

# Trade and Surpluses

MANAGING CHINA'S ADVANTAGE

## CHINA BALANCE SHEET

WWW.CSIS.ORG/CHINABALANCESHEET

## Background

- China's current account surplus in 2008 was approximately 10 percent of its GDP, compared to less than 2 percent of GDP in 2001 and 2002. Its estimated global surplus in 2008 was \$450 billion. After years of trade surpluses, China's stockpile of foreign currency reserves now exceeds \$1.9 trillion. About two-thirds of these reserves are estimated to be in U.S. government and agency securities and other U.S. investments. China's surpluses, the world's largest, are unprecedented for a major trading country and place significant pressure on the global economy.
- China has run a trade surplus with the United States since the late 1980s. These surpluses increased steadily in the 1990s, and in 2003, China became the largest single source of the U.S. global deficit. In 2007, the United States imported \$321 worth of goods from China, nearly five times the value of its exports. The resulting bilateral trade deficit with China of \$256 billion in 2007 amounted to more than a fourth of its total global imbalance. In 2008, U.S. exports to China grew twice as fast as imports from China. But given the large initial imbalance in bilateral trade flows, the bilateral U.S. deficit with China rose slightly.
- The surpluses result from competitive trade advantages of the Chinese economy. These include its low-wage structure, though that is rapidly eroding; its heavy investments in the export sector; China's high savings rate and low level of domestic consumption; and China's increasing role as the point of final assembly for manufactured goods. A major factor in the trade imbalance is, of course, the low savings and high consumption rate in the United States.
- But another major factor has been China's muscular intervention in the foreign exchange markets to prevent the appreciation of its currency. The Chinese currency has risen by 20 percent against the dollar over the past three years, but it has recently been buying as much as \$50 billion monthly in the currency markets to keep the rate from rising to an equilibrium level, which would be considerably higher (probably 25–30 percent). This "manipulation" has led to widespread criticism from its trading partners, especially the United States, and a perception that China's practices are unfair and inconsistent with global rules.

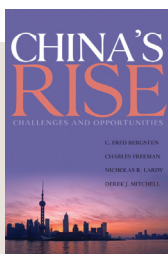
## Current Situation

- Trade accounts for more than twice as much of China's economy as it does for the United States or the European Union as a group. China's trade barriers, though some still remain, are by far the lowest of any of the large developing countries. China has a very open economy by any international standard.
- China's advantage as a low-wage manufacturing power is considerable but not as great as one might suppose. Chinese workers earn only about one-thirtieth of what is earned by their American counterparts. But Chinese productivity is also only about one-thirtieth that of the United States. Moreover, wages account for only 5 percent of the total cost of producing semiconductors and no more than 20 percent of the costs for apparel. And these wages are rising rapidly, so China is now losing market share to Asian competitors such as Vietnam and Bangladesh. More broadly, many developing countries have lower wages than China but are not large exporters.

### Current Situation

(continued)

- A major reason for China's growing bilateral surplus with the United States is that it has emerged as the final assembler of goods made in a production chain that extends throughout Asia and even to the United States. Other countries, marshalling their own competitive advantages, make parts for a broad range of goods that are then assembled in China by its large pool of unskilled workers. The import of these goods is calculated as coming from China even though large parts of these goods are made elsewhere (including the United States).
- China's rise as the point of final assembly has led to a decline over the past two decades in the share of the U.S. bilateral trade imbalance originating with other Asian countries (especially Hong Kong, Taiwan, Korea, and Japan). As these countries have moved manufacturing capacity to China, the share of the U.S. trade deficit that they account for fell from more than 50 percent in 1985 to only 17 percent in 2006.
- Under pressure from the United States and the International Monetary Fund (IMF), China has permitted its currency, the renminbi, to appreciate by 20 percent against the dollar since July 2005. On a trade-weighted basis, China's currency has now appreciated by about the same amount. China has the right to peg its currency under IMF rules, but its large-scale interventions in recent years violate international norms. By manipulating the value of its currency and making the cost of its exports artificially cheap to foreign purchasers, and the price of its imports artificially high, China's currency actions have substantially enhanced its competitive position and led to criticism and pressures for direct retaliation in the United States, Europe, and many developing countries. Underlying China's recalcitrance and rebuffs to the IMF on currency is an implicit threat that China might promote the creation of an Asian Monetary Fund as a rival to the IMF.
- China has undermined the international trading system in other respects. In July 2008, China rejected a compromise proposed for the international trade negotiations in the World Trade Organization (WTO) under the Doha Round. Its action was not the only reason for the failure of the talks. The United States, Europe, and India were among those who took a recalcitrant negotiating position. But China's rebuff was a decisive factor imperiling the future viability of the WTO system. In addition, China has preferred to reach modest, politically motivated bilateral and regional trade arrangements rather than more economically beneficial multilateral liberalization through the WTO. Its "free-trade agreement" with the Association of Southeast Asian Nations (ASEAN) in 2002 was an effort to gain a marginal trade advantage while assuaging its neighbors' fears of being swamped by Chinese goods. In addition, by declaring itself a "developing country," China has avoided the implementation of various WTO rules, further straining the global economic regime.
- In addition to jeopardizing the WTO system directly, China's trade policy could lead indirectly to the creation of an Asian trading bloc or other preferential trade arrangements advantaging China but leaving many other countries outside. A network of bilateral and multilateral trade accords has already started to expand in the region. In light of the failure of the Doha Round, there is a risk that these arrangements could evolve into an East Asian free-trade area led by China in the next decade, possibly spurring a backlash in the United States and Europe. China opposes the United States' proposal for an Asia-Pacific preferential trade accord, stirring concern that it wants to draw a line on trade down the middle of the Pacific. China's apparent pursuit of a multipolar world challenging the power of the United States threatens to accelerate the deterioration of today's global system.



FOR FURTHER INFORMATION:

SEE CHAPTER 1: "CHINA'S CHALLENGE TO THE GLOBAL ECONOMIC ORDER" IN

*CHINA'S RISE: CHALLENGES AND OPPORTUNITIES*

BY C. FRED BERGSTEN, CHARLES FREEMAN, NICHOLAS LARDY, DEREK J. MITCHELL &

CHAPTER 4: "CHINA AND THE WORLD ECONOMY: OPPORTUNITY OR THREAT?" IN

*CHINA: THE BALANCE SHEET: WHAT THE WORLD NEEDS TO KNOW ABOUT THE EMERGING SUPERPOWER* BY

C. FRED BERGSTEN, BATES GILL, NICHOLAS LARDY, DEREK J. MITCHELL