China and the US Trade Deficit: Who Gains from a Rise in the Yuan?

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China’s Trade

Growth in merchandise trade surplus

- Rose to $262 billion in 2007 – 11% of GDP

- Some appreciation of yuan against $ – 14% since July 2005
China - US Trade

- U.S. bilateral trade deficit with China running at over $230 billion
- Accounts for almost a third of total US trade deficit
- Members of Congress argue this is due to Chinese manipulation of its currency
- However, revaluation of yuan would probably benefit China more than US
China’s Economic Growth

- China has grown at 10% a year in real terms since 1978
- Currently world’s 4th largest economy, and 3rd largest trader
- Concern among Chinese leadership that growth path is unsustainable
- Outsiders argue it is contributing to global economic imbalances
China’s Economic Growth

The real export shock
Chinese exports, % of GDP

Headline exports-to-GDP ratio

Net exports
Government spending
Investment
Consumption

Breakdown of China’s GDP growth Percentage points

Sources: UBS; Standard Chartered
*Value-added share of manufactured exports
† Estimate

20%
40%
9%
31%
China’s Economic Growth

- China’s growth has largely been driven by investment not exports
- High total savings – 42% of GDP, households (16%), firms (20%), government (6%)
- Chinese consumption very low by international standards
# China’s Low Consumption

## Hey, small spender!

<table>
<thead>
<tr>
<th>Country</th>
<th>Private consumption as % of GDP 2006</th>
<th>China’s private consumption and wages as % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>0</td>
<td>55</td>
</tr>
<tr>
<td>Britain</td>
<td>10</td>
<td>50</td>
</tr>
<tr>
<td>Australia</td>
<td>20</td>
<td>45</td>
</tr>
<tr>
<td>Italy</td>
<td>30</td>
<td>40</td>
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<tr>
<td>Germany</td>
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<tr>
<td>India</td>
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<tr>
<td>Japan</td>
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<tr>
<td>France</td>
<td>70</td>
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<tr>
<td>South Korea</td>
<td>0</td>
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<tr>
<td>Singapore</td>
<td>10</td>
<td></td>
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<tr>
<td>China</td>
<td>20</td>
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</tbody>
</table>

Sources: CEIC; OECD; World Bank; The Economist estimates
Why Rebalance China’s Growth?

- Low productivity of investment
- Depressed wages
- Income inequality
- Regional inequality
- Environmental harm
How to Rebalance?

◊ Reduce investment

◊ Fiscal policy to reduce precautionary savings and raise consumption:
  - provision of health care, education
  - universal pension coverage

◊ Adopt flexible exchange rate regime
  - import more/export less
  - better able to set interest rates
China’s Exchange Rate

Many observers argue yuan is significantly undervalued:
- no improvement in trade balance
- China’s foreign exchange reserves continue to grow - $1.43 trillion
- “sterilizes” inflows by printing yuan, buying up $, and selling low-yielding government bonds
China's Exchange Rate

- China allowing faster appreciation – 13% a year
- Increasing inflation – especially imported food/raw materials
- Increasing cost of maintaining yuan due to higher relative yields in China
## US and China’s Currency

<table>
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<tr>
<th></th>
<th>1985</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>US Trade Deficit (%)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>0</td>
<td>24</td>
</tr>
<tr>
<td>Japan/Hong Kong</td>
<td>52</td>
<td>16</td>
</tr>
<tr>
<td>Korea/Taiwan</td>
<td>52</td>
<td>16</td>
</tr>
</tbody>
</table>

- China at end of East Asian supply chain
- Only 20% of export value captured by China, and has trade deficit of $130 billion with East Asia
- 20% appreciation of yuan would reduce US trade deficit by only $40-55 billion
China’s Agricultural Trade

China agricultural imports and exports

USDA/ERS
US-China Agricultural Trade

- US has agricultural trade surplus with China - $6.7 billion in 2006
- Concentrated in soybeans and cotton
- Appreciation of yuan would improve competitiveness of US agriculture
- China would import more wheat, and possibly import corn
Appreciation: Costs/Benefits

- Appreciation of yuan would reduce Chinese exports of labor-intensive horticultural crops
- Reduce production of field crops using scarce resources such as land and water
- Would hurt Chinese farmers, but help rural and urban consumers
China Needs Appreciation

- To rebalance growth, has to address external imbalance
- Independent monetary policy
- To get resources out of export sector
- With appreciation in other Asian currencies, “orderly correction” of US external imbalance
How to Get Global Adjustment

- China wants to move at its pace
- US Congress convinced yuan is being manipulated
- China and other Asian countries need to let currencies appreciate
- US should raise its savings rate
- Probably requires international cooperation brokered by the IMF
For Further Information:


Available at: