

WebMemo



Published by The Heritage Foundation

No. 2292
February 13, 2009

Secretary Clinton's Asia Trip: Imbalances in the U.S.–China Economic Relationship

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There is new and important context to Secretary of State Hillary Clinton's trip to Asia next week. New data make it clear that the huge imbalances in the U.S.–China economic relationship are likely to persist; they may even expand. With an agitated Congress and an Administration with an unsteady position on open trade, this is a dangerous development for bilateral economic relations.

No Sign of Improvement. The trade deficit the U.S. runs with China was just over \$266 billion last year, a modest \$10 billion more than in 2007. The deficit in the fourth quarter last year was \$3 billion more than the fourth quarter of 2007. The December 2008 deficit expanded by \$1 billion over the December 2007 deficit. The financial crisis slowed the growth of the Sino–American trade gap—it did not reverse or stop it.

Last year, American imports from China stood at almost \$338 billion, 5 percent more than 2007. Exports to China were \$71.5 billion, an almost 10 percent increase. This is another unpleasant reminder that American exports must greatly outpace imports for the deficit to ever shrink.

Perhaps equally unpleasant is the composition of bilateral trade. The mainstays of American imports—cell phones, assembled computers, and various clothing—lagged. (See Table 1.) Instead, the biggest absolute increment, at \$2.4 billion, is found in iron and steel. This immediately makes the “Buy American” provisions adopted by Congress more sensitive.

Main U.S. Imports in 2008

Item	Value, in Billions	Change from 2007
Telecom, chiefly cell phones	\$53.7	+3.7%
Office machines, chiefly computers	\$47.3	Flat
Clothing and footwear	\$41.7	+1.0%
Total for all goods	\$337.8	+5.1%

Source: “Foreign Trade Statistics,” U.S. Census Bureau, February 11, 2009 at <http://www.census.gov/foreign-trade/www> (February 13, 2009).

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On the export side, half of the American gains were accounted for by soybeans, the top U.S. export in 2008. (See Table 2.) It is very unlikely that kind of performance can be repeated. On the other hand, the top American export in 2007—commercial aircraft and related parts—saw a 30 percent decline in value. In light of the economic crunch, Beijing has understandably asked national carriers to delay aircraft purchases, so 2009 will see no improvement in that area.¹

Painful Reality. What is less understandable is Beijing's drive—whether deliberate or uncon-

This paper, in its entirety, can be found at:
www.heritage.org/Research/AsiaandthePacific/wm2292.fgm

Produced by the Asian Studies Center

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
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Main U.S. Exports in 2008

Item	Value, in Billions	Change from 2007
Soybeans	\$7.31	+77%
Advanced devices such as semiconductors	\$6.49	Flat
Metal ores and scraps	\$6.33	-3.1%
Total for all goods	\$71.5	+9.6%

Source: "Foreign Trade Statistics," U.S. Census Bureau, February 11, 2009 at <http://www.census.gov/foreign-trade/www/> (February 13, 2009).

Table 2 • WM 2292  heritage.org

scious—to expand its trade surplus. When the financial crisis erupted, there were wild claims that the PRC would somehow be immune from the effects of the meltdown. Then, more reasonable calls emerged for China to at least play a constructive role in the global response.² That role boiled down to increasing imports, thereby replacing lost global demand with supposedly robust Chinese consumption—a scenario that was dubious at best.³

The actual results have borne out the most hardened skeptics' worst fears. In August, the last month prior to the crisis becoming acute, China ran a then-record aggregate surplus of close to \$29 billion. That increased slightly in September, jumped with the full impact of the crisis in October, and since then has stayed at astronomical levels. (See Table 3.)

Over the past six months, China ran the largest six monthly trade surpluses in world history. These

surpluses have totaled a stunning \$211 billion. That is \$211 billion that has been extracted from global GDP and added to Chinese GDP, exactly the opposite of the assistance—much less leadership—many hoped China would provide.⁴

Going the Wrong Way. The situation may get worse. In moving to stimulate its economy, the PRC has more fully embraced harmful policies it clung to for a decade,⁵ including round after round of export support⁶ and an explosion in bank lending. In January, Chinese banks made close to \$240 billion in new loans, one-third of the ostensible target for 2009.⁷ The state owns essentially all of the formal banking system, and the large majority of loans are to state-controlled firms.

China's Reported Surpluses

Month	Amount, in Billions
August 2008	\$28.7
September 2008	\$29.3
October 2008	\$35.2
November 2008	\$40.1
December 2008	\$39.0
January 2009	\$39.1

Sources: "China Monthly Statistics," National Bureau of Statistics of China, February 13, 2009, at <http://www.stats.gov.cn/eNgliSH/statisticaldata/#> (February 13, 2009); Kevin Hamlin, "China's Imports, Exports Plunge on Global Recession (Update)," Bloomberg, February 11, 2009, at <http://www.bloomberg.com/apps/news?pid=20601068&sid=axZw6OyPaZY&refer=home> (February 13, 2009).

Table 3 • WM 2292  heritage.org

1. Bloomberg News, "China Encourages Nation's Airlines to Cancel, Delay Jet Orders," *The Seattle Times*, December 10, 2008, at http://seattletimes.nwsourc.com/html/business/technology/2008488576_airline100.html (February 13, 2009).
2. Malcolm Moore, "Financial Crisis: China Comes Hesitantly to the Rescue," *Telegraph*, October 11, 2008, at <http://www.telegraph.co.uk/finance/financetopics/financialcrisis/3180158/Financial-crisis-China-comes-hesitantly-to-the-rescue.html> (February 13, 2009).
3. Derek Scissors, "China's Stimulus Plan: Repackaged and Misdirected," Heritage Foundation *WebMemo* No. 2128, November 10, 2008, at <http://www.heritage.org/Research/AsiaandthePacific/wm2128.cfm>.
4. Simple claims that China contributes heavily to global growth overlook how trade is entered in GDP. Combining each country's growth weighted by their economic size is misleading. A trade surplus adds to GDP while a deficit subtracts. In GDP accounting, a major portion of Chinese growth is thus at the expense of the rest of the world, not in contribution to it. It is in terms of true economic welfare that China contributes greatly, through expanding the supply of goods and increasing efficiency.
5. Derek Scissors, "U.S.–China Economic Dialogue: In Need of Tough Love," Heritage Foundation *Backgrounder* No. 2200, October 21, 2008, at <http://www.heritage.org/Research/AsiaandthePacific/bg2200.cfm>.

Also in January, money supply measures representing consumer spending slowed. At the end of December, personal savings were expanding at a 25 percent annual clip.⁸ Firms now have much more money with which to produce goods, but consumers are not devoting much more money to buying them. The likely outcome is oversupply, which plagued the PRC for years after the Asian financial crisis.

The internal results of that crisis and bout of oversupply were deflation and shackled growth. The external result was broad introduction of bank-subsidized Chinese products to the American market. East Asian markets were shattered, but low-cost Chinese goods were welcome in a U.S. economy growing fast enough to spur inflation. From 1996 to 2000, China's trade surplus with the U.S. more than doubled, and the nature of the Sino-American economic relationship fundamentally changed.

It seems inconceivable that Chinese trade surpluses could move higher than they have been the past six months. But the PRC—sticking to what has worked for them in the past—is creating conditions for exactly that.

The Burden Is on Washington. The burden is on Washington to make better choices than Beijing has. The U.S. cannot simply block Chinese goods, as the mammoth quantity of diverted products would cause the E.U. and the rest of the world to raise trade barriers in response. These actions would partly recreate the calamitous effect of

Smoot–Hawley in 1930 and bring the U.S. closer to a true depression. Alternately, a more expensive *renminbi* would not have the impact Congress desires. The volume of loans being offered to state-owned manufacturers would overwhelm the impact of a pricier currency.

The bank bailout, fiscal stimulus, and (worst) Buy American put the U.S. on weak ground to call for liberalization. There is a way forward, though the path is narrow. President Obama has the option to strike the Buy American provisions from the stimulus package as not in the national interest. Secretary of State Clinton can communicate this intent in her upcoming visit to Beijing. At the same time, she should also be frank: Without very strong, properly directed action from China, congressional pressure will become overwhelming.

That action will be difficult for the PRC. The mass subsidization of exports by state banks must quickly be curbed, and negotiations for market access beyond WTO terms (for example, the 25 percent tariff and licensing barriers to foreign cars) must begin in earnest when the Administration's international economic team is finally in place. Such steps will certainly not erase the trade imbalance but will keep it at a tolerable level. Otherwise, China will continue toward provoking sharp and dangerous American trade action.

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6. For example, see “China Raises Garment, Textile Export Tax Rebate Rate to 15%,” *China View*, February 4, 2009, at http://news.xinhuanet.com/english/2009-02/04/content_10763463.htm (February 13, 2009); Ministry of Commerce, The People's Republic of China, “China Export Tax Rebate Net Widened,” January 4, 2009, at <http://english.mofcom.gov.cn/aarticle/counselorsreport/americaandocceanreport/200901/20090105987617.html> (February 13, 2009).
7. Xinhua, “China's Credit Extension up 103.6% in Jan,” *China Daily*, February 12, 2009, at http://www.chinadaily.com.cn/bizchina/2009-02/12/content_7469926.htm (February 13, 2009).
8. Press release, “Money and Credit Recorded Rational Growth and Financial System Performed Stably,” the People's Bank of China, January 13, 2009, at <http://www.pbc.gov.cn/english/detail.asp?col=6400&id=1245> (February 13, 2009).