMF’s augmented debt estimates expands parameter of government debt to include government-guided funds and the activity of local government financing vehicles.
**Table 1.**

<table>
<thead>
<tr>
<th>China’s Total Local Government Revenue (Government Managed Funds + General Public Budget Revenue)</th>
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<tbody>
<tr>
<td>(Percent of Total Revenue)</td>
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<tr>
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<tr>
<td>Land Use Related Revenue</td>
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<td>Land-Related Taxes</td>
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<tr>
<td>Other Local Taxes</td>
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<tr>
<td>Transfers from Central Government Funds/Central Government</td>
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<tr>
<td>Local Government Special Debt Revenue</td>
</tr>
<tr>
<td>All Others</td>
</tr>
</tbody>
</table>

*Source: PRC Ministry of Finance.*

**Figure 2.**

*Chinese GDP contributions*

*Percentage point contribution to annual growth*

*Source: Refinitiv Datastream / Fathom Consulting*
Figure 3.

Table 2.

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</thead>
<tbody>
<tr>
<td>% of China's Total Exports Going to US</td>
<td>21%</td>
<td>20%</td>
<td>20%</td>
<td>21%</td>
<td>22%</td>
<td>22%</td>
<td>22%</td>
<td>18%</td>
<td>17%</td>
<td>15%</td>
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</tr>
<tr>
<td>% of US's Total Exports Going to China</td>
<td>7%</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
<td>7%</td>
<td>7%</td>
<td>9%</td>
<td>9%</td>
<td>7%</td>
</tr>
<tr>
<td>% of China's Total Trade Surplus with the US</td>
<td>137%</td>
<td>123%</td>
<td>90%</td>
<td>62%</td>
<td>68%</td>
<td>89%</td>
<td>119%</td>
<td>81%</td>
<td>59%</td>
<td>53%</td>
<td>44%</td>
</tr>
<tr>
<td>% of US's Total Trade Deficit with China</td>
<td>42%</td>
<td>46%</td>
<td>46%</td>
<td>48%</td>
<td>46%</td>
<td>47%</td>
<td>47%</td>
<td>40%</td>
<td>34%</td>
<td>32%</td>
<td>32%</td>
</tr>
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Source: U.S. BEA, PRC GACC.
Table 3.

<table>
<thead>
<tr>
<th></th>
<th>% of Global Production</th>
<th>% of US Import</th>
<th>% of EU Import</th>
</tr>
</thead>
<tbody>
<tr>
<td>Solar Panels</td>
<td>80%</td>
<td>63% *</td>
<td>75%</td>
</tr>
<tr>
<td>Wind Turbines</td>
<td>58%</td>
<td>14% **</td>
<td>84%</td>
</tr>
<tr>
<td>Rare Earths</td>
<td>60%</td>
<td>78%</td>
<td>98%</td>
</tr>
<tr>
<td>Lithium-Ion Batteries</td>
<td>79%</td>
<td>80%</td>
<td>68%</td>
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* This includes imports from China, Malaysia, Vietnam, Singapore and Taiwan.

** 7 or 8 of the top 10 wind turbine manufacturers are Chinese.