“China-US Trade: Is It All ‘Yuan’-Way?”

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China recently became world’s largest trading economy, trade being significant factor in its economic growth

1991-2007: US imports from China increased by 1,156% compared to US exports to China which increased by 456%

During 2000s, China’s current-account surplus averaged 5% of GDP – similar to share of US trade deficit in GDP

High rate of US unemployment has intensified concerns over perceived impact of China’s exchange rate on US economy
Historically, US imports from low-wage countries have been small, but this changed in 2000s.

Between 2000 and 2007, share of US imports from low-income countries rose from 15 to 28%, China accounting for 89% of growth.

Recent research suggests significant impact on US unemployment and wages in local labor markets with import-competing sectors (Autor et al., 2013).

What has been role of China’s exchange rate?
Pre-1994: China maintained dual exchange rate - an official rate (5.77 RMB/$), and rate set in “swap market” (8.7 RMB/$)

1994: two rates unified at 8.7 RMB/$, allowed to rise to 8.28 RMB/$ and pegged – essentially convertible on current account basis

July 2005: a “managed float”, whereby peg was relaxed, RMB appreciating 20.8% by July 2008

July 2008-June 2010: exchange rate kept relatively constant at 6.83 RMB/$

June 2010: RMB/$ appreciation resumed, value increasing 10.7% by July 2013
Figure 1: RMB Exchange Rate Against US$, 1990-2011

Source: IMF (2012)
Argued China deliberately manipulates currency, resulting in growth of US bilateral trade deficit with China - $325 billion in 2013

Increases in foreign exchange reserves seen as evidence of Chinese manipulation of RMB

Decline in China’s trade surplus linked to RMB appreciation, but more likely due to falling global demand and foreign direct investment in China

Nevertheless, some analysts claim US trade deficit and US job losses are correlated – hence, RMB appreciation will boost US jobs
Figure 2: China’s Trade Balance and Foreign Exchange Reserves

Source: EIU, IMF and CSAFE (2012)
Some argue China has managed exchange rate to provide an anchor for its inflation rate

But if RMB is undervalued, common claim it is equivalent to an export subsidy-cum-import tariff

Nominal depreciation only leads to temporary real depreciation - increase in import prices eventually feeds back into higher wages and domestic prices

Hard to detect impact of RMB change on US-China trade: despite appreciation of RMB between 2005-08, US trade deficit with China grew by 30%

So what has driven Chinese exports?
- China has competitive edge in labor-intensive industries – shifting over past decade from footwear and toys to electronics
- Due to availability of cheap labor, multinational firms have outsourced assembly to China
- Foreign-invested firms account for over half of China’s trade flows, importing intermediate goods used to assemble final goods for export
- Appreciation of RMB in combination with rising Chinese wages may result in outsourcing elsewhere in emerging Asia – but US trade deficit unlikely to decline
Figure 3: Manufacturing Wages in Emerging Asia (2010 dollars)

Source: Li et al., 2012
• Overall trade balance a function of difference between domestic savings and investment

• Disparity between US and Chinese savings rates means US is a net debtor (trade deficit) and China a net creditor (trade surplus)

• US and Chinese contribution to global imbalances unlikely to change with appreciation of RMB

• As China’s capital account becomes more porous, its ability to manage its exchange rate and target inflation will simply become unsustainable